



SHIRE
of
DANDARAGAN

AGENDA

for

AUDIT COMMITTEE MEETING

to be held at the

JURIEN BAY ADMINISTRATION CENTRE, JURIEN BAY

on

THURSDAY 7 DECEMBER 2018

COMMENCING AT 3.00PM

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| AGENDA FOR AUDIT COMMITTEE MEETING TO BE HELD FRIDAY 7 DECEMBER 2018 |
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1. DECLARATION OF OPENING**2. RECORD OF ATTENDANCE / APOLOGIES / LEAVE OF ABSENCE**

Members Councillor K McGlew (Chair)
 Councillor A Eyre
 Councillor P Scharf
 Councillor D Slys

Staff Mr B Bailey (Chief Executive Officer)
 Mr S Clayton (Executive Manager Corporate & Community Services)

Auditors Mr Liang Wong (Office of the Auditor General)
 Ms Leanne Oliver (Byfield Business Advisors)
 Mr Vishal Desai (Byfield Business Advisors)

Apologies**Leave of Absence****3. CONFIRMATION OF MINUTES****3.1 MINUTES OF THE AUDIT COMMITTEE MEETING HELD 8 MARCH 2018****4. MATTERS FOR DISCUSSION****4.1 AUDIT REPORT FOR THE YEAR ENDED 30 JUNE 2018**

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| Location: | N/A |
| Applicant: | N/A |
| File Ref: | Business Classification Scheme / Financial Management / Audit / External |
| Disclosure of Interest: | None |
| Date: | 3 December 2018 |
| Author: | Scott Clayton, Executive Manager Corporate & Community Services |
| Senior Officer: | Brent Bailey, Chief Executive Officer |

PROPOSAL

That the Independent Audit Report for the 2017 / 2018 financial year be received.

BACKGROUND

Circulated with the agenda is a copy of the Office of the Auditor General Independent Audit Report which states:

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“Opinion

I have audited the annual financial report of the Shire of Dandaragan which comprises the Statement of Financial Position as at 30 June 2018, the Statement of Comprehensive Income by Nature or Type, Statement of Comprehensive Income by Program, Statement of Changes in Equity, Statement of Cash Flows and Rate Setting Statement for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information, and the Statement by the Chief Executive Officer.

In my opinion the annual financial report of the Shire of Dandaragan:

- (i) is based on proper accounts and records; and*
- (ii) fairly represents, in all material respects, the results of the operations of the Shire for the year ended 30 June 2018 and its financial position at the end of that period in accordance with the Local Government Act 1995 (the Act) and, to the extent that they are not inconsistent with the Act, Australian Accounting Standards.*

Basis for Opinion

I conducted my audit in accordance with Australian Auditing Standards. My responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Report section of my report. I am independent of the Shire in accordance with the Auditor General Act 2006 and the relevant ethical requirements of the Accounting Professional and Ethical Standards Board’s APES 110 Code of Ethics for Professional Accountants (the Code) that are relevant to my audit of the financial report. I have also fulfilled my other ethical responsibilities in accordance with the Code. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Emphasis of Matter – Basis of Accounting

I draw attention to Note 1 to the financial report, which describes the basis of accounting. The financial report has been prepared for the purpose of fulfilling the Shire’s financial reporting responsibilities under the Act. Regulation 16 of the Local Government (Financial Management) Regulations 1996 (Regulations), does not allow a local government to recognise some categories of land, including land under roads, as assets in the annual financial report. My opinion is not modified in respect of this matter.

Responsibilities of the Chief Executive Officer and Council for the Financial Report

The Chief Executive Officer (CEO) of the Shire is responsible for the preparation and fair presentation of the annual financial report, in accordance with the requirements of the Act, the Regulations and, to the extent that they are not inconsistent with the Act, Australian Accounting Standards. The CEO is also responsible for such internal control as the CEO determines is necessary to enable the preparation of a financial report that is free from material misstatement, whether due to fraud or error.

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In preparing the financial report, the CEO is responsible for assessing the Shire's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the State government has made decisions affecting the continued existence of the Shire.

The Council is responsible for overseeing the Shire's financial reporting process.

Auditor's Responsibility for the Audit of the Financial Report

The objectives of my audit are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial report.

As part of an audit in accordance with Australian Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.*
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Shire's internal control.*
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the CEO.*
- Conclude on the appropriateness of the CEO's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Shire's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial report or, if such disclosures are inadequate, to modify my opinion. My conclusions*

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are based on the audit evidence obtained up to the date of my auditor's report, as we cannot predict future events or conditions that may have an impact.

- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.

I communicate with the Council and the CEO regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

Report on Other Legal and Regulatory Requirements

In accordance with the Local Government (Audit) Regulations 1996 I report that:

- (i) In my opinion, the following material matter indicate significant adverse trend in the financial position of the Shire:
 - a. The Operating Surplus Ratio has been below the Department of Local Government, Sports and Cultural Industries standard for the past three years.
The financial ratios are reported in Note 26 of the financial report.
- (ii) The following material matter indicating non-compliance with Part 6 of the Local Government Act 1995, the Local Government (Financial Management) Regulations 1996 or applicable financial controls of any other written law was identified during the course of my audit:
 - a. Accounting journal entries were posted with no evidence of independent review and approval by another person. Accounting journals can represent significant adjustments to previously approved accounting transactions, and should therefore be independently reviewed and approved with evidence of this review being retained.
- (iii) All required information and explanations were obtained by me.
- (iv) All audit procedures were satisfactorily completed.
- (v) 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.

Other Matter

The financial report of the Shire for the year ended 30 June 2017 was audited by another auditor who expressed an unmodified opinion on that financial report. The financial ratios for 2017 and 2016 in Note 26 of the audited financial report were included in the supplementary information and/or audited financial report for those years.

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Matters Relating to the Electronic Publication of the Audited Financial Report

This auditor's report relates to the annual financial report of the Shire of Dandaragan for the year ended 30 June 2018 included on the Shire's website. The Shire's management is responsible for the integrity of the Shire's website. This audit does not provide assurance on the integrity of the Shire's website. The auditor's report refers only to the financial report described above. It does not provide an opinion on any other information which may have been hyperlinked to/from this financial report. If users of the financial report are concerned with the inherent risks arising from publication on a website, they are advised to refer to the hard copy of the audited financial report to confirm the information contained in this website version of the financial report."

In addition, a management report has been submitted to the Shire. This does not form part of the audit report itself, but does allow for the auditor to raise other findings that it considers warrant rectification.

Finally, Byfields Business Advisers have prepared an "exit brief" in relation to their role in conducting the audit or 2017/18.

COMMENT

The "Independent Auditor's Report" as attached is unqualified and therefore, there are no items that require the Shire of Dandaragan to "prepare a report addressing any matter identified as significant by the audit in the report, and stating what action the local government has taken or intends to take with respect to each of those matters." (Section 7.12A(4)(a) Local Government Act 1995)

The report does, however, identify two matters that warrant acknowledgment. Firstly;

"In my opinion, the following material matter indicate significant adverse trend in the financial position of the Shire:

a. The Operating Surplus Ratio has been below the Department of Local Government, Sports and Cultural Industries standard for the past three years.

The financial ratios are reported in Note 26 of the financial report."

The Shire's ratio has been negative for the last 3 financial years. The Department of Local Government, Sports and Cultural Industries guidelines state;

"A positive ratio indicates the percentage of total own source revenue available to help fund proposed capital expenditure, transfer to cash reserves or to reduce debt.

A negative ratio indicates the percentage increase in total own source revenue (principally rates) that would have been required to achieve a break-even operating result."

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This ratio and associated standard utilise the concept of "own source funding." To achieve a positive ratio for a Shire with such a low current debt, would mean that rates would need to increase significantly to achieve this. Achieving a positive ratio for the Shire of Dandaragan would mean the Shire would be sustainable without any type of non-operating grant funding from the State or Federal Government.

Examples of non-operating grants (the vast majority are for the renewal of assets) that have been excluded from this ratio include;

- Roads to Recovery
- Regional Road Group
- Commodity Route Funding

These are all grant funding that the Shire should expect on an ongoing basis to assist in meeting its asset renewal obligations. The prospect of there ever being a time where a Local Government would receive no government funding assistance is highly unlikely and therefore, increasing rates to simply achieve the ratio standard is not advised.

Furthermore, the Shires ratio includes \$6.15M of depreciation within the "expenditure" category of this ratio calculation. The Shire's current asset management plans are not mature enough at this stage to determine whether this depreciation figure is a true representation of the renewal funding required to be contributed back to existing assets. Until such time as maturity is reached in regard to the AMP's understanding of community level of service expectation, effective life and unit costs for its fixed assets, depreciation should only be used as a measure of the consumption of an assets economic potential over time.

This is not to say the ratio is entirely irrelevant, but the target for this ratio should be driven by sound asset management planning to underpin it, not simply to meet the standard.

In the meantime, the Shire of Dandaragan maintains significant reserves entirely for the purpose of asset renewal should urgent needs arise.

Secondly, the report states the following;

"Accounting journal entries were posted with no evidence of independent review and approval by another person. Accounting journals can represent significant adjustments to previously approved accounting transactions, and should therefore be independently reviewed and approved with evidence of this review being retained."

This concern was brought to the attention of administration early in the audit process. Process changes have already been implemented to ensure that controls are in place so that general journals are independently reviewed and approved.

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The management report (attached) has identified three findings of varying significance. In reviewing these findings, Shire staff were required to make comment and advise the auditor of the person responsible and the timeline for the rectification of the finding.

The first finding relates to general journals as mentioned earlier in this report. The auditor considers this a significant risk. Staff have already resolved this issue by implementing a process change to ensure general journals are independently reviewed and approved.

The second finding relates to out of date Asset Management and Long Term Financial Plans. The auditor considers this a moderate risk. The following comment has been made in relation to this finding;

"We are aware of the current state of our AMP's and are treating their review and update as a priority. While there is no current LTFP this is primarily because of the current quality of the AMP's. However, the methodologies used in the formation of a LTFP are currently used in calculating the financial position and performance of the Shire as currently presented within the Corporate Business Plan, therefore, we are not entirely lacking the information that would normally be contained within this document. The recently appointed CEO is currently undertaking a major review of the entire suite of Integrated Planning and Reporting documentation suite. The priority is the production of a new Strategic Community Plan, following this, focus will shift to the AMP and subsequent LTFP and CBP."

The auditor has been advised that the responsible people for this matter are the Executive Management Team with the completion date estimated to be December 2019.

In addition to this finding, there was discussion between the auditor and Shire staff as to the figures used in calculating the "Asset Renewal Funding Ratio."

$$\text{Asset Renewal Funding Ratio} = \frac{\text{NPV of Planned Capital Renewals over 10 years}}{\text{NPV of Required Capital Expenditure over 10 years}}$$

Historically, this ratio has used the Asset Management Plans as the source of the "Required Capital Expenditure" denominator of the ratio.

For the purposes of the Building and Public Open Space figures this is acceptable as the amount is also utilised in the "Planned Capital Renewal" figures used in the Corporate Business Plan and subsequently the numerator of this ratio.

However, while the "Required Capital Expenditure" for the "Infrastructure" asset class uses the figures from the AMP's the "Planned Capital Renewal" figure uses historical spend as the base for this figure. Traditionally, this has been higher than the amount

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identified in the AMP. Given the AMP's are overdue for review, the auditor has suggested the historical spend be used as the base for the "Required Capital Expenditure" figure as well.

This change has now been made and has also been recalculated for the preceding 2 financial years also. The auditor has asked that the audit committee acknowledge this change.

The final finding relates to the Long Service Leave on-cost assumptions. The on-cost percentage used has traditionally been the one utilised by Moore Stephens in their annual workshop. Whilst this has always seemed reasonably accurate the methodology has never been tested.

The Executive Manager of Community and Corporate Services will ensure this finding is rectified in calculating the provision for the year ending 30 June 2019.

CONSULTATION

Representatives of both the Office of the Auditor General and Byfields Business Advisers will be participating in this item via teleconference.

STATUTORY ENVIRONMENT

Section 7.12A Local Government Act 1995 requires a local government to receive and examine the report of the auditor and to prepare a report on any actions required in respect of the auditor's report.

POLICY IMPLICATIONS

There are no policy implications relevant to this item.

FINANCIAL IMPLICATIONS

There are no financial implications relevant to this item.

STRATEGIC IMPLICATIONS

2016 – 2026 Strategic Community Plan

| <i>Goal 5 - Proactive and Leading Local Government</i> | |
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| Objectives | How the Shire will Contribute |
| 5.2 High Performing Administration | c) Compliance in all legislative requirements and functions |

AGENDA FOR AUDIT COMMITTEE MEETING TO BE HELD FRIDAY 7 DECEMBER 2018**ATTACHMENTS**

Circulated with the agenda are the following items relevant to this report:

- Annual Financial Statements (Doc Id: 124284)
- Draft Independent Audit Report (Doc Id: 124287)
- Management letter from Byfields (Doc Id: 124375)

(Marked 4.1)

VOTING REQUIREMENT

Simple majority

OFFICER RECOMMENDATION

That;

- 1. the Independent Audit Report for the year ended 30 June 2018 be received, and;**
- 2. In accordance with Section 7.12A (3) of the Local Government Act 1995 determine that there are no matters raised in the report that require further action, and;**
- 3. the audit committee determine that the response by the Shire administration to the other matters identified in the audit report and management letter are appropriate, and;**
- 4. the audit committee acknowledge that utilising the historical spend for the infrastructure class of asset as the "Required Capital Expenditure" amount for the purposes of calculating the Asset Renewal Funding ratio is appropriate until such time as the Asset Management Plans are updated and refined.**

5. CLOSURE OF MEETING