

## 5.11. QAO INTERIM MANAGEMENT LETTER

**REPORT AUTHOR** Tara Killeen, Chief Financial Officer

**MANAGER** Mark Stoermer, Chief Executive Officer

**DEPARTMENT** Finance and Corporate Services

### RECOMMENDATION

**That Council notes the observations contained within the Douglas Shire Council Interim Management Report to the Mayor (Observation Report) from the Queensland Audit Office for the 2019/20 financial year.**

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### EXECUTIVE SUMMARY

The Interim Management Report is presented to Council for noting. The report also contains the current status of one audit issue outstanding.

### BACKGROUND

Each financial year Council's financial statements must be audited and for the 2019/20 financial year the audit is being undertaken by the Queensland Audit Office (QAO). *Section 54 of the Auditor-General Act 2009* enables the QAO to prepare an Interim Management Report containing observations and suggestions about anything arising out of the audit during the interim 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 an 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).

A Final Management report will be provided by the QAO upon the completion of the annual Audit.

### COMMENT

The External Audit for Douglas Shire Council was commenced by the QAO on the 16 March 2020. The QAO audit team conducted remote planning in the week beginning 16 March 2020 and remote interim audit testing from 18 May 2020. The Interim Management Report contains any issues identified during this interim audit and categorises these issues into either "Internal Control Deficiency" issues (assessed as 'significant deficiency', 'deficiency' or 'other matter') or "Financial Reporting" issues (assessed as 'high', 'medium' or 'low').

Section 1 summarises the audit progress.

Section 2 of the report outlines emerging risks.

Section 3 summarises reporting on deficiencies in internal controls. There were no new issues identified in the “Internal Control Deficiency” category. All of the prior year deficiencies have been resolved, with the exception of the establishment of an Audit Committee, which is a work in progress.

Section 4 summarises the status of financial reporting issued identified. There were no new issues identified in the “Financial Reporting” category. All prior year matters were resolved in the current year. The report contains details of the component, issue (and rating) for each issue identified/outstanding.

## PROPOSAL

The QAO’s Interim Management Report is presented to Council for noting of their observations.

## FINANCIAL/RESOURCE IMPLICATIONS

Additional resources will need to be directed to the establishment and ongoing operation of the Audit Committee.

## RISK MANAGEMENT IMPLICATIONS

Having the issues identified by Council’s external auditors and reporting on and resolving these issues will mitigate risks. In particular, the introduction of an Audit Committee with an expert independent Chair will likely reduce the ongoing risks for Council.

## SUSTAINABILITY IMPLICATIONS

**Economic:** The Queensland Audit Office assess internal controls, performance against sustainability ratios and emerging risks, including going-concern and liquidity. Monitoring these measures will ensure Council can stay on track to achieve long term economic sustainability.

**Environmental:** Nil

**Social:** Nil

## CORPORATE/OPERATIONAL PLAN, POLICY REFERENCE

This report has been prepared in accordance with the following:

### Corporate Plan 2019-2024 Initiatives:

#### Theme 5 - Robust Governance and Efficient Service Delivery

Strong governance and financial management are the foundations of the way in which Council will conduct its business and implement the initiatives of the Corporate Plan.

**Goal 1** - *We will conduct Council business in an open and transparent manner with strong oversight and open reporting.*

**Goal 3** - *We will make sound financial decisions by ensuring robust strategic planning, financial management and reporting.*

## 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>Custodian</b> | Council owns and manages infrastructure, facilities, reserves, resources and natural areas. In fulfilling its role as custodian, Council will be mindful of the community, the economy, the environment, and good governance.  |
| <b>Regulator</b> | Council has a number of statutory obligations detailed in numerous regulations and legislative Acts. Council also makes local laws to ensure that the Shire is well governed. In fulfilling its role as regulator, Council will utilise an outcomes based approach that balances the needs of the community with social and natural justice. |

## CONSULTATION

|                  |   |
|------------------|---|
| <b>Internal:</b> | Chief Executive Officer, Management Team, Finance & Corporate Services Team |
| <b>External:</b> | Queensland Audit Office, Pacifica (Internal Auditors)                       |

## ATTACHMENTS

1. 2020 Douglas Shire Council Signed Interim Report 9 June 2020 [5.11.1 - 11 pages]

# Douglas Shire Council

## 2020 Interim report to the Mayor

9 June 2020

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Your ref:  
Our ref: 2020-4139  
Sri Narasimhan 3149 6208

## SENSITIVE

9 June 2020

Councillor M Kerr  
Mayor  
Douglas Shire Council  
PO Box 723  
MOSSMAN QLD 4873

Dear Councillor Kerr

### 2020 Interim report

We present to you our interim report for Douglas Shire Council for the financial year ending 30 June 2020. This report details the results of our interim work performed to 30 April 2020. In this phase we assess the design and implementation of your internal controls, and whether they are operating effectively. To date our work has not identified any significant deficiencies in your internal controls.

This report also includes our assessment of your internal control framework; and a status update on matters raised in prior periods.

The *Auditor-General Act 2009* requires the Auditor-General to report to parliament on an issue raised during an audit if he considers it to be significant. The results of your entity's audit will be included in our report to parliament on results of Local Government Entities.

At this stage, the Auditor-General is working towards continuing to table most of the planned reports for this year but, given the current environment and associated community sensitivities, we will keep the tabling timeframe under continued review. I know that your focus is currently on responding to COVID-19 and that this may be a challenge over an extended period. As a result, if you find any of QAO's requests (or timeframes) difficult, we can work through revised response methods and dates.

Please note that under section 213 of the *Local Government Regulation 2012*, you must present a copy of this report at your council's next ordinary meeting. If you have any questions or would like to discuss the audit report, please contact me on 3149 6208 or Julie O'Brien on 3149 6160.

Yours sincerely



Sri Narasimhan  
Director

Enc.

cc. Mr M Stoermer, Chief Executive Officer

# 1. Summary



## Audit progress

| Emerging risk–COVID-19 | Action required |
|------------------------|-----------------|
|------------------------|-----------------|

COVID-19 poses several risks and challenges to entities globally and the Queensland public sector is no different. It is hard to determine the longevity of this pandemic, or the financial impact this may have.

In Section 2 [Emerging risks](#) we have provided a summary of what these challenges may be for your organisation and what this means for your financial statements and the statutory deadlines.

| Internal control assessment and issues | No issues identified |
|--|----------------------|
|--|----------------------|

We have tested the operating effectiveness of key controls for revenue, payroll, expenditure, and property, plant and equipment for the period 1 July 2019 to 30 April 2020. We have not identified any new control deficiencies in these areas – Refer to Section 2 of this report.

The status of control deficiencies raised in prior years is detailed in Section 4 of this report.

Based on the results of our testing completed to date, we have assessed your internal control environment as effective, meaning the environment supports an audit strategy that can rely upon these controls.

| Financial reporting issues and other matters | On track |
|--|----------|
|--|----------|

We have not identified any new financial reporting issues. Refer to section 3 of this report.

The status of other matters raised in prior years is detailed in Section 4 of this report.

| Areas of audit significance | On track |
|-----------------------------|----------|
|-----------------------------|----------|

We have commenced our audit procedures designed to address the areas of audit significance as outlined in our external audit plan dated 24 April 2020.

| Additional Matters | Continue to monitor |
|--------------------|---------------------|
|--------------------|---------------------|

### Managing Compliance Requirements

The regulatory and compliance responsibilities of those charged with governance of Queensland councils encompasses over 4,500 different legislative requirements.

From enquiries with council, we understand Douglas Shire Council currently does not have a centralised register or mechanism for recording its legislative requirements. The absence of a centralised legislative compliance register may impact the council's ability to effectively manage and monitor its legislative obligations. This includes identifying, reporting, and resolving breaches where required, and providing appropriate and targeted training to staff on legislation relevant to their role. This appears to be an issue for most, if not all, Queensland councils.





## 2. Emerging risks

COVID-19 is testing the resilience and agility of entities as they tackle multiple challenges, such as supporting their staff and the community, and managing sustainable operations. Management should continue to assess the impact of COVID-19 on their financial results and internal control environment. The AASB and AuASB are continuing to issue in-depth guidance to chief financial officers, audit committee members, directors and auditors refer [here](#). We will continue to consider the implications of this pandemic and have identified the following key areas that may impact Douglas Shire Council.

| Area of concerns and associated risk  | What to consider  |
|---|---|
| <p><b>Going concern</b></p> <p>Material uncertainties that cast significant doubt on the ability to continue as a going concern, such as the extent of the effect on future revenue and costs and the unknown duration of the event.</p> <p>Several revenue streams such as sale of goods and services and rental income may reduce. Timing of cash inflows may also be impacted.</p> | <p>Consider future information for at least, but not limited to, the twelve months after reporting date, for example travel bans, community restrictions, government assistance, financial health of key suppliers and customers, existing financial resources and likely period of expiry if conditions continue or deteriorate.</p> <p>We have released a blog on how to manage your cash reserves in uncertain times on our <a href="#">website</a>.</p>   |
| <p><b>‘Everyday’ internal controls</b></p> <p>Most entities have expanded to working from home to support social distancing. With any change in working arrangements comes an increased risk of controls failing, particularly manual controls and where controls previously operated with a high level of management oversight within an office environment.</p>                     | <p>Remain vigilant with your monitoring of internal controls during this time. This could mean your entity may need to implement new controls or revise current controls to accommodate the new work environment.</p> <p>We have recently issued a <a href="#">blog</a> on impact of operational controls under new working arrangements on our website.</p>  |
| <p><b>Information technology and cyber security</b></p> <p>Entities’ exposure to cyber security risks increases in vulnerable and uncertain times as their resources are focused on being re-deployed to address critical matters. There is also a risk that identifying cyberattacks may be potentially delayed causing financial and/or reputational risks.</p>                     | <p>Entities will need to periodically remind everyone of the increased cyber security risks in these times so their staff remain vigilant.</p> <p>Multi-factor authentication, if not already in place, should be activated immediately.</p> <p>Information technology staff should maintain visibility across the network. This will allow entities to proactively monitor the cyber environment and respond quickly if potential attack is in progress.</p> |
| <p><b>Valuation of property, plant and equipment</b></p> <p>Economic uncertainty and imposed community restrictions may impact the ability of valuers to accurately perform comprehensive and/or desktop valuations and meet the fair value measurement requirements of AASB 13.</p>  | <p>Entities may need to consider a number of factors depending on whether the fair value is determined using current replacement cost or income-based approach.</p> <p>Refer to <a href="#">Appendix C—Valuation considerations</a> for detailed guidance. We have also released a <a href="#">blog</a> on this issue on our website.</p>   |
| <p><b>Impairment of receivables</b></p> <p>There is an increased likelihood that debtors may take longer to pay and, in some instances, not be able to pay their obligations at all.</p>  | <p>Based on reasonable and supportable information, reassess whether there has been a change in the risk of default by the debtor. If it is deemed that the risk of default does exist, determine the probability of default and the loss that is likely to arise.</p>  |
| <p><b>Financial statement disclosure</b></p> <p>Several disclosures in the financial statements will be impacted</p>  | <ul style="list-style-type: none"> <li>• Revisit the going concern assessment disclosed in the financial statements</li> <li>• Consider disclosing additional information about significant judgement and estimates</li> </ul>  |











Some of these risks also heightens the risk of fraud. Management should enhance the controls in place to detect any fraudulent activities that entities may be exposed to. As auditors, we consider fraud risk to be pervasive to the financial statements and will increase our professional scepticism in carrying out the audit of the financial statements of Douglas Shire Council.




# 3. Internal control issues





The following table summarises our reporting on deficiencies in internal controls. Refer to Section 4 for details of unresolved prior year issues.

| Internal control issues by COSO element   | Number of significant deficiencies |                              | Number of deficiencies |                              | Rating  |
|---|------------------------------------|------------------------------|------------------------|------------------------------|---|
|   | Current year issues                | Prior year unresolved issues | Current year issues    | Prior year unresolved issues |   |
|  <b>Control environment</b><br>Structures, policies, attitudes and values that influence daily operations                        | -                                  | -                            | -                      | -                            |    |
|  <b>Risk assessment</b><br>Processes for identifying, assessing and managing risk  | -                                  | -                            | -                      | -                            |    |
|  <b>Control activities</b><br>Implementation of policies and procedures to prevent or detect errors and safeguard assets         | -                                  | -                            | -                      | -                            |    |
|  <b>Information and communication</b><br>Systems to capture and communicate information to achieve reliable financial reporting | -                                  | -                            | -                      | -                            |  |
|  <b>Monitoring activities</b><br>Oversight of internal controls for existence and effectiveness                                | -                                  | -                            | -                      | 1                            |  |

### Our ratings

 **Effective**  
 No significant deficiencies identified

 **Partially effective**  
 One significant deficiency identified

 **Ineffective**  
 More than one significant deficiency identified





## 4. Financial reporting issues and other matters

The following table summarises the status of financial reporting issues identified through our audit as at 30 April 2020.

| Financial reporting issues and other matters |            |                           |                            |                |            |                                      |          |
|--|------------|---------------------------|----------------------------|----------------|------------|--------------------------------------|----------|
|  | Prior year |                           |                            | Current year   |            |                                      |          |
|  | Unresolved | Resolved—<br>current year | Re-raised—<br>current year | Not yet<br>due | Unresolved | Resolved pending<br>QAO verification | Resolved |
| High risk                                    | -          | -                         | -                          | -              | -          | -                                    | -        |
| Medium risk                                  | -          | -                         | -                          | -              | -          | -                                    | -        |
| Low risk                                     | -          | -                         | -                          | -              | -          | -                                    | -        |
| *Other matters                               | -          | 1                         | -                          | -              | -          | -                                    | -        |

\*Queensland Audit Office only tracks resolution of other matters where management has committed to implementing action.



## 5. Prior year issues



### Status

The following table summarises the status of issues and other matters reported by audit in prior years.

| Reference                      | Rating  | Issue  | Status   |
|--------------------------------|---|--|--|
| <b>Internal control issues</b> |   |  |  |
| 19IR-2                         |    | <i>Lack of review of general journals</i><br>We found that not all journals were being independently reviewed.   | Resolved   |
| 19IR-6                         |    | <i>No audit committee in place</i>   | Work in progress<br>We understand that despite COVID-19 impacts, work is progressing with appointing an audit committee now Council has been sworn in. |
| 19IR-7                         |    | <i>Non-compliance with procurement policy</i><br>We identified two instances of non-compliance with the procurement policy in the prior year.                | Resolved   |
| <b>Other matters</b>           |   |  |  |
| 19IR-9                         |  | <i>Contents of the contracts register</i><br>We made recommendations to bring the content and format of the contracts register in line with better practice. | Resolved   |



## 6. Appendix A—Our rating definitions



### Our rating definitions

|                                   | Definition  | Prioritisation of remedial action   |
|-----------------------------------|---|---|
| <b>Significant deficiency</b><br> | <p>A significant deficiency is a deficiency, or combination of deficiencies, in internal control that requires immediate remedial action.</p> <p>Also, we increase the rating from a deficiency to a significant deficiency based on:</p> <ul style="list-style-type: none"> <li>the risk of material misstatement in the financial statements</li> <li>the risk to reputation</li> <li>the significance of non-compliance with policies and applicable laws and regulations</li> <li>the potential to cause financial loss including fraud, or</li> <li>where management has not taken appropriate timely action to resolve the deficiency.</li> </ul> | This requires immediate management action to resolve.                                 |
| <b>Deficiency</b><br>             | <p>A deficiency arises when internal controls are ineffective or missing, and are unable to prevent, or detect and correct, misstatements in the financial statements. A deficiency may also result in non-compliance with policies and applicable laws and regulations and/or inappropriate use of public resources.</p>   | We expect management action will be taken in a timely manner to resolve deficiencies. |
| <b>Other matter</b><br>           | <p>An other matter is expected to improve the efficiency and/or effectiveness of internal controls, but does not constitute a deficiency in internal controls. If an other matter is not resolved, we do not consider that it will result in a misstatement in the financial statements or non-compliance with legislative requirements.</p>  | Our recommendation may be implemented at management's discretion.                     |

### Financial reporting issues

|                   | Potential effect on the financial statements   | Prioritisation of remedial action  |
|-------------------|--|--|
| <b>High</b><br>   | <p>We assess that there is a high likelihood of this causing a material misstatement in one or more components (transactions, balances and disclosures) of the financial statements, or there is the potential for financial loss including fraud.</p> | This requires immediate management action to resolve.  |
| <b>Medium</b><br> | <p>We assess that there is a medium likelihood of this causing a material misstatement in one or more components of the financial statements.</p>  | We expect management action will be taken in a timely manner.  |
| <b>Low</b><br>    | <p>We assess that there is a low likelihood of this causing a material misstatement in one or more components of the financial statements.</p>   | We recommend management action to resolve; however, a decision on whether any action is taken is at management's discretion. |



## 7. Appendix B—Information on internal controls



### What is internal control?

'Internal control' is the processes, systems, records and activities that your entity designs, implements and maintains to provide you with reasonable assurance about the achievement of organisational objectives regarding:

- reliability of financial reporting
- effectiveness and efficiency of operations
- compliance with applicable laws and regulations.

Your governing body and executive management collectively are responsible for preparing reliable financial statements in accordance with generally accepted accounting principles. They are similarly responsible for maintaining effective internal control over financial reporting.

### Our assessments of your internal control framework

The auditing standards that we must comply with require us to understand and assess those aspects of your internal control that relate to our financial statement audit objectives. In the planning phase of our audit, we sought to understand and evaluate how controls are designed and implemented. We communicated to you the results of our analysis in our external audit plan.

If we decide that we can rely on your controls, we must then test them to confirm they operated effectively. The results of our testing may highlight deficiencies in your internal controls. We assess whether any identified deficiencies in internal control constitute, individually or in combination, a significant deficiency in internal control.

### Limitations of our reporting on internal control deficiencies

No system of internal control can provide absolute assurance about the absence of error or compliance. Even in the absence of identified control weaknesses, inherent limitations in your internal controls over financial reporting may not prevent or detect material misstatements.



## 8. Appendix C—Valuation considerations



Public sector entities in Queensland comprehensively fair value their property, plant and equipment at least once every five years. However, valuation policies of entities also require that specific appraisals be undertaken where an asset class has experienced significant and volatile changes in value (that is, 20 per cent or more).

The current economic downturn may impact the fair value of the assets. Each entity's situation needs to be considered individually. However, here are our general thoughts on whether we think asset classes are likely to move by more than 20 per cent over a short period.

| Valuation basis          | Our assessment  |
|--------------------------|---|
| Current replacement cost | <ul style="list-style-type: none"> <li>Given the nature of these assets are long term, our experience tells us that the key drivers for the valuation inputs for these asset classes are rarely volatile.</li> <li>Condition and useful lives of these long-term assets are also unlikely to be impacted as a result of COVID-19.</li> </ul>  |
| Income based valuation   | <ul style="list-style-type: none"> <li>Discount rates are expected to be impacted, particularly post February 2020.</li> <li>Cash flow forecast would need to be revisited due to:               <ul style="list-style-type: none"> <li>economic and financial announcements and directions, including ministerial directions are likely to impact cash flows</li> <li>re-prioritisation in deploying resources.</li> </ul> </li> </ul> |

In addition to the economic downturn, entities will have to consider the impact of restrictions that have been posed that prevent site visits by external valuers. This will impact local governments that are located in rural, remote and indigenous locations where some councils have restricted access to their communities to prevent the spread of COVID-19. Where such travel restrictions have been placed, entities will need to consider suitable alternatives such as those below.

| Valuation factors      | Consideration points   |
|------------------------|--|
| Gross replacement cost | <ul style="list-style-type: none"> <li>Using internal models (for internally constructed assets) or recent purchase price (assets acquired externally) to support unit rates.</li> <li>Where internal models are not workable, indexation is often enough for gross replacement cost. However, before relying on an index, consider whether:               <ul style="list-style-type: none"> <li>there have been any significant changes in unit rate categories since acquisition or the last detailed revaluation</li> <li>there has been a notable change in the modern substitute asset since the last detailed revaluation</li> <li>your engineering and finance staff have sufficient information to cost the modern substitute and make adjustments for the differences in service levels between the modern substitute and the existing asset.</li> </ul> </li> </ul> |
| Useful lives           | <ul style="list-style-type: none"> <li>Review the standard useful lives for each component and document the reasonableness of these useful lives.</li> <li>Review for individual assets whose useful lives are deviating from the standard life and adjust, as necessary.</li> </ul>   |

Materiality should also be considered when assessing valuations. Rolling valuations may mean that only one or two asset classes are due for a comprehensive valuation this year. If the most material classes are still within their cycle, and it is only one of the smaller classes due for revaluation this year, it may be possible to defer the specific appraisal of the smaller classes of assets and perform an alternative overall assessment.

We understand that you may have trouble completing your valuation in accordance with your planned timetables. Please continue to discuss your specific circumstances and timetables with your engagement leader.



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