#### **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



Your ref:

Our ref:

2015-4039

Athula Unantenne 3149 6093

15 October 2015

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

Dear Councillor Leu

## **Final Audit Report for Douglas Shire Council**

The Douglas Shire Council audit for 2014-15 has been completed.

QAO issued an unmodified audit opinion on Council's financial statements. An unmodified opinion was also issued on the current year financial sustainability statement. However, an emphasis of matter was included in that auditor's report to highlight the use the special purpose basis of accounting.

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

The closing report was presented to the audit committee on 23 September 2015 and provided the status of the audit as at date. Since the presentation of the closing report there have been no significant matters have come to our attention.

Appendix A provides Council with the detail of audit issues raised with management during the audit.

#### Reporting to Parliament

Each year we report the results of all financial audits to the Parliament. These sector-based reports include standing commentary on the suite of factors we take into consideration when forming an audit opinion, including:

- the timeliness and quality of the financial statements (including any significant adjustments to figures or disclosures)
- any significant events and transactions impacting on the financial statements and the audit considerations and judgements made about these
- future financial risks and sustainability.

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

Enc.

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.

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## 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

# 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 ionger 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

## 2.2 Non-current physical assets issues

# 2.2.1 Pavement components not to be shown separately in the fixed asset register

(Risk rating - Deficiency)

#### Observation

In the Council's position paper on residual values, the Council has identified two components of pavements as below:

	Useful Life	% of Pavement Cost
Sealed roads:		
Gravel material re-used	160	40%
Balance of pavement cost	80	60%
Unsealed roads:		
Gravel material re-used	160	40%
Balance of pavement cost	80	60%

As a short term solution to address the AASB's decision around residual values, the council has adopted a "blended depreciation rate" for different components. The Council plans to use weighted average depreciation of these two pavement components as it is assessed to be impractical and too onerous to maintain two separate assets for the pavement layer.

#### **Implications**

Maintaining a separate 'work around' outside the asset register/asset management system to calculate the weighted average valuation/depreciation of these two separate components will be difficult to maintain over the long term and likely to be more susceptible to error.

#### Recommendations

We recommend that Council show the Road Pavement Base Material and Balance of Pavement components of Pavement asset as two separate assets in the fixed asset register commencing financial year 2015-16.

#### Management response

Council's approach to this matter is not short term and is not a "work around" as described above.

Firstly, Council has separated the formation component of its roads from the pavement component, as the formation component previously equated to the residual value of Council's roads. The formation component is not depreciated as it is considered to have an unlimited useful life. This is not a short term solution but rather an ongoing treatment of the formation and pavement portions of Council's road assets.

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 (ives 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

## 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

#### 2.3.2 Improvement on Revaluation Process

(Risk rating - Deficiency)

#### Observation

We noted the following from our review of the revaluation process:

- Assumptions used by the valuer, Cardno, was based on the minimum standard based on FNQROC road
  construction design as Council currently does not have road hierarchy. However, the roads owned by the
  Council, which might require more than the minimum standard are considered small percentage and will
  not materially misstate the total fair value of the transport assets.
- Council reviewed and challenged the assumptions and methodologies used by Cardno. However, no
  formal documentation can be provided which provides evidence of this review and analysis.

#### **Implications**

- · Fair values of roads assets may be misstated if not valued according to its specific type.
- · Council will not be able to support is representations if no evidence can be provided.

#### Recommendations

We recommend the following:

- Council to analyse and classify its roads asset according to the manner they are established in the Shire
  and formulate appropriate road hierarchy, which can be utilised to derive more specific unit rates.
- Council to formally document its review and analysis of the assumptions and methodologies used by the valuer. We encourage Council to maintain minutes of meetings and reviews as good management practice and available for audit scrutiny.
- We encourage council to perform an analysis of it new transport asset unit rates and useful lives against
  costing from councils own internal projects to ensure comfort over the reasonableness of the new unit
  rates. Additionally, where practical Council must endeavor to benchmark its own unit rates against
  neighboring councils to assess the reasonableness of its unit rates.

#### Management response

Council has a draft road hierarchy that will be subject to further development.

It is Council's intention to clearly document all requirements / outcomes expected from external valuers when undertaking future comprehensive revaluations. It is also Council's intention to establish a library / database of unit rates based on the information currently available and as Council undertakes further construction work an analysis of this work will occur and Council's library / database will be updated and will continue to grow. This will enable Council to utilise this data when analysing / reviewing the results of any external valuation and the agreed outcomes of such valuations will also contribute to the ongoing development of the library / database.

#### Responsible Officer

Manager Finance & IT

Implementation Date

Ongoing

Status

## 2.3.3 Relevance of indices used for land assets

(Risk rating - Deficiency)

#### Observation

Our review of the indexation used for intervening fair value assessment for land assets showed that Council used non-residential building construction index. As land assets fair values are mainly based on market movements, the use of non-residential building construction index may not be the most relevant for this asset class.

#### **Implications**

The indexation adopted by the Council at 30 June 2015 may potentially not provide the most reliable or relevant measure of the fair value movement in Council's land assets.

#### Recommendations

We recommend Council explore potential alternate indexation options or at a minimum verify that the current indexation provides the most relevant and reliable estimation of fair value for land assets.

#### Management response

Agreed

Responsible Officer

Manager Finance & IT

Implementation Date

30/06/2016

#### Status

## 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

## 3. Other Matter issues

## 3.1 Financial reporting issues

## 3.1.1 Long outstanding items held on trust

(Risk rating - Other Matter)

#### Observation

Upon review of the trust register at final, audit noted that there were 150 accounts on the trust register which have been held for more than two years with no movement amounting to \$493 121.25.

#### **Implications**

The implication is that Council may be holding monies in trust that is required to be refunded to the original parties or forwarded to the public trustee.

#### Recommendations

We recommend that Council review the amounts in the trust register and ensure that the amounts currently held are controlled by Council. Council is reminded that under *Public Trustee Act 1978 (Qld)*, Section 102B states that "all unclaimed moneys that remain unclaimed must be paid to the public trustee."

#### Management response

Agreed. The recommended review of Council's trust register has already commenced.

#### Responsible Officer

General Manager Corporate Services

#### Implementation Date

30/06/2016

#### Status

#### **5.9. DAINTREE FORUM #2**

**REPORT AUTHOR(S):** Nevinia Davenport, Executive Assistant

Linda Cardew, Chief Executive Officer
Office of the Chief Executive Officer

**DEPARTMENT:** Office of the Chief Executive Office

#### **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 underserviced 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