SHIRE OF CHRISTMAS ISLAND

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10 February 2021

Our Ref: 3.1.4

Hon Nola Marino MP
Assistant Minister for Regional Development and Territories
PO Box 6022
House of Representatives
Parliament House
Canberra ACT 2600
By fax: (02) 6277 8424, (08) 9721 4911
and email: minister.marino@infrastructure.gov.au

Dear Assistant Minister

The following report is provided to you as required under the Local Government Act 1995 WA Section7.12A.

Due to the Shire's email system being down, I forward this report in the 1st instance via fax to your Canberra and Perth offices and will also forward it via email once our system is back on line. The report is also on the Shire's web site in accordance with the Act.

In the 19/20 Audit Report the auditor made the following comments.

(i) In my opinion, the following material matters indicate significant adverse trends in the financial position of the Shire:

   a. The Asset Sustainability Ratio as reported in Note 33 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries (DLGSCI's) standard of 0.90 for the last three financial years;

   b. The Own Source Revenue Coverage Ratio as reported in Note 33 of the annual financial report is below the DLGSCI's standard of 0.40 for the last three financial years;

   c. The Operating Surplus Ratio as reported in Note 33 of the annual financial report is below the DLGSCI's standard of 0.01 for the last three financial years.

(ii) Information and explanations were obtained by me.

(iii) All audit procedures were satisfactorily completed.

(iv) In my opinion, the Asset Consumption Ratio and the Asset Renewal Funding Ratio included in the annual financial report were supported by verifiable information and reasonable assumptions.

The Local Government Act 1995 requires the Shire to report on the actions taken to address those issues) 7.12A. Duties of local government with respect to audits

(4) A local government must —

(a) prepare a report addressing any matters identified as significant by the auditor in the audit report, and stating what action the local government has taken or intends to take with respect to each of those matters; and

(b) give a copy of that report to the Minister within 3 months after the audit report is received by the local government.

(5) Within 14 days after a local government gives a report to the Minister under subsection (4)(b), the CEO must publish a copy of the report on the local government's official website.

Accordingly, at the Ordinary Meeting of Council held 9th February 2021 in considering the CEO's report on the 19/20 Auditors Report passed the following resolution.

Council endorses the CEO's Report and directs the CEO to forward a copy of the Report to the Minister and to place on the Shire's Web Site in accordance with the Act.

A copy of that report is attached.

Yours Sincerely

David Price
Chief Executive Officer

In the 19/20 Audit Report the auditor made the following comments.

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(ii) Information and explanations were obtained by me.

(iii) All audit procedures were satisfactorily completed.

(iv) In my opinion, the Asset Consumption Ratio and the Asset Renewal Funding Ratio included in the annual financial report were supported by verifiable information and reasonable assumptions."

The comments the Auditor made are not isolated to the Shire of Christmas Island, as numerous small Shires throughout Western Australia including the Shire of Cocos have received similar reports on significant adverse trends.

At the Shire's Audit Committee meeting held 26 November 2020 the Auditor and the Auditor General WA representative noted that many small Shires in WA had adverse patterns in these ratios and the WA DLGSC were looking at reviewing those ratios and also the Asset Sustainability Ratio was challenging for all local governments that have unsealed roads in their networks.

The following Report outlines:

1. The reasons for the situation
2. What the Shire has done
3. What it intends to do to mitigate the adverse trend and when.

1. The reasons for the situation

The Asset Sustainability Ratio Purpose:

This ratio is a measure of Capital replacement against depreciation.

This indicates if the Shire is making the necessary capital replacement of the asset equal to the depreciation against the asset.

There are 4 primary reasons for the situation of the Asset Sustainability Ratio

(1) The amount of CRA funding to the Shire in the last 8 financial years is as follows

CRA Road Funding 2013-2020:

1.	2019/20	$600,000
2.	2018/19	$600,000
3.	2017/18	$600,000
4.	2016/17	$600,000
5.	2015/16	$660,000
6.	2014/15	Nil
7.	2013/14	$3,218,000
8.	2012/13	$1,056,000

Only $400,000 of the $600,000 CRA funding for the past 4 financial years is allocated to capital works with the other $200,000 directed to unsealed road maintenance which is not included in the capital expenditure, however the unsealed road depreciation is included in the total depreciation ratio calculation.

The reduction of CRA funding to capital road works over the past 8 financial years had a significant negative effect on the Asset Sustainability Ratio over that period. This has been exacerbated by the inclusion of the depreciation of unsealed roads but the exclusion of maintenance expenditure in the ratio calculation.

(2) The MOU that was signed in July 1998 between the Commonwealth and the Shire regarding the responsibility for the public road network on Christmas Island identified a necessity for clear funding arrangements to be put into place. This has never been finalised, and in fact the Shire has had to incur an increasing funding onus with the reduction of the Commonwealth funding.

(3) The deprecation of unsealed roads is only on the top layer of the road, and grading of the top layer would be considered capital works if it occurred once a year but not if it was carried out twice or more a year which would be considered maintenance work and therefore expenditure not included within the Asset Sustainability Ratio.

(4) The Asset Sustainability Ratio needs examination. As indicated by the Auditor to the Shire's Audit Committee on 26 November 2020 the Asset sustainability Ratio was challenging for all local governments that have unsealed roads in their networks, and the Asset Sustainability Ratio is in the suite of Ratios that the WA DLGSC were looking at reviewing.

2. What the Shire has done

The Shire and the IOTA have agreed to:

(a) Review the 1998 MOU with all the original parties.
(b) To commence a sealing program of the unsealed roads over the next the 3 years that will reduce the amount of money allocated to the maintenance of unsealed roads.

Together with Main Roads WA we are updating and refining our 10 year road capital works maintenance programs, which will form the basis of funding discussions with the Commonwealth and the IOTA.

The Shire in the financial year of 20/21 will continue to apply its entire FAG road allocation to road capital works to ensure it is within the Asset Sustainability Ratio calculations.

3. What it intends to do to mitigate the adverse trend and when

(1) To continue to renegotiate the MOU of 1998 with all the relevant parties collectively to ensure the questions of responsibility and resourcing is resolved that will enable the implementation of immediate, short-term and long-term maintenance and capital works to be carried out with the certainty of agreed funding arrangements in place.

This approach will resolve the current imbalance of funding to road maintenance and capital works and consequently will have a positive effect on the Asset Sustainability Ratio

(2) The Shire will continue to apply its entire FAG road allocation to road capital works to ensure it is within the Asset Sustainability Ratio calculations.

(3) Continue to press the Department of Local Government Western Australia to review of the Asset Sustainability Ratio. The Shire understands the ratios referred to in the auditor's report are in the suite of ratios to be reviewed within the 20/21 financial year.

(4) Review the road asset register to ensure that roads owned and on other Government departments asset registers are not also retained on the Shire road asset register. This will remove a large proportion of the unsealed roads from the shire's asset register thus having a positive effect on the Asset Sustainability Ratio.

Additional to the comments the Auditor and the Auditor General WA representative made at the Shire's Audit Committee meeting of 26 November 2020 regarding the current suitability of these ratios to small regional Local Councils, the Western Australian Local Government Association in its Financial Performance Indicators Discussion Paper 6 November 2019 also makes the following observations on the ratios.

1. The Asset Sustainability Ratio

"This ratio suffers from a lack of definition and the clarity of terminology.
The Finance Regulations defines –
capital renewal and replacement expenditure mean expenditure to renew or replace existing assets whilst the asset management guidelines couch the outlays in terms of service potential.

Asset Renewal Costs (Capital Renewal Expenditure) - Expenditure on an existing asset which returns the service potential or the life of the asset to that which it had originally.

In addition, the ratio is impacted substantially by the depreciation expense. Over-stated revaluations have seen a dramatic increase in depreciation expenses and therefore a reduction in this ratio over time."

2. Own Source Revenue Coverage Ratio

"In Western Australia, the State has used the Financial Health Indicator (FHI) as a means of measuring the financial health of a local government and is published on the MyCouncil website. A result of 70 and above indicates sound financial health. The maximum result achievable is 100. The FHI is one factor to consider in assessing overall performance.

In presenting this information the integrity of the base indicators and the weighting between indicators plays a critical role.

The current calculation suffers from the flaws in the existing data and construction of the raw scores.

Serious consideration, in consultation with the industry and stakeholders, of the weightings needs to be undertaken."

3. Operating Surplus Ratio

"Results are also subject to fluctuations by using own source revenue as the denominator in the calculations. Own source income used to calculate this ratio is not transparent and has little application for non-metropolitan local governments.

This ratio does not provide an accurate picture of operating results year on year. The volatility in the results is not a true reflection of the industries performance."

Both the Own Source Revenue Coverage and Operating Surplus ratios in their current form will always have a negative result with small Shires that have a small rate income within their total revenue base. The review of these ratios and their application to Shires with small rate based revenue will provide a more realistic ratio application to such Shires.

The Audit Committee will be advised of the implementation of the above measures.