



**Western  
Metropolitan  
Regional Council**

*Managing waste wisely*

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1 August 2019

## **Audit Committee**

### **Report: WMRC Asset Sustainability Ratio**

#### **SUMMARY**

This report addresses the WMRC Asset Sustainability Ratio which was identified as a significant issue in the Regional Council's 2017-18 Audit Report by the auditors Macri and Partners.

This report was endorsed by Council at its meeting of 1 August 2019 following review by the WMRC Audit Committee.

#### **BACKGROUND**

In the 2017/2018 External Audit, Macri Partners found that the Western Metropolitan Regional Council has an Asset Sustainability Ratio (ASR) that has been well below the required standard for the previous three years. Macri Partners identified this as a significant issue in its Audit Report dated 8 November 2018.

Section 7.12A(4) of the *Local Government Act 1995* states that a local government must prepare a report stating the intended action to address matters identified as significant by the auditor. The report must:

- state what action the local government has taken or intends to take with respect to each of those matters;
- give a copy of the report to the Minister within three months of the audit report being received by the local government; and
- within 14 days of providing a report to the Minister, the CEO must publish a copy of the report on the local government's official website.

The Department of Local Government, Sport and Cultural Industries raised the matter of the deficiency of addressing the issue in a letter to the WMRC dated 28 June 2019.

In order to complete the required action, the Audit Committee must seek Council's endorsement of this report before it is provided to the Minister; Department of Local Government, Sport and Cultural Industries; and published on the WMRC website.

#### **WMRC Member Councils**

Town of Claremont | Town of Cottesloe | Town of Mosman Park | City of Subiaco | Shire of Peppermint Grove

## DETAIL

### The Asset Sustainability Ratio

The Asset Sustainability Ratio (ASR) indicates whether the WMRC is replacing or renewing existing non-financial assets at the same rate that its overall asset stock is wearing out and reaching the end of usefulness. The ASR measures expenditure on an existing asset to return the service potential or the life of the asset up to that which it had originally. It is periodically required expenditure as it reinstates existing service potential it may reduce operating and maintenance costs. The calculation of the ASR is as per the below equation:

$$\text{ASR} = \frac{\text{Capital Expenditure on Replacement of Assets (Renewals)}}{\text{Depreciation Expenditure}}$$

The ASR excludes expenditure on new or additional assets. Depreciation expense represents an estimate of the extent to which the assets have been consumed during that period. Measuring assets at fair value is critical to the calculation of a valid depreciation expense value. An asset revaluation is currently underway.

### Required level of ASR

The standard is met if the ASR can be measured and is 90 percent (or 0.90). A ratio over 90 percent indicates that a local government is likely to be sufficiently maintaining, replacing or renewing existing infrastructure assets as they reach the end of their useful lives. A ratio under 90 percent indicates that a local government is likely to not be sufficiently maintaining, replacing or renewing existing infrastructure assets as they are being depreciated. Insufficient capital expenditure on replacement of assets may create an 'asset renewal backlog' which may well result in a reduction in service levels and/or useful lives of assets. This in turn may create a burden on the WMRC's member councils who will either incur financial costs to restore the asset or a convenience cost from not being able to fully utilise the asset.

### ASR low in the three years to 2017/18

The WMRC's ASR was well below the required 90 percent in the three years to 30 June 2018 owing to uncertainties about the strategic direction and future of the organisation.

In large part these uncertainties were due to a major contractual dispute in relation to waste processing. The nature of the dispute necessitated that considerable funds be allocated to legal expense; and that capital expense be minimised in the event the WMRC became exposed to liabilities flowing from possible adverse outcomes of the dispute.

The WMRC therefore deferred the replacement, renewal and maintenance of assets on an 'as required' basis in the three years to 2017/18. The following table shows the low extent of capital expenditure on replacement of assets and its effect on the ASR in the three years to 2017-18.

Annual Budget	Asset Sustainability Ratio	Total Capital Budget (new and replacement assets)
2015/2016	0.03	\$112,450
2016/2017	0.04	\$112,500
2017/2018	0.00	\$15,000

## Action by Council - recovery of the ASR

Since the beginning of the 2018/19 year, the strategic direction and the future of the WMRC has become far clearer. The extent of uncertainty in respect of the WMRC's legal disputations were considerably reduced by a Supreme Court judgement in favour of the WMRC in August 2018; and a series of consultations with WMRC Member Councils led to greater certainty about the strategic direction of the organisation. The developments clarified the operational environment for the WMRC to the extent that the organisation embarked on a new Strategic Community Plan which was released for public comment in June 2019.

The greater certainty for the organisation provided the confidence necessary for Council to approve a seven-fold increase in capital expenditure on replacement of assets in the 2019-20 budget. This step should restore the ASR well above the minimum required and acts to redress the shortfalls in capital expenditure identified by Macri and Partners in the 2017-18 Audit Report.

Annual Budget	Asset Sustainability Ratio	Total Capital Budget (new and replacement assets)
2018/2019	0.21 <sup>1</sup>	\$37,000
2019/2020	2.28 <sup>2</sup>	\$288,000

### Notes:

1. To be confirmed following finalisation of 2018-19 accounts.
2. Estimate based on approved capital budget and estimated depreciation expense

## Depreciation Method

With the development of a digitised asset register the WMRC has changed its depreciation method. Buildings continue to be depreciated via the straight-line method, but other assets are now depreciated via the diminishing value method. Both methods are approved by the Department of Local Government. Diminishing value means more depreciation occurs at the beginning of an assets life which more accurately represents the value and usefulness over time. This effectively decreases the amount of depreciation expense for the 2019-20 financial year. Council approval of the 2019-20 capital budget, all of which is allocated for asset renewal and replacement, should see the ASR outcome for this year well above the minimum standard.

## Asset Management Planning

Once the revised ten-year Strategic Community Plan is completed and approved, work will begin on a new Corporate Business Plan which will incorporate a new Asset Management Plan; and projections of revenues and expenditure for the four succeeding financial years. Resolution of any remaining backlog in asset replacement, including its effect on the ASR, will form part of the new Asset Management Plan.



Stefan Frodsham  
Chief Executive Officer