

## 5.9. FINAL MANAGEMENT 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 Management Report (Observation Report) from the Queensland Audit Office for the 2015/16 financial year.**

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### EXECUTIVE SUMMARY

The Final Management Report is presented to Council for noting and staff have also provided a summary of the number and type of QAO audit issues outstanding as at June 2016 compared to June 2015.

### BACKGROUND

Each financial year Council's financial statements must be audited and for the 2015/16 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 management 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 October 2016 and Council was provided with an unmodified (unqualified) audit opinion (Independent Auditor's Report) on 18 October 2016. The Final Management Report contains all issues identified in the final stage of the audit and these issues have been categorised into either "Internal Control Deficiency" issues (assessed as 'significant deficiency' or 'deficiency') or "Financial Reporting" issues (assessed as 'high', 'medium' or 'low') as explained in appendix A of the report. There are ten issues assessed as 'deficiency', one issue assessed as 'medium' and three issues assessed as 'low'. There is also one issue that has been categorised as "Other Matters".

Appendix A of the Final Management Report contains details of the component, issue, rating, QAO recommendation, management response and status for each of the issues identified. All of these issues were workshopped with Council on 14 October 2016 as part of the QAO's presentation of the audit closing report.

The following table provides a summary of the number and type of QAO audit issues outstanding as at June 2016 compared to June 2015.

Category	QAO Audit Issues Outstanding				Comment
	Jun-15	Added	Resolved	Jun-16	
<b>Information Technology</b>					
Significant Deficiency					
Deficiency	10		2	8	IT governance and security issues
High					
Medium					
Low					
<b>Property, Plant &amp; Equipment</b>					
Significant Deficiency	1		1		Asset Management Plan / Strategy
Deficiency	6		6		Various asset related matters
High					
Medium					
Low					
<b>Other</b>					
Significant Deficiency					
Deficiency	1	1	2		System close, Purchasing
Other matter	1	1	2		Trust Account, Related Party Disclosures
High					
Medium					
Low					
	19	7	14	12	

Council's audit matrix will now be updated to reflect the current status of these issues.

## PROPOSAL

The QAO's Final Management 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 new financial or resource implications with the 2015/16 Final Management Report.

## RISK MANAGEMENT IMPLICATIONS

Having the issues identified by Council's external auditors and reporting the progress on resolving these issues 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:

<b>Fully-Responsible</b>	Delivering a program or activity for another organisation (usually another level of government).
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## CONSULTATION

<b>Internal:</b>	When preparing management responses to the issues identified by the QAO internal consultation was undertaken with relevant staff.
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## ATTACHMENTS

1. 2015-16 QAO Final Management Report **[5.9.1]**

Your ref:  
Our ref: 2016 -4039  
Ms Debra Stoltz

10 November 2016

Councillor J Leu  
Mayor  
Douglas Shire Council  
PO Box 723  
MOSSMAN QLD 4873

Dear Councillor Leu

**Final Management Report for Douglas Shire Council**

The 2015-16 audit for Douglas Shire Council has now been completed.

QAO has issued an unmodified audit opinion on your financial statements. An unmodified audit opinion was also issued on the current year financial sustainability statement. However, an emphasis of matter paragraph was included in the Independent Auditor's Report to highlight the use of the special purpose basis of accounting. These financial reports were returned to you by letter 17 October 2016.

The purpose of this letter is to provide the council with details of significant audit matters and other important information related to the audited financial statements

Our closing report was presented to the Council at the Workshop held on 14 October 2016 to review the financial statements prior to their adoption at a Special meeting of the Council on same day. I believe this process benefited the Councillors to understand the audit process and demonstrate the positive working relationship the Council has developed with QAO.

Since the presentation of the closing report, there have been no significant matters that have come to our attention.

For your information, Appendix A provides you with details of all audit issues we have raised with management.

**Report to parliament**

Each year we report the results of all financial audits and significant issues to parliament. In this report, we will comment on the results of the audit of your financial report, financial performance and position and sustainability matters, and any significant control issues we identified, together with our audit recommendations.

You and the chief executive officer will be given an opportunity to comment and those comments will be reflected in the report.

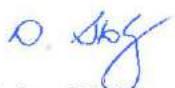
**Audit fees**

The final audit fee for this year is \$97 000 (prior year \$98 000). The actual final fee is \$2 000 above the fee we communicated in our External Audit Plan and we have discussed and agreed this increase with the Management.

We would like to thank you and your staff for the assistance provided to us during the audit.

If you would like to discuss these issues or any matters regarding the audit process, please feel free to contact me or Audit Manager, Athula Unantenne on 3149 6093.

Yours sincerely



Debra Stoltz  
Director

Enc.

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

## Appendix A

### Issues formally reported to management

#### Internal control deficiency categories

We have assessed all internal control deficiencies in this report based on their potential to cause a material misstatement in the financial statements or are of sufficient importance to merit Council's attention. The risk assessment categories are as follows:

Assessed category	Potential effect on the financial statements	Prioritisation of remedial action
Significant deficiency	<p>This is a deficiency in internal control, or combination of deficiencies in internal control that, in our professional judgement, may lead to a material misstatement of the financial statements.</p> <p>Significant deficiencies are always of sufficient importance to merit the attention of those charged with governance.</p>	This requires immediate management action to resolve.
Deficiency	<p>We have assessed that the control:</p> <ul style="list-style-type: none"><li>(i) is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements component on a timely basis, or</li><li>(ii) is necessary to prevent, or detect and correct, misstatements in the financial statements component on a timely basis, but is missing.</li></ul>	<p>This requires management action to resolve within eight months of this report date.</p> <p>(This is not required to be resolved before the issuance of the current year audit opinion; however unless otherwise agreed it must be resolved before next year interim audit work is commenced.)</p>

This table provides you with a summary of internal control deficiencies included in the interim audit letter dated 26 July 2016.

Component	Issue	Rating	Our recommendation	Management Response	Status
Control Activities	<p><b>Lack of segregation of duties over purchasing</b></p> <p>We observed instances of where,</p> <ul style="list-style-type: none"> <li>• Officers with approved financial delegations have the ability to raise, approve and receipt goods.</li> <li>• Management has not run Monthly self-approval reports throughout the year.</li> <li>• During the period 1 July 2015 to 18 February 2016 one employee has raised requisitions totalling more than \$200 000 that were automatically approved in the Authority system. No documented evidence of an independent review of these requisitions is available.</li> </ul> <p><b>Implication:</b></p> <p>Purchasing practices are inconsistent with council purchasing policy and potential fraudulent ordering of goods and services may occur.</p>	Deficiency	<p>We recommend that Council separate incompatible duties such as ordering, approving and receipting processes in the authority system.</p>	<p>Management are undertaking a process monthly to complete and review a self-approver report.</p>	Resolved
Control Environment	<p><b>Date issue raised: 2015</b></p> <p><b>Business continuity and IT Disaster Recovery</b></p> <p>An approved corporate business continuity plan with supporting IT disaster recovery procedures is not available.</p>	Deficiency	<p><b>We recommend that</b></p> <p>Council Develop and document a business continuity plan that supports disaster recovery procedures.</p> <p>Council perform testing of the plan regularly.</p>	<p>Council have budgeted for a contract Business Analyst to progress and resolve this matter.</p> <p>Expected completion by June 2017.</p>	Management undertaking for corrective action.

Component	Issue	Rating	Our recommendation	Management Response	Status
Control Environment	<p><i>Date issue raised: 2015</i></p> <p><b>Change management policy and procedures</b></p> <p>Council do not have an approved up-to date IT change management policy or supporting procedures.</p> <p>Council was tailoring IT policies taken on during de-amalgamation from the parent Council, when this issue was first raised.</p>	Deficiency	<p><b>We recommend that</b></p> <p>Council implement a change management policy and supporting procedures for its business systems. This policy will assist Council to control configuration changes made to IT infrastructure.</p>	<p>The council staff are now recording the changes (Ticketing system to log change requests) and manually following control points. An ICT change control guide line is documented to formalise the process.</p>	Resolved.
Control Environment	<p><i>Date issue raised: 2015</i></p> <p><b>Information security management</b></p> <p>Council modifying the IT policies initially adopted from Cairns Regional Council. We identified:</p> <ul style="list-style-type: none"> <li>• Information systems were not classified using an appropriate security classification scheme (QGISCF).</li> </ul> <p>Compliance and monitoring processes in relation to the ICT security policy requirements are not in place.</p>	Deficiency	<p><b>We recommend that</b></p> <p>Council develop, document and implement an information security classification policy, that provides</p> <ul style="list-style-type: none"> <li>• Standard process to allow Council to evaluate information assets, determine appropriate levels of security to deal with the sensitivity and confidentiality of information assets.</li> <li>• Security classification level for all key business information – e.g. ICT security standard or register.</li> <li>• Identify gaps in the existing controls, implement and maintain appropriate IT controls.</li> </ul> <p>Demonstrate support and commitment to information security.</p>	<p>Council have budgeted for a contract Business Analyst to progress and resolve this matter. Expected completion by June 2017.</p>	Management undertaking for corrective action.

Component	Issue	Rating	Our recommendation	Management Response	Status
Control Activities	<p><i>Date issue raised: 2015</i></p> <p><b>IT governance framework</b></p> <p>The ICT team leader regularly meets with key management however; there are limited opportunities to contribute to investment planning, and the assessment of IT risks in associated programs or projects.</p>	Deficiency	<p><b>We recommend that</b></p> <p>Council establish</p> <ul style="list-style-type: none"> <li>• IT governance arrangements for effective use of ICT portfolio resources.</li> <li>• An effective IT strategic planning processes, plans and roadmaps for all critical information assets.</li> </ul> <p>This will better align IT investments business needs.</p> <p>ICT unit actively participates in new programs and associated IT project.</p>	<p>Council have budgeted for a contract Business Analyst to progress and resolve this matter. Expected completion by June 2017.</p>	Management undertaking for corrective action.
Control Environment	<p><i>Date issue raised: 2015</i></p> <p><b>Network security management</b></p> <p>Council has not established a formal plan or standards to manage Council's current network security.</p>	Deficiency	<p><b>We recommend that</b></p> <p>Council implement standards relating security over wireless technology, mobile devices, network devices and SOE.</p> <p>Council monitor compliance with standards and provide security awareness, training to Council and IT staff.</p>	<p>Council is considering outsourcing Network Security Service. Council plans to issue a request for quotes against a standardised framework soon. The scope will include:</p> <ul style="list-style-type: none"> <li>• Periodic firewall rule review.</li> <li>• Network monitoring.</li> <li>• Performing routine maintenance.</li> </ul> <p>Expected completion by June 2017.</p>	Management undertaking for corrective action.
Control Activities	<p><i>Date issue raised: 2015</i></p> <p><b>SCADA system security</b></p> <p>Supervisory Control and Data Acquisition (SCADA) systems are used to manage the infrastructure that delivers water and sewage services. Firewalls to protect this system are not isolated from corporate network and firewall logs are not reviewed regularly.</p>	Deficiency	<p><b>We recommend that</b></p> <p>Council allow only authorised access, restrict internet access to SCADA, prohibit/restrict connection of memory sticks to SCADA workstation, Secure methods to authorise remote support and monitor/ audit physical and logical access and review firewall rules for its effectiveness.</p>	<p>The Council has undertaken the following corrective action:</p> <ul style="list-style-type: none"> <li>• A logical network separation has been completed including remote access.</li> <li>• Password expiry for remote access users has been implemented in compliance with password policy.</li> </ul>	Management undertaking for corrective action.

Component	Issue	Rating	Our recommendation	Management Response	Status
Control Activities	<p><i>Date issue raised: 2015</i></p> <p><b>User access management policy and procedures</b></p> <p>Council had established process to manage user requests for access to its computer systems. However, the council has not documented and approved the user access policy.</p> <p>In addition, there is no regular review of user accounts and user access permissions.</p>	Deficiency	<p><b>We recommend that</b></p> <p>Council Develop and implement a policy that details</p> <ul style="list-style-type: none"> <li>• Procedures in relation to provisioning and managing user access to all Council's business systems and Electronic Fund Transfer (EFT) system.</li> <li>• Periodic review of the appropriateness of user access permissions for all key business systems.</li> </ul> <p>We recommended a policy that tighten security over business systems in our original recommendation.</p>	<p>Further enhancements are currently being undertaken relating to password controls.</p> <p>Expected completion by June 2017.</p> <p>Council have budgeted for a contract Business Analyst to progress and resolve this matter.</p> <p>Expected completion by June 2017.</p>	Management undertaking for corrective action
Control Activities	<p><i>Date issue raised: 2015</i></p> <p><b>Privileged system access</b></p> <p>Council has granted full access to the Authority system to Five ICT support staff and vendor staff.</p> <p>There is no regular review of their activities.</p>	Deficiency	<p><b>We recommend that</b></p> <p>Council restrict the use of privileged administration to specified staff and monitor activities of privileged administration and generic accounts.</p>	<p>Council have budgeted for a contract Business Analyst to progress and resolve this matter.</p> <p>Expected completion by June 2017.</p>	Management undertaking for corrective action.

Component	Issue	Rating	Our recommendation	Management Response	Status
Control Activities	<p><i>Date issue raised: 2015</i></p> <p><b>User access and segregation of duties</b></p> <p>We observed that Council has started modifying access profiles from full access to a profile that aligning with the business requirements.</p> <p>Segregation of duties conflicts are not considered prior to assignment of access roles.</p> <p>Council has scheduled the documentation of controls for the end-to-end business processing in the 2015–16.</p>		<p><b>Recommendation</b></p> <ul style="list-style-type: none"> <li>• Council document key end-to-end business processes considering conflict of interest for staff and using segregation of duties matrix.</li> <li>• Business owners approve user roles and any subsequent changes.</li> <li>• Log all key changes to user access permissions; restrict allocation of multiple roles to users.</li> <li>• Communicate any changes to staff, position or roles to system administrators.</li> </ul> <p>Review user access regularly, and implement compensating detective controls.</p>	<p>Council have budgeted for a contract Business Analyst to progress and resolve this matter. Expected completion by June 2017.</p>	<p>Management undertaking for corrective action.</p>

## Financial reporting issues

We have assessed all financial reporting issues in this report based on their potential to cause a material misstatement in their financial statements. The assessed risk ratings are as follows:

Risk rating	Potential effect on the financial statements	Prioritisation of remedial action
High	We assess that there is a high likelihood of this causing a material misstatement, whether due to fraud or error, in one or more components (transactions, balances and disclosures) of the financial statements.	This requires immediate management action to resolve.
Medium	We assess that there is a medium likelihood of this causing a material misstatement, whether due to fraud or error, in one or more components of the financial statements.	This requires management action to resolve within four months of this report date.  (This is not required to be resolved before we issue this year's audit opinion.)
Low	We assess that there is a low likelihood of this causing a material misstatement, whether due to fraud or error, in one or more components of the financial statements.	We recommend management action to resolve; however, a decision on whether any action is taken is at management's discretion.  (This is not required to be resolved before we issue this year's audit opinion.)

This table provides you with a summary of financial reporting issues identified during year end audit and formally reported to management.

Financial statement component(s) affected	Issue	Rating	Our recommendation	Management Response	Status
Property, plant and equipment	<p><b>Road unit rates do not distinguish geographical location of Council roads</b></p> <p><b>Implication:</b> The current situation gives rise to a potential material difference in the fair value of roads that are north and south of the Daintree River.</p>	Medium	<p>We recommend that</p> <ul style="list-style-type: none"> <li>Council identify the geographical location of its roads in terms of Daintree River.</li> <li>Council should assess the reasonableness of the unit rates in the register by comparing with the actual costs of capitalised roads recently.</li> </ul> <p>Develop an appropriate and relevant unit rate base for Council roads.</p>	<p>Council will assess of the impact on the value of its roads north of the Daintree River.</p> <p>Council intention is to undertake another independent revaluation of its road assets during 2016-17 and this issue will be addressed as part this process.</p>	Management undertaking for corrective action.
Property, Plant and Equipment	<p><b>Assets that have a remaining useful life greater than their total lives for Assets</b></p> <p><b>Implication:</b></p> <ul style="list-style-type: none"> <li>No risk of material misstatement as Council does not use total life field to calculate depreciation.</li> <li>This inaccuracy is likely to result in inefficient asset management/asset analysis.</li> </ul>	Low	<p>We recommend that</p> <p>Council review the total lives of all assets in a timely manner.</p>	<ul style="list-style-type: none"> <li>This issue relates to asset data transferred on de-amalgamation.</li> <li>The system does not use the total life to calculate depreciation and therefore these inaccuracies do not impact upon Council's asset values.</li> <li>Issue is generally corrected at full revaluation.</li> <li>Majority of assets listed with incorrect total lives yet to be comprehensively revalued.</li> </ul> <p>Council's asset accountant resolving this matter progressively.</p>	Management undertaking for corrective action.

Financial statement component(s) affected	Issue	Rating	Our recommendation	Management Response	Status
Property, Plant and Equipment	<p><b>Large number of assets with a written down value of zero</b></p> <p><b>Implication:</b></p> <p>Council's property, plant and equipment may be understated due to assets existing and in use but are valued at nil. In addition, having shell assets within the asset register which cannot be traced to supporting documentation may hamper effective asset management.</p>	Low	<p>We recommend that</p> <ul style="list-style-type: none"> <li>• Council identify all active assets and re-value them to their fair value.</li> </ul> <p>Council undertakes a data cleansing exercise of the fixed asset register to remove all shell assets.</p>	<p>Council is well underway in cleansing its asset register and so far has removed over 4 000 zero valued assets from the register.</p> <p>A number of the current issues will be resolved when the remaining asset classes are revalued by Council (water, footpaths, land and buildings).</p> <p>In addition, staff will continue to progressively cleanse the asset register where possible.</p>	Management undertaking for corrective action.
Property, Plant and Equipment	<p><b>Inconsistent capitalisation of road assets</b></p> <p><b>Implication:</b></p> <p>High level capitalisation of road assets results in an inconsistent asset register.</p>	Low	<p>We recommend that</p> <p>Council reviews the capitalisation of high level assets to ensure roads are capitalised on a consistent basis with existing assets in the register.</p>	<p>Council agrees with the observation and will undertake corrective action.</p>	Management undertaking for corrective action.

### Other matters identified during the audit and reported to management.

Area	Business improvement opportunity	Our recommendation	Management Response	Status
Financial reporting	<p>AASB 124 Related Party Disclosures will apply to all Councils from 1 July 2016.</p> <p><b>Implication:</b></p> <p>Management's ability to capture and disclose related party information may be hindered unless appropriate policies and procedures are in place by 1 July 2016.</p>	<p>We recommended that:</p> <p>Council adopt a related party policy and implement appropriate procedures to capture related parties relationships and transactions.</p>	<p>Council has adopted a Related Party Disclosure Policy.</p>	Resolved