

3 October 2017

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Dear Cr Johnston,

MANAGEMENT REPORT FOR THE YEAR ENDED 30 JUNE 2017

We advise that we have completed our audit procedures for the year ended 30 June 2017 and enclose our Audit Report.

We are required under the Local Government Audit Regulations to report certain compliance matters in our audit report. Other matters which arise during the course of our audit that we wish to bring to the Council's attention are raised in this management report.

It should be appreciated that our audit procedures are designed primarily to enable us to form an opinion on the financial statements and therefore may not bring to light all weaknesses in systems and procedures which may exist. However, we aim to use our knowledge of the Shire's organisation gained during our work to make comments and suggestions which, we hope, will be useful to you.

COMMENT ON RATIOS

Ratios provide useful information when compared to industry and internal benchmarks and assist in identifying trends. Whilst not conclusive in themselves, understanding ratios, their trends and how they interact is beneficial for the allocation of scarce resources and planning for the future. Information relating to the statutory ratios disclosed in the financial report is summarised in the table below and commentary provided on the following pages.

	Target Ratio ¹	Actual 2017	Council's Adjusted Ratios					Council's 5 Year Trend ²	5 Year Average ³	
			2017	2016	2015	2014	2013		Regional	State
Current Ratio	≥ 1	1.61	1.31*	1.14*	1.26*	0.90	1.25	↑	1.97	2.22
Asset Sustainability Ratio	≥ 1.1	0.66	0.66	0.29	0.50	0.58	0.72	↑	1.04	1.18
Debt Service Cover Ratio	≥ 10	8.50	7.05*	7.21*	5.63*	2.95*	3.91*	↑	4.61	12.41
Operating Surplus Ratio	≥ 0.15	(0.12)	(0.16)*	(0.10)*	(0.16)*	(0.05)*	0.00*	↓	0.54	(0.11)
Own Source Revenue Coverage Ratio	≥ 0.9	0.78	0.78	0.81	0.82	0.82*	0.82*	↑	0.54	0.67
Asset Consumption Ratio	≥ 0.75	0.71	0.71	0.72	0.74	0.70	0.74	↓	0.62	0.73
Asset Renewal Funding Ratio	≥ 1.05	1.17	1.17	1.67	0.53	2.11	3.05	↓	1.42	0.94

¹ Target ratios per Department of Local Government and Communities (DLGC) Guidelines except the Debt Service Ratio which is a target devised by Moore Stephens (and based on experience). For information, DLGC Guidelines indicate a target Debt Service Cover Ratio of 5.

² The 5 year trend compares the adjusted 2017 ratios to the average of the adjusted ratios for the last 5.

³ The average in relation to the Regional and State comparisons is a 4 year average of 2013, 2014, 2015 and 2016.

* Adjusted for "one-off" timing/non-cash items.

COMMENT ON RATIOS (CONTINUED)

Adjustment relating to 2017

Three of the ratios in the accompanying table were distorted by an item of significant revenue relating to the early payment of 2017/18 Financial Assistance Grants (FAGs) totaling \$1,485,897 received before 30 June 2017. The early payment of the grant increased operating revenue in 2017.

This item is considered “one-off” timing in nature and was adjusted when calculating the ratios in the above table (as shown by “*”) as were relevant comparative year ratios (which had been affected by similar “one-off” items).

Regional and State 5 Year Averages

Regional and State 5 year averages have not been adjusted for “one-off” items even though these items may have been applicable in prior years as they are based on the statutory ratios which have been reported in published financial reports. However, they still provide a useful reference point as they are indicative of a trend.

Commentary on Specific Ratios

- **Asset Sustainability Ratio**

The Asset Sustainability ratio expresses capital expenditure on renewal and replacement of existing assets as a percentage of depreciation costs. This ratio is used to identify any potential decline or improvement in asset conditions. A percentage of less than 100% on an ongoing basis indicates assets may be deteriorating at a greater rate than spending on renewal or replacement.

This ratio has improved in the current year, however is still below the 5 year Regional and State averages.

The main reason for the improvement of the ratio is due to an increase in capital renewal expenditure from \$3.5 million in the last year to \$9.3 million in the current year. This continued improvement to this ratio is important to assist the Shire maintain its asset base at current levels into the future.

Whilst the total depreciation for the current year has relatively consistent with the prior year, it still represents a higher amount of depreciation when compared to 2015.

As previously mentioned in our management report for the year ended 30 June 2016, this higher depreciation is attributable to the revaluation of infrastructure assets conducted during the year ended 30 June 2015, which resulted in a significantly higher depreciable asset base. We noted one possible reason relates to the Remaining Useful Life (RUL) assessments performed on individual assets especially roads may not have been comprehensive enough to adjust to more realistic conditions which would have resulted in a lower depreciation expense.

Discussion with management indicated the Shire was unable to implement a plan to review the condition and RUL assessments in time for the current year. They have indicated it is planned to undertake and incorporate this review in the upcoming round of infrastructure assets revaluation which is due in the next financial year.

They also anticipate the depreciation charged for the next year should be more reflective of asset consumption once the review is complete and adjustments to RUL made.

Interpretation of this ratio should also be considered together with the Asset Consumption Ratio (slightly below target at 0.71) and the Asset Renewal Funding Ratio (above target at 1.17).

- **Operating Surplus Ratio**

The Operating Surplus Ratio represents the percentage by which the operating surplus (or deficit) differs from the Shire’s own source revenue which includes rates and operating grants.

On an adjusted basis, this ratio has been trending downwards over the last five years and is currently below the target level and both the Regional and State averages.

COMMENT ON RATIOS (CONTINUED)

- **Operating Surplus Ratio (Continued)**

In order to continue the improvement and achieve a positive ratio (≥ 0.15), both Council and Management will need to constantly consider ways to improve the operating surplus position either via increasing revenue or by decreasing expenditure (or a combination of both). Once again, this will be dependent upon the Council and Management's understanding of the Shire circumstances and the interaction operating surplus has on other ratios and operations in general.

In raising this point, we note Management's review of depreciation as discussed at the Asset Sustainability Ratio comment above will assist with a realignment of the Shire's operating position and impact on this ratio.

Summary

The Shire's ratio position, after adjustment for FAGs, appears consistent with prior years.

Whilst some ratios are below the accepted industry benchmark, given the relative strength of the other ratios and the Shire's balance sheet, lower ratios may be expected and acceptable in the short term, provided other measures/strategies are maximised.

Notwithstanding this, a number of the ratios do appear to be trending downwards over the longer term and this should be considered when making future decisions.

We would also like to take this opportunity to stress one-off assessments of ratios at a particular point in time can only provide a snapshot of the financial position and operating situation of the Shire. As is the case with all ratios and indicators, their interpretation is much improved if they are calculated as an average over time with the relevant trends being considered.

We will continue to monitor the financial position and ratios in future financial years and suggest it is prudent for Council and management to do so also as they strive to manage the scarce resources of the Shire.

If the Shire requires, we have a report available which is able to compare your ratios against other Local Governments across the State and by Region. The report is also able to incorporate a selection of your peer Local Governments, whether they be of near neighbours or similar type in nature. This may be of particular relevance in your case as you are included in the South West region when comparison to other, more similar local governments, may be more relevant.

If you are interested in such an expanded report, please contact us.

We noted no other matters we wish to bring to your attention.

UNCORRECTED MISSTATEMENTS

We advise there were no uncorrected misstatements noted during the course of our audit.

We take this opportunity to thank all staff for the assistance provided during the audit. Should you wish to discuss any matter relating to the audit or any other matter, please do not hesitate to contact us.

Yours faithfully



DAVID TOMASI

PARTNER

Encl.