Shire of
Bruce Rock
Where friends become family

Audit Committee Agenda Attachments

Thursday 21 May 2020

SHIRE OF BRUCE ROCK

AUDIT COMMITTEE AGENDA ATTACHMENTS 21 MAY 2020

SHIRE OF BRUCE ROCK

AUDIT COMMITTEE MEETING MINUTES 16 APRIL 2020

TABLE OF CONTENTS

SHIRE OF BRUCE ROCK

AUDIT COMMITTEE MEETING MINUTES 16 APRIL 2020

1. Declaration of Opening

The Committee Chair, Stephen Strange declared the meeting open at 2.50pm

2. Record of Attendance / Apologies / Leave of Absence (Previously Approved)

President	Cr SA Strange
Deputy President	Cr R Rajagopalan
Councillors	Cr AR Crooks
	Cr IS Dolton
	Cr KP Foss
	Cr NK Kilminster
	Cr PG Negri
	Cr BJ Waight
	Cr RA Waye
Chief Executive Officer	Mr DRS Mollenoyux
Acting Deputy Chief Executive Officer	Mrs MJ Schilling
Manager of Finance	Mrs JL Bow
Acting Executive Assistant	Miss CE Negri

3. Response to Previous Public Questions Taken on Notice

4. Public Question Time

5. Petitions / Deputations / Presentations / Submissions

6. Confirmation of Minutes

6.1. Audit Committee Meeting – 20 Feb 2020

COMMITTEE DECISION
Resolution ACM April 20 – 6.1

Moved: **Cr Rajagopalan**
Seconded: **Cr Waye**

That the minutes of the Audit Committee held 20 February 2020 be confirmed as a true and correct record.

Carried 9/0

7. Reports of Officers

7.1. Manager of Finance

Agenda Reference and Subject:	
	7.1.1 Entry Meeting for Interim Audit
File Reference:	8.2.6.1 – Annual Audit
Reporting Officer:	Jennifer Bow, Manager of Finance
Author:	Jennifer Bow, Manager of Finance
Disclosure of Interest	
Attachments:	*Attachment A - 7.1.1 – Entry Interview Agenda*

Summary
The Shire President, CEO, MOF, AMD's Representative Ms Maria Cavallo & Office of the Auditor General's Representative Mr Kien Neoh held the Entry Meeting teleconference for the Interim Audit which is scheduled for 6th to 8th April 2020.

Background
A teleconference entry meeting was held prior to the commencement of the interim audit which will be conducted remotely by 2 representatives from AMD, who have been contracted by OAG, to perform the audit.

Comment
The teleconference entry meeting allowed for comments to be made by Mr Neoh regarding the audit as this is the third year that the OAG is overseeing the audit. It also allowed staff to ask questions about the requirements and any other queries.

Ms Cavallo outlined her approach to the audit through AMD's Annual Financial Report Audit Planning Summary which detailed;

- Introduction
- Our Audit Approach
- Significant Risks and Other Audit Issues
- Audit Emphasis and Significant Account Balances
- Management Representation Letter
- Related Entities
- Reporting Protocols
- Proposed Audit Schedule
- Specific Audit Requirements
- Your Audit Team

The interim audit is required to be done remotely now due to COVD implications and the requirement for essential travel only. A recent development to the timing of the interim audit has been the establishment of the temporary supermarket which AMD has been notified of. AMD appreciate that the remote audit may take longer due to increased work load for staff.

Consultation
Shire President, CEO, MOF and Council's Auditor, Ms Cavallo and OAG's Mr Neoh

Statutory Implications
Local Government Act 1995, Local Government (Financial Management) Regulations 1996

Policy Implications
Nil

Risk Implications

Risk: Compliance – Non-compliance with relevant sections and regulations of the Local Government Act 1995.		
Likelihood	**Consequence**	**Rating**
Possible	Moderate	Moderate
Action / Strategy		
This item has been evaluated against the Shire of Bruce Rock's Risk Management Procedures Risk Matrix. The perceived level of risk is considered to be "Medium" risk and will be managed to mitigate the risks associated with each of the areas of the financial audit.		

Financial Implications
Nil

Strategic Implications
Shire of Bruce Rock – Strategic Community Plan 2017-2027
Governance
Goal 12 Council leads the organisation in a strategic and flexible manner

Voting Requirements
Simple Majority

COMMITTEE DECISION
Resolution ACM Feb 20 – 7.1.1

Moved: Cr Waye
Seconded: Cr Rajagopalan

That the Audit Committee receives the information regarding the Audit Entry Meeting for the Interim Audit to be conducted 6th to 8th April 2020.

Carried 9/0

8. New Business of an urgent nature introduced by discussion of the meeting.

8. Closure of Meeting.

The Committee Chairman, Mr Stephen Strange thanked everyone for their attendance and closed the meeting at 2.53pm.

These minutes were confirmed at a meeting on

____
Cr Stephen Strange
Shire President

Report Addressing Significant Items Raised in the Audit Report for the year ending 30th June 2019 as per s.7.12A of Local Government Act 1995	
Agenda Reference:	May 2020 Audit Committee Meeting, Item 7.1.1
File Reference:	8.2.6.1 – Annual Audit
Author:	Jennifer Bow, Manager of Finance
Attachments	Appendix A – Audit Report

Introduction
Section 7.12A of the Local Government Act 1995 outlines the requirements that the local government must follow in response to receiving an Audit Report that contains a significant matter/s.

The Shire of Bruce Rock received its Audit Report (Attachment A) for the year ending 30th June 2019 however this year it was a qualified audit opinion. This is on the basis that the OAG is unable to verify that the Other Infrastructure assets listed in the financial statements has not been corrected valued or condition assessments conducted on these assets as required as per the 2018 Management Letter.

The issues raised in the Audit Report included the following;

1. Qualified Audit Opinion as unable to verify valuation of Other Infrastructure Assets without condition assessments;

2. Report on Other Legal and Regulatory Requirements;
   a. Adverse Trends of Ratios
      i. <u>Asset sustainability ratio</u> is below the Department of Local Government, Sport & Cultural Industries standard of 0.8 for the last three years.
      ii. <u>Operating surplus ratio</u> is below the Department of Local Government, Sport & Cultural Industries standard of 0 for the last three years.
      iii. <u>Own source revenue ratio</u> is below the Department of Local Government, Sport & Cultural Industries standard of 0.35 this year.

   b. Non-compliant with Part 6 of the Local Government Act 1995, the Local Government (Financial Management) Regulations 1996 or applicable financial controls of any other written law were identified during the course of the audit:
      i. The Shire has included bonds and other monies in its trust account which are not held in trust, or required to be credited to the trust account under section 6.9(1) of the Local Government Act 1995.

Legislative Requirement
The legislative requirement for this report is provided in section 7.12(A) of Local Government Act 1995.

7.12A. Duties of local government with respect to audits

(3) A local government must —

(aa) examine an audit report received by the local government; and

(a) determine if any matters raised by the audit report, require action to be taken by the local government; and

(b) ensure that appropriate action is taken in respect of those matters.

(4) A local government must —

(a) prepare a report addressing any matters identified as significant by the auditor in the audit report, and stating what action the local government has taken or intends to take with respect to each of those matters; and

(b) give a copy of that report to the Minister within 3 months after the audit report is received by the local government.

(5) Within 14 days after a local government gives a report to the Minister under subsection (4)(b), the CEO must publish a copy of the report on the local government's official website.

The following is the Shire of Bruce Rock's response in addressing the above issues that were raised in the Audit Report as per the requirements set out in section 7.12A of Local Government Act 1995.

Comment

1. OTHER INFRASTRUCTURE VALUATION

Finding

The valuation of bridges, footpaths, drainage, other infrastructure, and the airstrip which was performed in 2017-18 was a desktop valuation and did not include an assessment of the condition of each of assets. Under Australian Accounting Standards, the condition of the asset is an important characteristic which needs to be considered when determining the fair value of an asset.

Implication

At 30 June 2019 and 30 June 2018 we were unable to obtain evidence that infrastructure assets amounting to $33,767,492 and $34,303,030 respectively, represent fair value in accordance with the requirements of Australian Accounting Standards and the requirements of Regulation 17A of the Local Government (Financial Management) Regulations 1996.

Recommendation

The Shire should ensure that future valuations of property, plant and equipment include assessments of the condition of assets.

Management Comment

Management will engage a suitably qualified consultant to provide fair values in accordance with the Australian Accounting Standards and Regulation 17A of the Local Government (Financial Management) Regulations 1996 for other infrastructure as at 30th June 2020. This will include the physical inspection of assets as required.

Responsible Person: MOF

Completion Date: 30th June 2020 (for inclusion in the financial statements for the year ending 30th June 2020)

2. ADVERSE RATIO TRENDS

a. Asset Sustainability Ratio

Finding
The Asset Sustainability Ratio is below the Department of Local Government, Sport & Cultural Industries standard of 0.8 for the last three years.

Implication
A ratio below the standard of 0.8 indicates that the local government is not replacing assets soon enough and is a direct correlation to the depreciation expense in the financials.

Recommendation
A review of the depreciation expense needs to be conducted.

Management Comment
The depreciation expense requires reviewing as it is particularly high in regards to infrastructure. This review will be carried out over the next two years as the new fair values are importing into the asset register, as all classes are being revalued and will be completed by 30th June 2021.

Responsible: MOF

Completion Date: 30th June 2021 (for inclusion in the financial statements for the financial year ending 30th June 2021).

b. Operating Surplus Ratio

Finding
The Operating surplus ratio is below the Department of Local Government, Sport & Cultural Industries standard of 0 for the last three years (2016; -0.86, 2017; -0.70, 2018; -1.87).

Implication
A negative ratio indicates the inability of the local government to meet operational and service requirements. However, the ratio removes grants and contributions towards capital assets which makes up a significant proportion of our revenue.

Recommendation
To improve operating surplus ratio.

Management Comment
This will prove quite challenging given our revenue stream is highly reliant on capital grants and contributions for the development of assets. We are also a small local government with a small rate base and unable to raise large revenue streams from other facilities or other services.

The Auditor General has previously commented after the 2017/18 Audits that most local governments have had this reported as an adverse trend as local governments are not meant to make a profit and so there may be a flaw in the standard and that it needs revising.

Responsible: MOF

c. <u>**Own Source Revenue ratio**</u>

Finding
Own source revenue ratio is below the Department of Local Government, Sport & Cultural Industries standard of 0.35 (2016; 0.43, 2017;0.30, 2018;0.22).

Implication
That the Local Government is unable to raise sufficient revenue from rates, fees and charges and other income to not rely on grants and other contributions.

Recommendation
To improve the own source revenue ratio.

Management Comment
This ratio will also be difficult to improve as the Shire has a small rate base and is unable to raise significant revenue from rates and, fees and charges.

It is evident amongst smaller local governments that we are reliant on particularly the Federal Assistance Grants which make up a large proportion of our revenue stream.

Responsible: MOF

3. TRUST MONIES

Finding

In accordance with the OAG 'Accounting for work bonds, building bonds and hire bonds' position paper dated 1 July 2019 bonds such as work bonds, building bonds and hire bonds should not, for accounting purposes, be regarded as Trust Fund moneys in terms of the Local Government Act 1995.

Our review of the Shire of Bruce Rock's financial statements Note 26 and discussions with management indicate the following trust monies continue to be held in trust and an assessment as to whether they need to be reclassified to municipal funds has not yet been completed:

- Factory unit and housing bonds;
- Fundraisers;
- Kwolyin Progress Association;
- Sale of land deposits;
- Bruce Rock museum funds;
- Rates overpayment;
- Community recreation centre;
- Tidy towns;
- Vietnam veterans;
- Wind up committee; and
- Wheatbelt women.

Implication

Risk of incorrect classification of trust and municipal funds and non-compliance with Local Government Act 1995.

Recommendation

We recommend a review of trust funds be completed in 2019/20 to identify monies required to be returned to customer, recognised as income by the Shire or reclassified to municipal funds.

Management Comment

Management did conduct a review of bonds held in the Trust Account and have moved any bond that does not state in the agreement that they must be held in Trust. The remaining bond monies are associated with factory units and their agreements do state that the bonds must be held in the Shire's Trust Account.

The other monies held in trust are not bonds. There are several that can be brought through to the municipal account which will be done in the course of 2019/20 financial year. However, there will be some monies that must remain in the Trust Account and we will obtain confirmation that these funds are to remain in the Trust Account.

Responsible Officer: MOF

Completion Date: 30th June 2020

APPENDIX A

Auditor General

INDEPENDENT AUDITOR'S REPORT

To the Councillors of the Shire of Bruce Rock

Report on the Audit of the Financial Report

Qualified Opinion

I have audited the annual financial report of the Shire of Bruce Rock which comprises the Statement of Financial Position as at 30 June 2019, the Statement of Comprehensive Income by Nature or Type, Statement of Comprehensive Income by Program, Statement of Changes in Equity, Statement of Cash Flows and Rate Setting Statement for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information, and the Statement by the Chief Executive Officer.

In my opinion, except for the effects of the matters described in the Basis for Qualified Opinion section of my report, the annual financial report of the Shire of Bruce Rock:

(i) is based on proper accounts and records; and
(ii) fairly represents, in all material respects, the results of the operations of the Shire for the year ended 30 June 2019 and its financial position at the end of that period in accordance with the *Local Government Act 1995* (the Act) and, to the extent that they are not inconsistent with the Act, Australian Accounting Standards.

Basis for Qualified Opinion

Other than for roads, the valuation of infrastructure assets including bridges, footpaths, drainage, other infrastructure and the airstrip which was performed in 2017-18 was a desktop valuation and did not include an assessment of the condition of assets.

I am therefore unable to obtain sufficient appropriate audit evidence to confirm that infrastructure assets other than roads, totalling $33,767 492 at 30 June 2019 and $34,303,030 at 30 June 2018 represent fair value in accordance with Regulation 17A of the Local Government (Financial Management) Regulations 1996 and Australian Accounting Standards. In addition, I am also unable to obtain sufficient appropriate audit evidence that the revaluation surplus and movements in comprehensive income associated with the 2017-18 valuation of these assets are fairly presented.

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

Emphasis of Matter – Basis of Accounting

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

7th Floor Albert Facey House 469 Wellington Street Perth MAIL TO: Perth BC PO Box 8489 Perth WA 6849 TEL: 08 6557 7500 FAX: 08 6557 7600

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

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

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

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

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

- Identify and assess the risks of material misstatement of the annual financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Shire's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the CEO.

- Conclude on the appropriateness of the CEO's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Shire's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the annual financial report or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report, as we cannot predict future events or conditions that may have an impact.

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

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

Report on Other Legal and Regulatory Requirements

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

(i) In my opinion, the following material matters indicate significant adverse trends in the financial position of the Shire:

a. The Asset Sustainability Ratio as reported in Note 32 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the last three years;

b. The Operating Surplus Ratio as reported in Note 32 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the last three years; and

c. The Own Source Revenue Coverage Ratio as reported in Note 32 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the last three years.

(ii) The following material matters indicating non-compliance with Part 6 of the *Local Government Act 1995*, the Local Government (Financial Management) Regulations 1996 or applicable financial controls of any other written law were identified during the course of my audit:

a. The Shire has included bonds and other monies in its trust account which are not held in trust, or required to be credited to the trust account under section 6.9(1) of the *Local Government Act 1995*.

(iii) All required information and explanations were obtained by me.

(iv) All audit procedures were satisfactorily completed.

(v) In my opinion, the Asset Consumption Ratio and the Asset Renewal Funding Ratio included in the annual financial report were supported by verifiable information and reasonable assumptions.

Other Matter

The annual financial ratios for 2017 in Note 32 of the annual financial report were audited by another auditor when performing their audit of the Shire for the year ending 30 June 2017. The auditor expressed an unmodified opinion on the annual financial report for that year.

Matters Relating to the Electronic Publication of the Audited Financial Report

This auditor's report relates to the annual financial report of the Shire of Bruce Rock for the year ended 30 June 2019 included on the Shire's website. The Shire's management is responsible for the integrity of the Shire's website. This audit does not provide assurance on the integrity of the Shire's website. The auditor's report refers only to the annual financial report described above. It does not provide an opinion on any other information which may have been hyperlinked to/from this annual financial report. If users of the annual financial report are concerned with the inherent risks arising from publication on a website, they are advised to refer to the hard copy of the audited annual financial report to confirm the information contained in this website version of the annual financial report.

CAROLINE SPENCER
AUDITOR GENERAL
FOR WESTERN AUSTRALIA
Perth, Western Australia
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Auditor General

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Basis for Qualified Opinion

Other than for roads, the valuation of infrastructure assets including bridges, footpaths, drainage, other infrastructure and the airstrip which was performed in 2017-18 was a desktop valuation and did not include an assessment of the condition of assets.

I am therefore unable to obtain sufficient appropriate audit evidence to confirm that infrastructure assets other than roads, totalling $33,767,492 at 30 June 2019 and $34,303,030 at 30 June 2018 represent fair value in accordance with Regulation 17A of the Local Government (Financial Management) Regulations 1996 and Australian Accounting Standards. In addition, I am also unable to obtain sufficient appropriate audit evidence that the revaluation surplus and movements in comprehensive income associated with the 2017-18 valuation of these assets are fairly presented.

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

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

- Identify and assess the risks of material misstatement of the annual financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Shire's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the CEO.

- Conclude on the appropriateness of the CEO's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Shire's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the annual financial report or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report, as we cannot predict future events or conditions that may have an impact.

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

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

Report on Other Legal and Regulatory Requirements

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

(i) In my opinion, the following material matters indicate significant adverse trends in the financial position of the Shire:

   a. The Asset Sustainability Ratio as reported in Note 32 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the last three years;
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   c. The Own Source Revenue Coverage Ratio as reported in Note 32 of the annual financial report is below the Department of Local Government, Sport and Cultural Industries (DLGSCI) standard for the last three years.

(ii) The following material matters indicating non-compliance with Part 6 of the *Local Government Act 1995*, the Local Government (Financial Management) Regulations 1996 or applicable financial controls of any other written law were identified during the course of my audit:

   a. The Shire has included bonds and other monies in its trust account which are not held in trust, or required to be credited to the trust account under section 6.9(1) of the *Local Government Act 1995*.

(iii) All required information and explanations were obtained by me.

(iv) All audit procedures were satisfactorily completed.

(v) In my opinion, the Asset Consumption Ratio and the Asset Renewal Funding Ratio included in the annual financial report were supported by verifiable information and reasonable assumptions.

Other Matter

The annual financial ratios for 2017 in Note 32 of the annual financial report were audited by another auditor when performing their audit of the Shire for the year ending 30 June 2017. The auditor expressed an unmodified opinion on the annual financial report for that year.

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CAROLINE SPENCER
AUDITOR GENERAL
FOR WESTERN AUSTRALIA
Perth, Western Australia
18 February 2020

GOVERNMENT OF
WESTERN AUSTRALIA

Department of
Local Government, Sport and Cultural Industries

Our ref M20000968-01
Enquiries Industry & Sector Regulation
Phone (08) 6552 7300
Email audits@dlgsc.wa.gov.au

CEO	DCEO	WORKS
EHO	BS	NRM
MOF	SFO	FO
CDO	EXO	ADMIN

23 APR 2020

FILE 8.2.6.1
RECORD ICR 42209512
*Manual Picklist

Mr Darren Mollenoyux
Chief Executive Officer
Shire of Bruce Rock
PO Box 113
BRUCE ROCK WA 6418

Dear Mr Mollenoyux

SHIRE OF BRUCE ROCK – RESPONSE TO AUDIT REPORT

Thank you for your correspondence dated 23 March 2020 to Hon David Templeman MLA, Minister for Local Government, regarding the significant finding(s) identified in the annual audit carried out by the Auditor General. The Minister has asked me to respond to you on his behalf.

Section 7.12A(1) to (4) of the *Local Government Act 1995* (the Act) prescribes the local government response where significant findings are identified by a local government's independent auditor. The Department considers that the response provided does not meet the requirements.

The response addresses matters identified as significant in the management letter. It does not address matters identified as significant in the Independent Auditor's Report, namely the Asset Sustainability Ratio, Operating Surplus Ratio and Own Source Revenue Coverage Ratio being below standard for the last three years. For the purposes of reporting to the Minister, audit management letters are not considered to meet the definition of an audit report. The Council is only required to respond to the Independent Auditor's Report. For further information, please refer to the LG Alert from 20 February 2020, *Significant matters reported by the auditor in an audit report*.

We request that you submit the Council's 7.12A response to the Audit and Risk Committee and then Council for endorsement, then provide a copy to the Department.

Yours sincerely

NLethorn

Narrell Lethorn
Director, Industry & Sector Regulation

15 April 2020

Gordon Stephenson House, 140 William Street
PO Box 8349 Perth Business Centre, WA 6849
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Department of
Local Government, Sport and Cultural Industries
GOVERNMENT OF WESTERN AUSTRALIA

Significant matters reported by the auditor in an audit report

If the Auditor General or a local government's appointed auditor reports a significant matter in an audit report, section 7.12A of the Local Government Act 1995 (the Act) requires a response from the local government.
20 Feb 2020

The requirements of this reponse are:

1. Upon receipt of the auditor's report, the local government must prepare a report for its Audit Committee to address the significant matters raised and outline what action(s) the local government has taken or intends to take in respect of each of the matters raised.
2. The Audit Committee minutes and the report to the Minister are referred to Council for proper review and endorsement of any proposed actions.
3. Within 3 months of receipt of the auditor's report, a copy of the Council-endorsed report must be provided to the Minister.
4. Within 14 days of providing a copy of the report to the Minister, a copy must be published on the local government's website.

A local government is not considered compliant with its statutory obligations until all of the above actions have been completed.

Additional information

The Act requires local governments to have an Audit Committee. The functions of the Audit Committee are laid out in Regulation 16 of the Local Government (Audit) Regulations. These functions cover audits, therefore any matters relating to audits are required to be considered by the Audit Committee before going to Council. The timing of Audit Committee Meetings should be cognisant of the local governments audit timeframes, including any performance audits.

An audit report encompasses the following reports:

- Performance Audit Report tabled in Parliament by the Auditor General; and
- Independent Auditor's Report provided for the annual financial statement audit.

Audit management letters do not meet the definition of an audit report for the purpose of reporting significant matters to the Minister (Audit Reg. 10(4)). They should still be considered by the Audit Committee to determine if any action should be taken (refer 7.12A(3)) and for the audit committee to oversee the implemetation of any action the local government has taken or intends to take in a report required to be prepared in accordance with section 7.12A(4)(a).

If a local government does not agree with the auditor's assessment, they have the opportunity to engage with the auditor to argue their case. The report to the Minister should not explain why the local government disagrees with the auditor but should focus on the actions taken/to be taken.

The current prescribed financial ratios are being reviewed as part of the Local Government Act Review. Until that work has been finalised and any amendments endorsed, the existing ratios will remain.

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The Auditor General's work program includes a Better Practice Guide — Public Sector Audit Committees (state and local government) report which is scheduled for tabling in Parliament in the second quarter of 2020. Non-essential amendments to an Audit Committee's terms of reference would best be left until after tabling of the Auditor General's report.

Tags

- **audit (/department/news/tagged-news/-in-tags/tags/audit)**

Related pages

Local Government Act 1995 ›

Page reviewed 20 Feb 2020

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MOORE STEPHENS

Guidance Series

Short Guide to Financial Ratios

May 2019

About the Short Guide Series:

This document and others in the Moore Stephens Short Guide Series are intended as a guide to good practice.

They are not designed to be a definitive authority on the various topics. Rather, as the name suggests, they are a guide to assist both Council and management alike.

They are based on the author's many years experience within the local government industry. They should be interpreted with this in mind.

Contents

1.0 Overview

Financial ratios are designed to provide users of financial information a clearer picture of the performance and results as well as a comparison across periods.

The purpose of this guide is to:-

- assist the Council and management group of local governments gain a greater understanding of the individual ratios; and
- assist with understanding what constitutes a good or poor ratio.

Over time, it has become apparent inconsistencies in the calculation of the ratios occur. If ratio information is to be meaningful, then it is important it is prepared both accurately and consistently.

The ratios selected in this guide are the seven currently defined in Local Government (Financial Management) Regulation 50 and required to be disclosed in the annual financial report. These are explained in detail in the various sections which follow.

Whilst these ratios are a useful guide, it should be remembered there are many indicators of the financial position of a local government.

Each ratio should not be considered in isolation.

Rather, they should all be assessed in context of the particular local government's circumstances and each considered as part of the picture.

A picture with both good and poor ratios may indicate some remedial policies need to be implemented.

A picture with nearly all poor ratios may indicate serious financial repairs are needed.

Local Government (Financial Management) Regulation 50 (1a) allows ratios to be disclosed either as a percentage or as a factor of one.

Our guide uses risk indicators which correspond to the standards established by the Department of Local Government, Sport and Cultural Industries (DLGSCI) and contained within *Local Government Operational Guidelines – Number 18* issued in June 2013.

We have also detailed the Office of Auditor General (OAG) threshold when assessing whether a Local Government meets the basic standard or not.

For each ratio, we have also provided comments and information relating to potential problems with interpretation or financial reporting.

Please note, our comments are in relation to the basic standard established by the DLGSCI. The OAG's basic standard is used for assessing in an audit report context and is highlighted for information only.

NOTE: THIS GUIDE HAS BEEN UPDATED AND IS CURRENTLY EFFECTIVE FROM 1 JULY 2012.

FOR DETAILS OF RATIOS APPLICABLE FOR THE YEAR ENDED 30 JUNE 2012 AND PRIOR YEARS, PLEASE REFER TO EARLIER VERSIONS OF THIS GUIDE.

Should you have any queries in relation to this guide, please contact Russell Barnes or Greg Godwin of Moore Stephens by:

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2.0 Current Ratio

2.1 Current Ratio

$$\frac{\text{current assets minus restricted assets}}{\text{current liabilities minus liabilities associated with restricted assets}}$$

Current Assets - total current assets as shown in the balance sheet

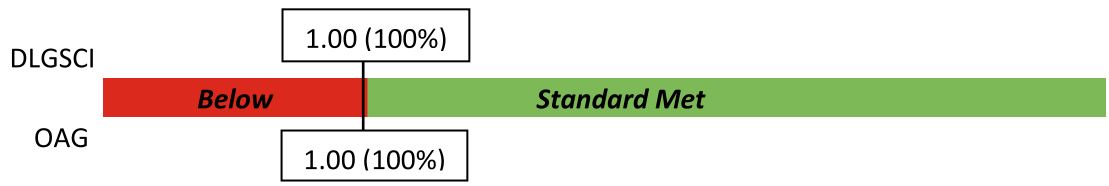
Current Liabilities - total current liabilities as shown in the balance sheet

Liabilities Associated with Restricted Assets – the lesser value of a current liability or the cash component of restricted assets held to fund that liability

Interpretation:

This ratio is a measure of short term (unrestricted) liquidity. That is, the ability of the local government to meet its short term financial obligations from unrestricted current assets as and when they fall due.

Risk Indicators:



Standard met – 1.00 (100%) or greater

A ratio of greater than 1.00 (100%) indicates the local government has more current assets than current liabilities.

Below standard – Less than 1.00 (100%)

If less than 1.00 (100%), current liabilities are greater than current assets and the local government may have a short term funding issue.

Comment:

Provided restricted assets are excluded correctly, it is a very useful indicator of the “true” financial position of the local government, particularly in the short term.

As a general rule, when the current ratio of a local government is calculated at less than one (100%) it indicates a short term funding issue. However, it also needs to be considered in context of the overall financial position.

If monitored correctly during the course of the year (particularly with the benefit of comparative historical information) it is a good indicator for when follow up action is necessary.

2.0 Current Ratio (Continued)

2.1 Current Ratio (continued)

Potential Problems for Financial Reporting:

Errors in calculation are often made with this ratio as balances which should be included are not (or vice versa).

- As this is the current ratio it only considers **current** assets and **current** liabilities;
- Only make a deduction for current liabilities associated with restricted assets if there are restricted assets associated with the liabilities in question;
- If the restricted account balance is greater than the current liability amount associated with it, you may only deduct up to the amount of the liability;
- If the liability amount associated with the restricted account balance is greater than the restricted account balance itself, you may only deduct up to the amount of the restricted account; and
- If a restricted account is for one purpose only (eg long service leave) you may only deduct the current liability in respect to it (ie current portion of long service leave liability). The current liability for annual leave cannot be deducted in this instance.

NOTE: On occasions, anomalies may arise due to heavy loan repayments in the twelve months following the point of calculation of the current ratio. This will effectively inflate the level of current liabilities when in fact they are not necessarily due at the point of calculation. They are due over the course of the next twelve months and, in accordance with budgeting protocol, are budgeted to be funded from sources in the following financial year.

Under the current definition it is not possible to adjust for this in the "official" ratio. In these circumstances you may wish to do so to determine the "underlying" ratio for illustrative purposes.

3.0 Asset Ratios

3.1 Asset Consumption Ratio

$$\frac{\text{depreciated replacement cost of assets}}{\text{current replacement cost of depreciable assets}}$$

Depreciated Replacement Cost of Assets – the meaning given in Australian Accounting Standards

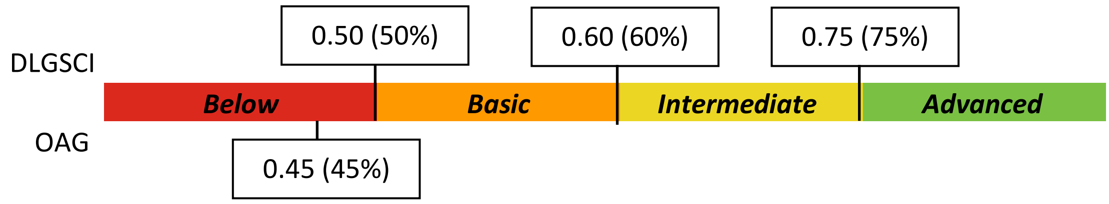
Current Replacement Cost of Depreciable Assets – the cost of replacing assets at current prices

Interpretation:

Measures the extent to which depreciable assets have been consumed by comparing their written down value to their replacement cost.

Where the written down value is based on a condition assessment of the assets, the ratio highlights the aged condition of the depreciable assets.

Risk Indicators:



Advanced standard – greater than 0.75 (75%)

Indicates a local government is investing in asset renewal to a level where a high percentage of the local government depreciable assets remain in an ‘as new’ condition.

Intermediate (improving) standard – between 0.60 (60%) and 0.75 (75%)

Basic standard – greater than 0.50 (50%) up to 0.60 (60%)

Ratios below 0.50 (50%) are higher risk and, if sustained over a long period, will indicate a local government is having difficulty maintaining the average ‘aged’ condition of its assets.

Comment:

When this ratio enters the higher risk zone it should immediately prompt a review of depreciation rates and asset valuations to ensure they are reasonable and are generating reliable and representative written down values.

It should also prompt a review of operations and revenue raising capacity necessary to support ongoing asset renewal.

Potential Problems for Financial Reporting:

- This ratio relies on accurate written down values being maintained.
- Current Replacement Cost may be problematic if net method of disclosure is used as current replacement cost will not be disclosed within the financial statements.

3.0 Asset Ratios (Continued)

3.2 Asset Sustainability Ratio

$$\frac{\text{capital renewal and replacement expenditure}}{\text{Depreciation expense}}$$

Capital Renewal and Replacement Expenditure – expenditure to renew or replace existing assets

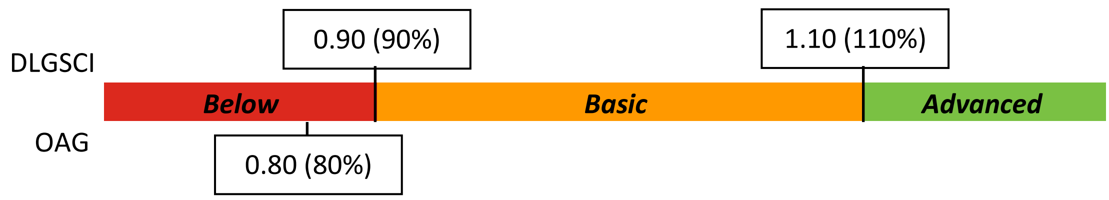
Depreciation Expense – has the meaning given in Australian Accounting Standards

Interpretation:

Measures the extent to which assets are being renewed/replaced compared to the amount consumed (depreciation).

Interpretation of this ratio is much improved if it is calculated as an average over time (say at least 5 years) as this reduces skewing caused by large scale intermittent investment in major infrastructure (such as buildings and facilities).

Risk Indicators:



Advanced standard – greater than 1.10 (110%)

Indicates a local government is investing in asset renewal/replacement to the degree that offsets the current consumption of its assets (1.00) and provides for the effect of inflation.

Basic standard – between 0.90 (90%) and 1.10 (110%)

When less than 0.90 (90%) a higher risk is evident and indicates the local government is having difficulty undertaking a sustained capital investment program sufficient to renew/replace assets while also negating the effect of inflation on purchasing power over time.

Comment:

A ratio classified as below the basic standard should immediately prompt a review of the local government's depreciation rates and asset valuations to ensure that they are reasonable and are generating reliable and representative depreciation expenditure.

It should also prompt a review of operations and revenue raising capacity necessary to support the ongoing asset base. This should be performed with reference to the forward expenditure estimates detailed in the Asset Management Plan of the local government.

Potential Problems for Financial Reporting:

- Need a clear definition as to what is considered replacement expenditure. Including gross cost of plant and equipment rather than net of trade in has the potential to skew this ratio and reduce its intended effectiveness.
- Need to make sure new expenditure is excluded.

3.0 Asset Ratios (Continued)

3.3 Asset Renewal Funding Ratio

$$\frac{\text{NPV of planned capital renewals over 10 years}}{\text{NPV of required capital expenditure over 10 years}}$$

NPV – net present value

Planned Capital Renewals –capital renewals and replacement expenditure as estimated in the long-term financial plan

Required Capital Expenditure – capital renewal and replacement expenditure as estimated in the asset management plan

Interpretation:

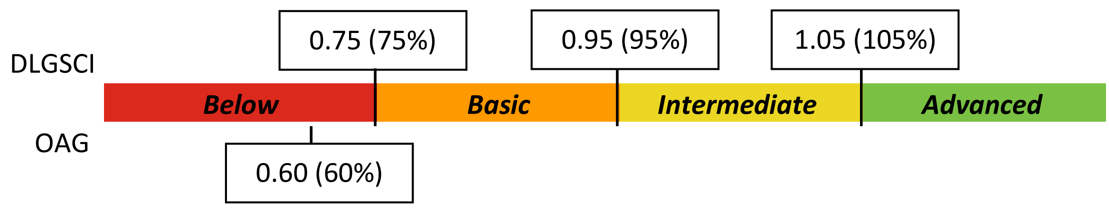
Measures the extent to which assets are being renewed compared to the amount consumed (depreciation).

Provides an indication whether the local government has the financial capacity to fund asset renewals as required and can continue to provide existing levels of services in the future without requiring:

- additional income;
- reduction in expenditure; or
- increase in borrowings (above current projections)

Interpretation of this ratio is much improved if it is calculated as an average over time (say at least 5 years) as this reduces skewing caused by large scale intermittent investment in major infrastructure (such as buildings and facilities).

Risk Indicators:



Advanced standard – greater than 1.05 (105%)

Indicates a local government is investing in asset renewal to the degree that offsets the current consumption of its assets (1.00) and provides for the effect of inflation.

Intermediate standard – between 0.95 (95%) and 1.05 (105%)

Basic standard – between 0.75 (75%) up to 0.95 (95%)

A ratio below 0.75 (75%) is considered to be in the higher risk zone and indicates the local government is having difficulty undertaking a sustained capital investment program sufficient to renew assets while also negating the effect of inflation on purchasing power over time.

3.0 Asset Ratios (Continued)

3.3 Asset Renewal Funding Ratio (continued)

Comment:

The Asset Renewal Funding Ratio (ARFR) should be read in conjunction with **Asset Consumption Ratio (ACR)** and the **Asset Sustainability Ratio (ASR)**

The DLGSCI provides a guideline for a satisfactory combination as follows:

ARFR – 95%+

ACR – 50%+

ASR – 90%+

When this ratio or the combination of ratios indicates a higher risk it should immediately prompt a review of the local government's depreciation rates and asset valuations to ensure that they are reasonable and are generating reliable and representative depreciation expenditure.

It should also prompt a review of operations and revenue raising capacity necessary to support the ongoing asset base.

Potential Problems for Financial Reporting:

- NPV requires more complex calculations and means the forecasts contained in the long term financial and asset management plans need to be kept up to date to be meaningful and verifiable.

4.0 Debt Ratio

4.1 Debt Service Cover Ratio

$$\frac{\text{annual operating surplus before interest and depreciation}}{\text{principal and interest}}$$

Annual Operating Surplus before Interest and Depreciation – operating revenue minus net operating expense

Depreciation – has the meaning given in Australian Accounting Standards

Interest – interest expense for moneys borrowed, credit obtained or financial accommodation arranged under section 6.20.

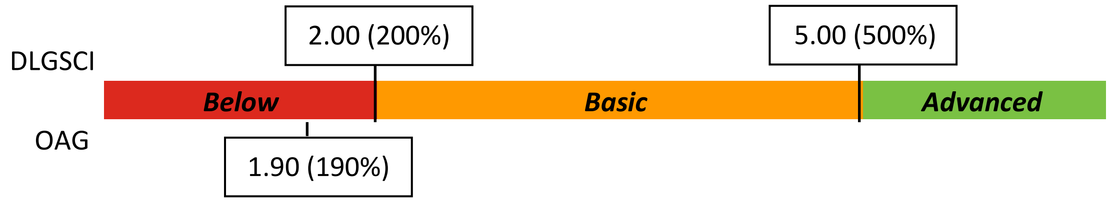
Principal and Interest – all principal and interest for money borrowed, credit obtained or financial accommodation arranged under section 6.20

Interpretation:

Not unlike the previous debt service ratio although an inverse application.

Measures a Council's ability to service debt out of its uncommitted or general purpose fund available for its operations.

Risk Indicators:



Advanced standard – greater than 5.00 (500%)

Basic standard – 2.00 (200%) or greater

Below 2.00 (200%) starts to indicate a higher risk

Comment:

Those local governments with a higher proportion of revenue from rates can also effectively operate at lower debt service ratios as they are more able to generate income (via rate increases) to cope with the debt burden.

Consequently, the effect of any borrowing increases in a particular year should be considered when formulating funding options for the budget in any given year.

The longer term effect on the ratios when repayments do kick in should not be ignored (as often is the case).

Quite often, borrowings are proposed in one year and repayments do not commence until the following year and it is only then, the true effect of the debt servicing costs become evident in budget deliberations.

It is important the knock on effect on debt ratios are considered as a part of borrowing deliberations.

These ratios also need to be weighed with the need for the local government to consider the future plans/growth including the rationalisation of Reserve funds.

Reference to the Long Term Financial Plan of the local government may assist in identifying these trends.

5.0 Operating Surplus

5.1 Operating Surplus Ratio

$$\frac{\text{operating revenue minus operating expense}}{\text{own source operating revenue}}$$

Operating Revenue – the revenue that is operating revenue for the purposes of Australian Accounting Standards, excluding –

a) grants for the development or acquisition of assets; and

b) contributions for the development or acquisition of assets

Operating Expense – the expense that is operating expense for the purposes of Australian Accounting Standards

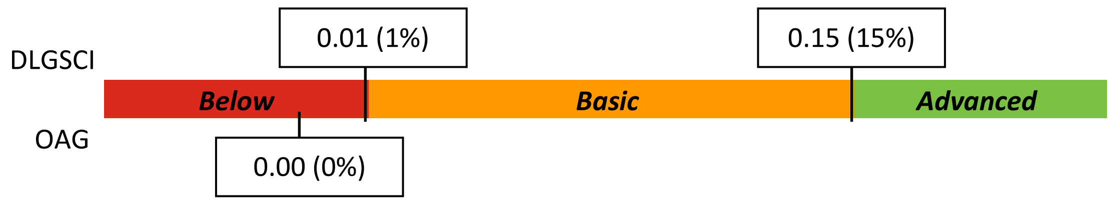
Own source operating revenue – revenue from rates and service charges, fees and user charges, reimbursements and recoveries, interest income and profit on disposal of assets

Interpretation:

Effectively highlights the scale/extent of any operating surplus or deficit in relation to the overall size of the local government.

Helps to measure if own source revenue raised is able to meet operational needs and have revenues available for capital or other purposes.

Risk Indicators:



Advanced standard – greater than 0.15 (15%)

The local government is providing a strong operating surplus which will give flexibility in the future in relation to operational service levels and asset base.

Basic standard – between 0.01 (1%) and 0.15 (15%)

When this ratio starts to drift into negative territory it indicates a deficit and higher risk.

Comment:

A sustained period of deficits will erode the local government's ability to maintain both its operational service level and asset base.

Potential Problems for Financial Reporting:

- Own Source Operating Revenue includes reimbursements and recoveries which are not currently a separate nature or type. It is important the accounting system allows for this to be tracked/obtained.

  The Somewhere manual/model does provide for separate disclosure for ease of reference.

5.0 Operating Surplus (Continued)

5.2 Own Source Revenue Coverage Ratio

$$\frac{\text{own source operating revenue}}{\text{operating expense}}$$

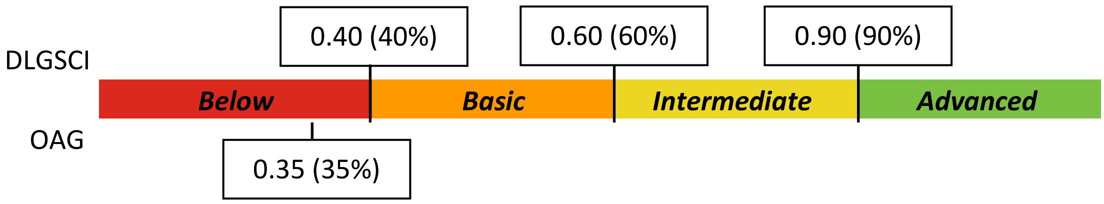
Own source operating revenue – revenue from rates and service charges, fees and user charges, reimbursements and recoveries, interest income and profit on disposal of assets

Operating Expense – the expense that is operating expense for the purposes of Australian Accounting Standards, including net interest expense and depreciation expense

Interpretation:

Measures the local government's ability to cover operating expenses from own source revenue.

Risk Indicators:



Advanced standard – greater than 0.90 (90%)

Intermediate standard – between 0.60 (60%) and 0.90 (90%)

Basic standard – less than 0.60 (60%) but no lower than 0.40 (40%)

Below 0.40 (40%) indicates a higher risk.

Comment:

The higher the ratio, the more self-reliant the local government is it allows greater flexibility as less external funds are required for operational purposes.

Notwithstanding this, some rural and remote local governments have a limited rate base and revenue raising capability.

At the other extreme, major metropolitan and regional local governments have a significantly greater rate base and own source revenue.

The particular nature/circumstances of the local government need to be considered. Analysis also needs to recognise the varying revenue raising capabilities across the sector when determining the most applicable standard.

In the current funding environment, it is unrealistic to expect rural and remote local governments to operate at the intermediate and advanced standard.

Likewise, major metropolitan and regional local governments would be experiencing financial stress if they operated at the basic standard or even the bottom half of the intermediate standard.

Potential Problems for Financial Reporting:

- Own Source Operating Revenue includes reimbursements and recoveries which are not currently a separate nature or type. It is important the accounting system allows for this to be tracked/obtained.

  The Somewhere manual/model does provide for separate disclosure for ease of reference.

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