

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
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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. Asset sustainability ratio is below the Department of Local Government, Sport & Cultural Industries standard of 0.8 for the last three years.
 - ii. Operating surplus ratio is below the Department of Local Government, Sport & Cultural Industries standard of 0 for the last three years.
 - iii. Own source revenue ratio 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. Own Source Revenue ratio

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



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 *Auditors 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.

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 12 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
/s/ February 2020