



24 February 2020

## 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 2018-19 Audit Report by the auditors Macri and Partners.

### BACKGROUND

In the 2018-2019 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 6 December 2019.

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.

### 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

#### WMRC Member Councils

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 2018-19

The WMRC's ASR was well below the required 90 percent in the three years to 30 June 2019 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 2018-19. 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 2018-19.

Annual Budget	Asset Sustainability Ratio	Total Capital Expenditure
2016-2017	0.04	\$12,393
2017-2018	0.00	\$0
2018-2019	0.25	\$50,494

### Action by Council - recovery of the ASR

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 approved by Council at the 3 October 2019 Ordinary Council Meeting.

The greater certainty for the organisation provided the confidence necessary for Council to approve an 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 2018-19 Audit Report.

Annual Budget	Asset Sustainability Ratio	Forecast Capital Expenditure
2019-2020	108	\$153,197
2020-2021	225	\$283,000
2021-2022	208	\$283,000

### 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 asset's 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

A new WMRC Strategic Community Plan, Corporate Business Plan, Asset Management Plan and Long-Term Financial Plan have been developed and approved by Council in the past six months. I am pleased to report that the WMRC Asset Sustainability Ratio is not forecasted to drop below the minimum 90% standard in the next 10 years.



Stefan Frodsham  
Chief Executive Officer