

5.8. FINAL AUDIT REPORT FROM QUEENSLAND AUDIT OFFICE

REPORT AUTHOR: John Rehn, Manager Finance & IT
GENERAL MANAGER: Darryl Crees, General Manager Corporate Services
DEPARTMENT: Corporate Services

RECOMMENDATION

That Council notes the observations contained within the Final Audit Report (Observation Report) from the Queensland Audit Office for the 2014/15 financial year.

EXECUTIVE SUMMARY

The Final Audit Report is presented to Council for noting and staff have also provided an update on work undertaken to date or planned to be undertaken to address the issues raised.

BACKGROUND

Each financial year Council's financial statements must be audited and for the 2014/15 financial year the audit was undertaken by the Queensland Audit Office (QAO). Section 54 of the *Auditor-General Act 2009* enables the QAO to prepare a final audit report containing observations and suggestions about anything arising out of the audit. Where those observations or suggestions require further attention the QAO is required to provide a copy of the report to the Mayor.

Under the provisions of Section 213 of the *Local Government Regulation 2012* (the Regulation) this report is known as the **auditor-general's observation report** and it must be presented to the next ordinary meeting of Council.

It is important to note that the observation report is additional to the Independent Auditor's Report that is provided with Council's certified set of financial statements (with the latter being included in Council's Annual Report and referenced in Section 182 of the Regulation in relation to the timing of the adoption of Council's Annual Report).

COMMENT

The audit undertaken by the QAO was completed in September 2015 and Council was provided with an unmodified (unqualified) audit opinion (Independent Auditor's Report) on 29 September 2015. The Final Audit Report contains all issues identified in the final stage of the audit and these issues have been assessed as 'material deficiency', 'significant deficiency', 'deficiency' or 'other matter' as explained in appendix A of the report. There are no issues in the first category, one in the second, seven in the third and one in the last.

Appendix A of the Final Audit Report contains the observation, implications, recommendations and management response to each of the nine issues identified. These management responses were provided to the QAO in late September 2015 and by way of update the following additional information is provided:

Item	Description	Comment
1.1.1	Development of asset management strategy and asset management plans	To be addressed by Council's Asset Management Committee
2.1.1	Ability for transactions to be back-dated after close of year end	Corrective action has been put in place to address this issue
2.2.1	Pavement components not to be shown separately in the fixed asset register	Subject to future discussions with the QAO during the 2015/16 financial year
2.2.2	Annual review of property, plant and equipment useful lives	Framework has been established to address this issue
2.3.1	Asset records that couldn't be identified in the fixed asset register	Being addressed progressively as asset register data is updated
2.3.2	Improvement on revaluation process	Framework being established to address this issue
2.3.3	Relevance of indices used for land assets	Review to be undertaken by 30 June 2016
2.3.4	Inconsistency in accounting policies for the treatment of demolition and removal of debris used in the valuation methodology	Framework being established to address this issue
3.1.1	Long outstanding items held in trust	Review of trust balances has commenced and will be ongoing

These issues will now be recorded in Council's audit matrix and progress on addressing each issue will be reported to the Audit Committee at its future meetings.

PROPOSAL

The QAO's Final Audit Report is presented to Council for noting of their observations.

FINANCIAL/RESOURCE IMPLICATIONS

Preparing financial statements for audit and addressing issues identified during the audit form part of staff core duties and currently there are no financial or resource implications with the 2014/15 Final Audit Report.

RISK MANAGEMENT IMPLICATIONS

Having the issues identified by Council's external auditors and reporting the progress on resolving these issues to the Audit Committee will mitigate any risks.

CORPORATE/OPERATIONAL PLAN, POLICY REFERENCE

This report has been prepared in accordance with the following:

Corporate Plan 2014-2019 Initiatives:

Theme 5 - Governance

5.2.1 - Provide Councillors and community with accurate, unbiased and factual reporting to enable accountable and transparent decision-making.

COUNCIL'S ROLE

Council can play a number of different roles in certain circumstances and it is important to be clear about which role is appropriate for a specific purpose or circumstance. The implementation of actions will be a collective effort and Council's involvement will vary from information only through to full responsibility for delivery.

The following areas outline where Council has a clear responsibility to act:

Fully-Responsible Delivering a program or activity for another organisation (usually another level of government).

CONSULTATION

Internal: When preparing management responses to the issues identified by the QAO internal consultation was undertaken with relevant staff.

ATTACHMENTS

Attachment 1 - QAO Final Audit Report

The *Auditor-General Act 2009* requires also that the Auditor-General report to Parliament on any significant issues raised during an audit. We assign 'Material' deficiency and 'Significant' deficiency risk ratings to matters raised in our management report, and use these ratings as a guide for determining if any significant issues need to be publicly reported. Whether issues with a 'Material' or 'Significant' risk rating are reported to Parliament depends on a number of factors, including management action taken to resolve these issues prior to the completion of the audit.

If we intend to include any significant issues in a report to Parliament, you will be given an opportunity to comment and your comments will be reflected in the report.

Audit Fees

The estimated 2014-15 audit fee for external audit services provided by QAO for Douglas Shire Council was \$98 000 (exclusive of GST).

The actual fee will be no more than the estimated fee and will be advised in due course.

If you would like to discuss these issues or any issues regarding the audit process further, please feel free to contact me.

Yours sincerely



Athula Unantenne
Manager

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c.c. Mrs L Cardew, Chief Executive Officer, Douglas Shire Council

Ratings definitions and remedial action plan

The rating of audit issues in this report reflects our assessment of both the likelihood and consequence of each identified issue in terms of its impacts on:

- the reliability, accuracy and timeliness of financial reporting
- the effectiveness and efficiency of operations, including probity, propriety and compliance with applicable laws.

Without anticipating the Auditor-General's final decision on what may be referenced in an Auditor-General's Report to Parliament, each of the issues included in this report has been assessed and categorised against the following risk categories:

Category	Client Impact	Prioritisation of remedial action
Material deficiency	A significant deficiency that will lead to a material misstatement of the financial report and will result in qualification if not corrected.	Requires immediate management action.
Significant deficiency	A deficiency or combination of deficiencies that may lead to a material misstatement of the financial report.	Requires prompt management action to resolve within 2 months.
Deficiency	The control is not working or non-existent and, therefore, will not prevent, detect or correct misstatements in the financial report.	Requires a management action plan in this reporting period.
Other matter	Matters relevant to those charged with governance not related to deficiencies in internal control.	Implementation at management's discretion.

New issues

1. Significant Deficiency issues

1.1 Non-current physical assets issues

1.1.1 Development of asset management strategy and asset management plans

(Risk rating - Significant deficiency)

Observation

Council does not have its own asset management strategy and asset management plans which reflects the Council's current direction and methodologies in asset management.

Local Government Regulation 2012 section 167 (1) requires that a local government must prepare and adopt a long-term asset management plan.

Implications

Council is not complying with prescribed requirements under the Local Government Regulation 2012. Without a clearly defined long-term asset management plan, Council is unable to demonstrate how it manages Council's assets including necessary planned capital expenditure for the renewal, upgrading and/or extension of existing assets.

Recommendations

We recommend that Council develop a robust asset management strategy and asset management plans linked to its long term financial projections.

Management response

Agreed. Council has formed an Asset Management Committee, comprised of senior management staff and other key personnel to progress this matter.

Responsible Officer

Manager Infrastructure and Manager Water & Wastewater

Implementation Date

Ongoing

Status

Management undertaking for corrective action.

2. Deficiency issues

2.1 Financial reporting issues

2.1.1 Ability for transactions to be back-dated after close of year end

(Risk rating - Deficiency)

Observation

Audit identified during audit testing that transactions were able to be back dated after the close of financial year end. This caused the bank reconciliation, the accounts receivable reconciliation and the accounts payable reconciliation to no longer match their balances in the general ledger. This was not identified by the Council during the financial statement preparation phase.

Implications

The implication for Douglas Shire Council is that the current control environment is not strong enough to detect back dated transaction. This weakness could result in material misstatement if material back dated transactions are not identified. It could also lead to misstatement of prior year balances without detection by Council.

Recommendations

It is recommended that the client ensures that the accounting system blocks the ability of users to back date transactions after the year end close.

Management response

Council's software provides a warning message when any attempt is made to post entries into the prior financial year. In addition, Council's Team Leader Accounting provides an email to all relevant staff prior to the end of financial year advising them not to over-write this message. Council's practice has been to close as many modules as possible once they are finalised / reconciled for the end of financial year. However, end of year accrual posting cannot be undertaken unless certain modules are open. To alleviate this problem in future years Council will close all modules and only open the required modules temporarily for specific end of year posting purposes.

Responsible Officer

Team Leader Accounting

Implementation Date

30/09/2015

Status

Management undertaking for corrective action.

Secondly, Council has recognised that a portion of its pavement value of roads is re-used during road re-construction projects and therefore will have twice the life of the portion that is not re-used. These portions consist of basically the same material and are not separate / different components. A determination is made on each job regarding the amount of material that is re-useable and it is general practice across the road construction industry to re-use a portion of the pavement material in this way. Accordingly, it is not practical to create two asset categories within the pavement category and therefore Council does not agree with the recommendation.

QAO Additional comments and responses

Management response noted.

We consider these are two distinct components, with different useful lives that need to be recognised separately under AASB 116 para 43.

It may be difficult to quantify the actual amounts relating to each component the way it is currently presented. This is because each component maybe renewed at different intervals and the allocation of these costs may not be easily identifiable.

Componentizing will also assist management in establishing whether works are capital or repairs and maintenance in nature as well as identifying what components have been disposed and renewed.

QAO will continue discussions on this matter in 2015-16.

Status

Unresolved.

2.2.2 Annual review of property, plant and equipment useful lives (re-issued)

(Risk rating - Deficiency)

Observation

For 2014-15, the Council only reviewed the useful lives of the assets, which were comprehensively revalued - transport assets (excluding bridges and footpaths) and sewerage assets. We noted that for those assets, which have not been comprehensively revalued since the de-amalgamation and fleet assets, the useful lives adopted were lives allocated by Cairns Regional Council.

Whilst acknowledging Council's efforts in improving its asset management practices, under AASB 116 *Property, Plant and Equipment*, Council should be review the useful life of its assets at the end of each reporting period. If expectations differ from previous estimates the consequential change in the rate of depreciation is to be accounted for as a change in an accounting estimate in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*."

Implications

- Assets useful lives may not be accurate if they don't reflect Council's own pattern of consumption.
- Non-compliance with AASB 116 *Property, Plant and Equipment*.

Recommendations

We recommend that Council re-assess its assets useful lives to ensure that these reflect the Council's own pattern of consumption at least at the end of each financial year in accordance with AASB 116 *Property, Plant and Equipment*.

Management response

Agreed. As advised during final audit, Council had developed a spreadsheet for the purposes of reviewing the useful lives of each class of assets not comprehensively revalued in a particular financial year. Unfortunately, due to a number of factors, Council was unable to undertake the review for 2014/15 but did provide a copy of this spreadsheet to the audit team for perusal. Moving forward it is Council's intention to undertake the useful lives review on an ongoing basis throughout each financial year.

Responsible Officer

Manager Finance & IT

Implementation Date

2015/16 financial year

Status

Management undertaking for corrective action.

2.3 Property plant and equipment issues

2.3.1 Asset records that couldn't be identified in the fixed asset register

(Risk rating - Deficiency)

Observation

On capitalisation of asset renewals and upgrades, Council was not able to derecognise some old asset balances in the fixed asset register as asset records couldn't be identified. Instead, council created new assets to capitalise these renewals and upgrades. We noted that these instances mainly pertain to asset classes, which have not been comprehensively revalued since Council's re-instatement on 1 January 2014 where the fixed asset register details were from Cairns Regional Council.

Implications

- Possible duplication of asset records if new assets are created for renewals and upgrades rather than updating the old asset details/balances in the fixed asset register.
- Misstatement of asset balances if old assets balances of renewed and upgraded assets are not derecognised in the fixed asset register.

Recommendations

We recommend that Council:

- Revisit these capitalised asset renewals and upgrades in 2015-16 to identify any possible duplication of asset records and derecognise the old asset balances in the fixed asset register.
- Ensure these assets can relate to physical assets as in the physical asset stocktake or comprehensive revaluation of its assets and performing a reconciliation with asset details in the fixed asset register.

Management response

Following a request from the QAO, Council populated its asset additions spreadsheet with estimated disposal details for assets that were renewed or upgraded during the financial year. In many instances however it was not possible to identify the particular asset (or asset portion) involved. Council also identified a number of duplications between road reseal renewal additions and the comprehensive revaluation of Council's road assets. As advised by email on 16 September 2015 Council decided not to adjust the 2014/15 financial statements due to materiality considerations but did agree to make the adjustments to the asset register (and ledger) during the 2015/16 financial year.

Council is not in a position to comprehensively revalue all of its fair value asset classes in the one financial year, however is progressively updating its asset register each year as asset classes are revalued in accordance with its revaluation schedule. In many instances this means removing all or most of the old data relating to a particular asset class and replacing it with new / updated revaluation data. Likewise, performing a physical stocktake of all assets in one year is not practical as this forms part of the ongoing condition assessment / revaluation of Council's assets. Whilst Council's ledger reconciles to the values in the asset register, neither revaluation nor physical stocktake will enable a full reconciliation of asset details with the existing details in the asset register (as there are issues relating to asset aggregation, percentage allocations to Douglas from CRC, incomplete data descriptions etc) and this is why Council is progressively updating / replacing the existing data.

Responsible Officer

Manager Finance & IT

Implementation Date

- Adjustments to the asset register as agreed by email on 16 September 2015 – during 2015-16 financial year.
- Improvements to the quality/accuracy of asset data in the asset register – Ongoing.

Status

Management undertaking for corrective action.

2.3.4 Inconsistency in asset accounting policies for the treatment of demolition and removal of debris used in the valuation methodology

(Risk rating - Deficiency)

Observation

As part of the 30 June 2015 transport assets comprehensive revaluation, the Council's cost models in deriving valuation unit rates excludes costs for demolition and removal of debris. However, when assets are initially recognised the Council currently capitalise all costs to replace an existing asset including costs such as demolition and removal of debris.

Accounting standard AASB 116 Property, plant and equipment states that an asset is recognised only if it is probable that future economic benefits flow to the entity. It is difficult to rationalise how some costs can represent "future economic benefits" on initial recognition but have no value (no future economic benefit) on subsequent measurement at fair value.

The Council's method for initial recognition of the transport assets and subsequent revaluation of these assets considers two different cost structures. This treatment appears to directly conflict with AASB 108 Accounting policies, changes in accounting estimates and errors where paragraph 13 states that entity should select and apply its accounting policies consistently for similar transactions.

Implications

The adoption of different assumptions in asset recognition and revaluation, will result in some costs capitalised on initial recognition of the asset and subsequently being written-off through asset revaluation surplus as part of the year end revaluation. This practice will overstate the net profit and financial sustainability ratios as expenses will flow through equity and not through the income statement.

Recommendations

We recommend that council reconsider this process in 2015-16, so that there is consistency in the recognition and subsequent measurement of assets. This approach may necessitate enhancements to the Council's current job/project costing system to ensure that expenses are captured and recorded more accurately on each phase/activity of the work.

Management response

As discussed during final audit, Council's Manager Infrastructure has developed a spreadsheet to track the various components of project costs (compared to budget) and this will include details of demolition and removal of debris costs (ie asset disposal costs). To compliment this process, Council will also be establishing appropriate tasks within its work order structure to record these costs so that they can be capitalised against the relevant replaced asset (or applicable portion) as part of its disposal cost.

Responsible Officer

Manager Finance & IT

Implementation Date

2015/16 financial year

Status

Management undertaking for corrective action.

5.9. DAINTREE FORUM #2

REPORT AUTHOR(S): Nevinia Davenport, Executive Assistant
Linda Cardew, Chief Executive Officer

DEPARTMENT: Office of the Chief Executive Officer

RECOMMENDATION

That Council receive and note the report.

EXECUTIVE SUMMARY

This report details the issues raised by the local community at the second Daintree Forum held at Diwan on 23 July 2015, and Council's actions to date in response.

BACKGROUND

On 3 June 2014 the following Notice of Motion was carried unanimously:

1. *That the Council undertake no less than three (3) community Forums engaging with the communities north of the Daintree River within the term of the current Council;*
2. *The first Forum to be conducted early in the 2014/15 financial year and the second and third Forums to be conducted during the 2015 calendar year; and*
3. *That the Forums either be general or specific in terms of the issues the Council may seek to canvass.*

Councillors were in agreement that there are many unique issues affecting the communities living north of the Daintree River, and that there is an opportunity for the new Council to demonstrate that it has a serious intention to respond to and rectify any perception that the community has been somewhat ignored and underserved by the former Douglas Shire and Cairns Regional Councils, and other service providers.

While not all issues are the responsibility of Council to resolve, Council considered that providing a Forum as an opportunity for the communities north of the River to have direct contact with Council would be beneficial, particularly if the new Douglas is to stay true to its objective of providing open, transparent and inclusive government.

The second forum attended by approximately 35 local residents and business operators was convened in Diwan on 23 July 2015 from 10.00am to 2.00pm with discussion generally under the following five sessions:

1. Capital Works and Operational Initiatives completed in 2014-2015 and planned for 2015-2016;
2. Mayoral advocacy;
3. NDDRA update;
4. Coconut Management Plan; and
5. Waste collection