



Local Government: Results of the 2008–09 Audits



Audit summary

This is the first of six reports to Parliament scheduled for 2009–10 covering the results of the annual financial report audits of the Victorian state and local government sectors. This report provides the results of the 2008–09 audit of 79 councils, 12 entities they control, and 12 regional library corporations (RLCs).

The key conclusion from this audit is that Parliament can have confidence in the financial statements of the 103 completed entities included in this report.

Our external audit provides authoritative independent assurance regarding the financial, standard and performance statements which have been prepared by the management of the reporting entities. Not all entities are required to prepare all three types of statements.

76 councils and 11 RLCs received a 'clear' or unqualified opinion on their financial and standard statements as at 30 September, which means the financial and standard statements fairly present the financial position and results of the entity.

Manningham City, Mildura Rural, Murrindindi Shire councils' statements were not complete by 30 September, however ministerial extensions were provided to **Manningham** due to an office fire, **Murrindindi** due to the bushfire and **Mildura** has subsequently been completed on 20 October 2009.

Goulburn Valley RLC's statements were not complete as at 30 September.

11 associated entities received a 'clear' or unqualified opinion on their financial statements as at 30 September, with **Regional Landfill Clayton South Joint Venture's** financial statement subsequently completed on 23 October 2009.

74 councils received 'clear' or unqualified opinion on their performance statement as at 30 September, however **Moorabool Shire Council** received a qualification on their performance statement because their annual budget did not set out targets to enable performance to be judged and **Hepburn Shire Council** did not prepare a performance statement as no specific performance measures or targets were set. **Manningham City, Mildura Rural, Murrindindi Shire** councils' statements were not complete as at 30 September.

The most efficient audits are the ones where management takes a mature and responsible approach to their reporting obligations and constructively embraces their responsibility to understand and apply the relevant accounting standards in the preparation of their financial statements, including engaging with the auditor at an early stage of the preparation process when issues of principle or major accounting policy changes are being considered. In these circumstances the audits generally proceed in a smooth and predictable manner as the respective responsibilities of preparer and auditor are recognised, respected and exercised in a complementary manner.

In addition to this reporting of significant matters arising from audits to the Parliament, a management letter is provided to individual reporting entities which also covers lesser and procedural matters identified during the course of the audit.

Timely submission is also an indicator of the good quality of the financial statements. Results for timeliness were strong with 97 per cent of statements being finalised by 30 September, as required by the *Local Government Act 1989* (the LG Act).

Local governments are the third tier of government and while administered under the LG Act, each council operates autonomously and is directly accountable to its own constituency.

Local government entities are required by the LG Act to prepare financial statements, standard statements and performance statements. The financial and performance statements must be independently audited, and an audit opinion expressed on each statement. The statements and the accompanying audit opinions are included in the annual report of each entity.

The independent audit opinion adds credibility to the financial and other reports by providing reasonable assurance that the information in the statements is reliable.

A qualified audit opinion means that a statement has not been prepared in accordance with the relevant reporting framework and, therefore, is less reliable and useful as an accountability document.

Quality of reporting

Important attributes of the quality of reporting are its accuracy, the timeliness of preparation and finalisation of the financial report. The later the reports are produced and published after year end, the less useful they become.

Quality of financial statements

Ideally, each council should prepare only one draft set of statements for audit that require no adjustments. However, this financial year the majority of councils were still required to make material adjustments to their draft accounts as a result of the audit process.

In 2008–09, the number of material adjustments required indicates that while quality control over reporting was not totally effective, there has been some improvement. On average, 1.5 adjustments to the financial statements prior to audit clearance, compared with two last year.

To improve further on the timeliness and accuracy of draft financial statements, most councils need better processes and systems to produce their financial statements.

Quality of performance statements

Measures and targets that form the performance statement are set and agreed prior to the start of the financial year. These are included in the published budgets and submitted to the Minister for Local Government by 31 August yearly. This year data reported by councils was found to be accurate and the quality of narrative has improved. However **Moorabool Shire Council** received a qualification and **Hepburn Shire Council** did not prepare a statement for audit. Further statement deficiencies were not detected and addressed when the budget was submitted as legislatively required under the LG Act.

The 2008–09 performance measures were set and agreed prior to the start of the year and after issue of our June 2008 Report, *Performance Reporting in Local Government* (2007–08:27) and better practice guide *Performance Reporting: Turning Principles into Practice* (2007–08:29). We expect these reports to serve as a catalyst for councils to significantly improve the relevance and appropriateness of performance statements in 2009–10.

Accordingly, enhancement to the 2009–10 performance measures are expected and should lead to progressively improving performance statements in the future.

Current issues

New standard AASB 1051 *Land Under Roads* required councils to elect either to recognise all land under roads held at 30 June 2009, or to recognise land under roads acquired after 1 July 2008 and then on either a cost basis or on a fair value basis.

The LG Act requires that local government entities prepare their financial reports to comply with standards set by the Australian Accounting Standards Board (AASB).

In the absence of guidance from Local Government Victoria, a division of the Department of Planning and Community Development, councils have variously utilised all four elections available to account for land under roads when implementing the new standard. Therefore dependent on which elections are used, large variation in values are possible. This reduces the utility and consistency of financial reporting across the local government sector.

Effectiveness of internal control

Internal control encompasses the systems, policies, processes, behaviours and other aspects of an organisation that are established to assure that business objectives will be met reliably and cost effectively.

Business planning

This year we focused on Business Continuity Management (BCM) as a significant financial management control within councils.

All councils had started to implement some elements of BCM, however there remains a need for substantial further development before the sector can claim to have adequate systems in place to mitigate, and recover from an unexpected event that adversely affect council's operations.

62 councils had a Business Continuity Plan (BCP) in place, however on only six of those councils was it up to date and tested.

Overall however, internal control as it relates to financial reporting was sound although the following weaknesses common to a number of councils were identified:

- Reconciliations of cash, payroll and creditors were not performed or were lacking in accuracy, timeliness and quality.
- Inadequate controls over employee and creditor masterfile amendments.

IT security

Councils need to balance the requirement to provide staff with ready access to systems and information to enable them to perform their roles; with the obligation to protect sensitive information, guard against manipulation of financial data and prevent unauthorised changes to their IT systems.

Our review of IT security found 65 (84 per cent) of councils had a formal process for granting user access to new members of staff. However, only 45 of the 65 councils or 69 per cent reviewed the access levels on a regular basis.

Financial sustainability

Financial sustainability bears directly on the audit process and as required by Australian Auditing Standards annually, we evaluate whether a council is a going concern for the next 12 months. This annual assessment of financial sustainability is a by-product of our audit process and its scope is limited to reviewing key financial ratios. The assessment, nevertheless, is of interest to those governing and managing councils—councillors and executive management—and to those who hold councils to account for their financial stewardship.

In Part 3 and Appendix C a further detailed analysis of financial sustainability is provided. This analysis provides each council a sustainability risk rating for the past five financial years, based on the five key indicators that we commenced reporting in 2003–04.

To be financially sustainable, councils should have sufficient financial capacity to meet future expected requirements and be able to absorb financial risks and shocks without radically altering their expenditure and revenue policies.

Our analysis of five indicators of financial sustainability shows that there has been an overall improvement in financial sustainability of the local government sector in 2008-09. This year as with last year, no council result was assessed as high risk. Further the councils rated as medium risk decreased from 15 to eight. Figure A summarises the sustainability risk assessment results for the 76 councils that have completed their audited statements across five council groups which have regard to size and location.

Figure A
Summary sustainability risk rating

| Council group | 2007-08 | | | 2008-09 | | |
|--------------------|---------|-----------|-----------|---------|----------|-----------|
| | High | Medium | Low | High | Medium | Low |
| Inner metropolitan | – | 2 | 15 | – | 1 | 16 |
| Outer metropolitan | – | 2 | 12 | – | 1 | 12 |
| Regional city | – | 4 | 7 | – | 2 | 8 |
| Large shire | – | 4 | 11 | – | – | 15 |
| Small shire | – | 3 | 19 | – | 4 | 17 |
| Total | – | 15 | 64 | – | 8 | 68 |

Note: Three councils financial reports not complete by 30 September.

Source: Victorian Auditor-General's Office.

The medium risk ratings provided to eight councils reflects the challenge the sector faces in addressing the maintenance and upgrade requirements for existing assets, while balancing community requests for new facilities.

An additional indicator for 2008-09 which builds on the investment gap ratio is the renewal gap. It shows that 70 per cent of councils are not spending sufficient financial resources on maintaining and restoring existing infrastructure.

Impact of bushfires

The bushfires affected 19 councils directly and the extent of damage varied.

There has not been any significant impact from the bushfires affecting the financial sustainability indicators. However these councils will be monitored in the coming years for medium to longer term effects.

Recommendations

| Number | Recommendation | Page |
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| 1. | The Department of Planning and Community Development (DPCD) should review the submitted budgets against the requirements of the <i>Local Government Act 1989</i> and initiate remedial action when non-compliance occurs. | 7 |
| 2. | DPCD should provide guidance to entities within the local government sector to improve the consistency and comparability of the financial information across the sector. | 14 |
| 3 & 4. | Relevant reconciliations should be prepared, reviewed and authorised in a timely manner. | 18 |
| 5. | DPCD should work with the councils to develop an effective better practice BCM, including addressing the key areas of risk registers, BCPs and DRPs. | 20 |
| 6, 7 & 8. | Councils should maintain a current risk register, business continuity plan and disaster recovery plan. These should be tested at least annually. | 20 |
| 10. | Councils should have an approved IT security policy which restricts user access to only the IT systems required to undertake and perform their role; regularly review user access levels for continued appropriateness; and enforce password complexity. | 22 |

General

The total cost of preparing and printing this report was \$172 000.