



## Local Government: Interim Results of the 2009–10 Audits





VICTORIA

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Victorian  
Auditor-General

# Local Government: Interim Results of the 2009–10 Audits

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Ordered to be printed

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VICTORIAN  
GOVERNMENT PRINTER  
August 2010



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ISBN 978 1 921650 47 5

The Hon. Robert Smith MLC  
President  
Legislative Council  
Parliament House  
Melbourne

The Hon. Jenny Lindell MP  
Speaker  
Legislative Assembly  
Parliament House  
Melbourne

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my report on  
*Local Government: Interim Results of the 2009–10 Audits*.

Yours faithfully



D D R PEARSON  
*Auditor-General*

11 August 2010



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# Audit summary

## Background

This report informs Parliament of our findings about the effectiveness of internal controls arising from our interim financial audits of 79 councils, the 13 entities they control and the 12 regional library corporations (RLCs).

All public sector entities should have adequate internal controls to assure the reliability of their financial reporting, the efficiency and effectiveness of their operations and compliance with all relevant laws and regulations. In our annual financial statement audits, we focus on controls relating to financial reporting. While it is not our responsibility to form an opinion about internal controls, we nevertheless raise any control weaknesses or breakdowns we identify with management.

## Overall conclusion

Councils need to further strengthen their internal controls, particularly those over information technology change management policies and declarations of interest.

The utility and consistency of financial reporting across the local government sector is reduced by a lack of timely coordination and guidance in the adoption of consistent approaches for presenting income and expenditure in the comprehensive income statement and valuing land under roads reported in the balance sheet.

## Findings

### Common internal control weaknesses

The audit of the design and effectiveness of the control environment at local government entities includes a review of controls over those financial systems that provide information for the annual financial statements.

Our interim audits found instances where internal controls should be strengthened and were reported to the audit committee and management of each entity. Three common control weaknesses were identified:

- masterfile changes at 31 councils (39 per cent) for the payroll and accounts payable systems were not verified
- poor bank reconciliation controls at 14 councils (18 per cent), including not completing reconciliations promptly, leaving reconciliations with unresolved variances, and inadequately segregating the duties of preparing and reviewing reconciliations
- inadequate information technology (IT) disaster recovery planning at 12 councils (15 per cent), including councils without plans, or with untested plans.

No common control weaknesses were identified through our audits of the RLCs and other local government entities.

### Controls over declarations of interest

We use a cyclical approach to reviewing internal controls relating to significant annual financial report balances and disclosures consistent with Australian Auditing Standards. This year we reviewed key controls over declarations of interests and gifts.

These controls are important as:

- one of councils' primary roles is to provide governance and leadership for the local community through advocacy, decision making and action
- councillors and council employees should act, and be seen to act, honestly and impartially at all times.

### Declarations of interests

Amendments to the *Local Government Act 1989* (the Act), which took effect in December 2008, introduced revised requirements for councillors.

It is pleasing to note in 2009–10, councillors at 76 of the 79 councils completed all the required returns in line with the Act; however, councillors at three councils did not complete all required returns in line with the Act.

Fifty-seven councils (72 per cent) did not have a council approved policy covering the completion of declarations of interest by councillors.

Of the 22 councils with an approved policy, three could be further improved by including the time frames required for the completion of ordinary and primary returns.

### Declarations of gifts

The December 2008 amendments to the Act also requires councillors and staff to declare gifts, as part of the declaration of interest, when they receive gifts with a cumulative value of more than \$200 over five years.

Eleven councils (14 per cent) do not have an approved gifts policy that builds on the Act, with guidelines for when gifts are received.

Analysis of the 68 councils with an approved gift policy shows that 54 councils (68 per cent) had specified a dollar threshold for declaring gifts, up to \$220. However, specifying a dollar threshold in this way can result in councillors and staff not complying with the Act's requirement to declare all gifts with a cumulative value of more than \$200 over five years.

### Controls over information technology change management

IT change management policies assist councils to reliably plan, authorise and test changes to their IT infrastructure before implementation.

Fifty-one councils (65 per cent) did not have an approved IT change management policy. Eleven of which outsourced all or part of their IT services without having a policy for in-house IT services. These councils had not reviewed and accepted their providers' IT change management policies.

The 28 with an approved policy could be further improved given:

- five (18 per cent) did not require that requested changes be supported by a risk/ benefit assessment
- ten (36 per cent) did not address the authorisation and implementation of emergency changes.

### Financial reporting framework

During the 2009–10 financial year there was a significant change to the financial reporting framework in local government, which was the revision of Australian Accounting Standard AASB 101 *Presentation of Financial Statements*. The presentation of the financial statements has changed, with a new format for the income statement and greater disclosure required when comparative information for previous periods is restated.

Different approaches were adopted for presenting income and expenditure and valuing land under roads in 2008–09. It is evident that this will continue in 2009–10. Without timely guidance, which requires the adoption of consistent approaches, the utility and consistency of financial reporting across the local government sector is reduced.

The Australian Accounting Standards Board (AASB) and the New Zealand Financial Reporting Standards Board (FRSB) issued a joint exposure draft, ED 180 *Income from Non-exchange Transactions* (Taxes and Transfers) in June 2009, to replace AASB 1004 *Contributions*. AASB 1004, requires that funds from non-exchange transactions, such as grants and developer contributions are recognised on receipt rather than as expended. This has introduced volatility in operating results at councils and reduces the usefulness of financial statements for users making decisions about resource allocation and management accountability. The proposals in the exposure draft are likely to result in the deferral of the recognition of income, which will reduce year-on-year volatility in entities' net results.

## Recommendations

Number	Recommendation	Page
1.	Local government entities should assess their policies and procedures against the commonly identified internal control weaknesses to assess if they are operating in a reliable, efficient and cost-effective manner.	9
2.	Local government entities should have a comprehensive declarations of interest policy that builds on the requirements of the <i>Local Government Act 1989</i> , including disclosure of conflicts of interests and the maintenance of the register of interests.	14
3.	Local government entities should have a comprehensive gifts policy that builds on the requirements of the <i>Local Government Act 1989</i> .	15
4.	Local government entities should have a comprehensive information technology change management policy.	20
5.	The Department of Planning and Community Development should facilitate provision of timely guidance to local government entities to achieve consistency and comparability in financial reporting across the sector.	24

## Submissions and comments received

In addition to progressive engagement during the course of the audit, in accordance with section 16(3) of the *Audit Act 1994* a copy of this report, or relevant extracts from the report, was provided to the Department of Planning and Community Development with a request for comments or submissions.

Agency views have been considered in reaching our audit conclusions and are represented to the extent relevant and warranted in preparing this report. Their full Section 16(3) comments and submissions; however, are included in Appendix B.

## Audit conduct

The interim audit of the 79 councils, the 13 entities they control and the 12 RLCs were undertaken in accordance with the Australian Auditing Standards.

The total cost of preparing and printing this report was \$125 000.



# 1 Background

## 1.1 Introduction

The state election is scheduled for 27 November 2010, with Parliament rising in early October 2010. This shortens our time lines for reporting on the annual financial statement audit of the local government sector. Accordingly, we have produced this interim report on the annual financial statements audits of the local government sector and will produce a final acquittal report in February 2011.

This report is the second of seven reports to be presented to Parliament covering the results of audits of local government financial, standard and performance statements. Figure 1A shows the intended reports and time frames.

This report comments on the effectiveness of internal controls and management controls relating to declarations of conflicts of interest, declaration of gifts and information technology (IT) change management processes.

**Figure 1A**  
**VAGO reports on the results of the 2009–10 financial audits**

Report	Description
Portfolio Departments: Interim Results of the 2009–10 Audits (2010–11:1 tabled 28 July 2010)	Reported on the interim results of audits of the 11 portfolio departments. It examined the effectiveness of internal controls for IT systems; for identifying, declaring interests and managing conflicts; and for procurement. It also commented on financial reporting developments.
Local Government: Interim Results of the 2009–10 Audits (this report)	This report has the interim results of audits of 79 local governments, the 13 agencies they control and 12 regional library corporations. It examines the effectiveness of internal controls supporting the preparation of the financial reports, controls over conflicts of interests and IT change management.
Water Entities: Interim Results of the 2009–10 Audits	The report will provide interim results of audits of 19 water entities. It will examine the effectiveness of internal control supporting the preparation of the financial reports and aspects of how they manage capital projects and creditors <i>Scheduled for tabling in Parliament in August 2010.</i>

**Figure 1A**  
**VAGO reports on the results of the 2009–10 financial audits – *continued***

Report	Description
Public Hospitals: Interim Results of the 2009–10 Audits	The report will provide the interim results of audits of approximately 110 agencies in the sector. It will examine the effectiveness of internal control supporting the preparation of the financial reports and aspects of how they manage leave and creditors. <i>Scheduled for tabling in Parliament in September 2010.</i>
Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2009–10	The report will provide the results of the audit of the state's annual financial report. It will examine the quality and timeliness of financial reporting, explain significant financial results for the state and make observations on the status and financial implications of significant issues. <i>Scheduled for tabling in Parliament in October 2010.</i>
Acquittal Report: Results of the 2009–10 Audits	The report will provide the results of the annual financial statement audits of approximately 420 agencies across the portfolio departments and associated entities, and all other sectors, including local government, water entities and public hospitals. The report will include comment on the timeliness of their financial reporting and financial sustainability. <i>Scheduled for tabling in Parliament in February 2011.</i>
Tertiary Education and Other Entities: Results of the 2010 Audits	This report will provide the results of the annual financial audits of approximately 110 entities with financial year ends other than 30 June 2010. It will examine timeliness of their financial and performance reporting, the effectiveness of their internal control, their financial sustainability and aspects of how they manage creditors, employee costs and student fee revenue. <i>Scheduled for tabling in Parliament in May 2011.</i>

Source: Victorian Auditor-General's Office.

## 1.2 Financial audit framework

An annual financial audit has two aims:

- to give an opinion about whether financial statements are fairly stated, consistent with section 9 of the *Audit Act 1994*
- to consider whether there has been any wastage of public resources or any lack of probity or financial prudence in the management or application of public resources, consistent with section 3A(2) of the *Audit Act 1994*.

Figure 1B shows the three phases of a financial audit and details how the 2009–10 interim audits of the 79 councils, the 13 entities they control and the 12 regional library corporations (RLCs) were conducted.

**Figure 1B**  
**Financial audit framework**

### *Planning*

Planning is not a discrete phase of a financial audit, rather it continues throughout the engagement. However, initial audit planning is conducted at two levels:

- At a high or entity level, planning involves obtaining an understanding of the entity and its environment, including its internal controls. The auditor identifies and assesses: the key risks facing the entity; the entity's risk mitigation strategies; any significant recent developments; and the entity's governance and management control framework.
- At a low or financial reports line item level, planning involves the identification, documentation and initial assessment of processes and controls over management, accounting and information technology systems.

The output from the initial audit planning process is a detailed audit plan and a client strategy document, which outlines the proposed approach to the audit. This strategy document is issued to the client after initial audit planning and includes an estimate of the audit fee.

### *Conduct*

The conduct phase involves the performance of audit procedures aimed at testing whether or not financial statement balances and transactions are free of material error. There are two types of tests undertaken during this phase:

- Tests of controls, which determine whether controls identified during planning were effective throughout the period of the audit and can be relied upon to reduce the risk of material error.
- Substantive tests, which involve: detailed examination of balances and underlying transactions; assessment of the reasonableness of balances using analytical procedures; and a review of the presentation and disclosure in the financial reports, for compliance with the applicable reporting framework.

The output from this phase is a final (and possibly an interim) management letter which details significant findings along with value-adding recommendations on improving controls and processes. These documents are issued to the client after any interim audit work and during the reporting phase.

### *Reporting*

The reporting phase involves the formal presentation and discussion of audit findings with client management, and / or the audit committee. The key outputs from this process are:

- A signed audit opinion, which is presented in the client's annual report alongside the certified financial reports.
- A report to Parliament on significant issues arising from audits either for the individual entity or for the sector as a whole.

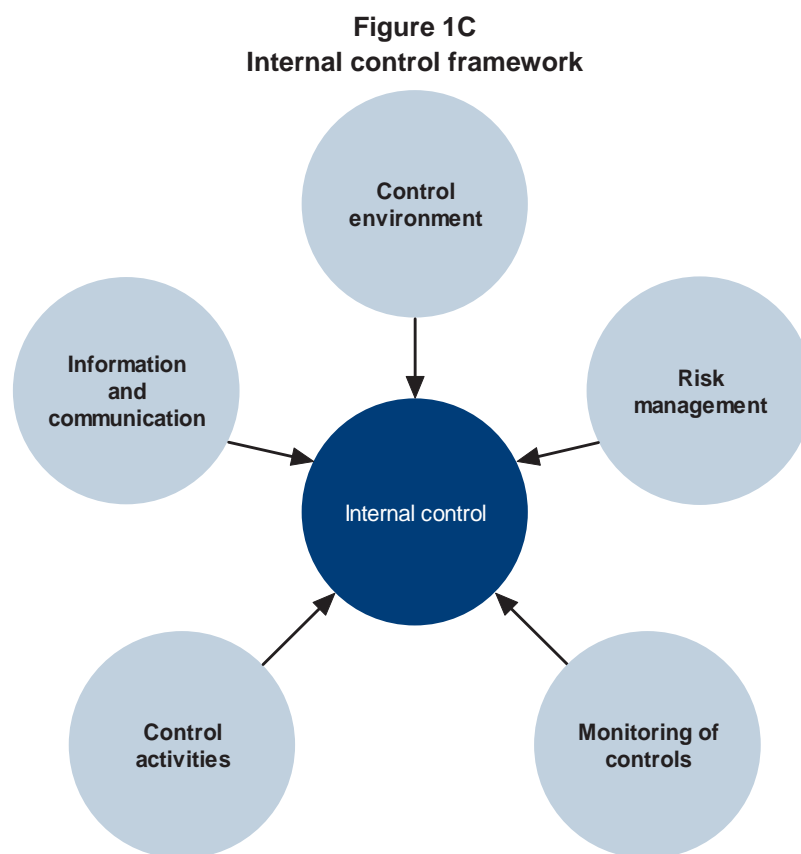
Source: Victorian Auditor-General's Office.

## 1.2.1 Audit of internal controls

Assessment of an entity's internal controls is part of a financial audit. Internal controls are how an entity can reasonably assure itself that its financial reporting is reliable, its operations are effective and efficient and that it is complying with laws and regulations.



Figure 1C shows the main components of an effective internal control framework.



Source: Victorian Auditor-General's Office.

The internal control framework comprises:

- the **control environment**—provides the fundamental discipline and structure for controls and includes governance and management functions and the attitudes, awareness and actions of those charged with governance and management
- **risk management**—involves identifying, analysing and mitigating risks
- **monitoring of controls**—assesses the effectiveness of internal controls in practice
- **control activities**—are the policies, procedures and practices that management prescribes to help meet the entity's objectives
- **information and communication**—involves communicating control responsibilities throughout the entity and providing information in a form and time frame that allows officers to discharge their responsibilities.

The annual financial audit enables the Auditor-General to form an opinion on an entity's financial report. An integral part of this process, and a requirement of Australian Auditing Standard 315 *Understanding the Entity and its Environment and Assessing the Risk of Material Misstatement*, is to assess the adequacy of the entity's internal control framework and governance processes as they relate to the accuracy, completeness and reliability of their financial reporting.

Internal control weaknesses we identify during an audit will usually not result in a qualified audit opinion. A qualification is usually only warranted if weaknesses cause significant uncertainty about the financial information being reported. Often, an entity will have other compensating controls to mitigate the risk of material error. We bring any weaknesses we find during an audit of a local government entity to the attention of its management, audit committee and council or board, as appropriate.

Section 16 of the *Audit Act 1994* empowers the Auditor-General to report to Parliament on the results of audits. This report includes the results of our review of internal controls related to the financial reporting responsibilities of 79 councils, the 13 entities they control and the 12 RLCs.

## 1.3 Financial reporting framework

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The principal legislation governing the establishment and operation of local governments is the *Local Government Act 1989* (the Act). Local Government Victoria, a division of the Department of Planning and Community Development, administers the Act.

Figure 1D outlines the reporting requirements for all local government entities under the Act.

**Figure 1D**  
**Local government sector reporting requirements under the Act**

Statement	Details	Council	RLCs	Other
Financial	<p>General purpose financial statements prepared in accordance with Australian Accounting Standards, as issued by the Australian Accounting Standards Board. The statements are:</p> <ul style="list-style-type: none"> <li>• comprehensive income statement</li> <li>• balance sheet</li> <li>• cash flow statement</li> <li>• statement of changes in equity.</li> </ul>	✓	✓	✓
Standard	<p>Special purpose financial statements comprising of:</p> <ul style="list-style-type: none"> <li>• income statement</li> <li>• balance sheet</li> <li>• cash flow statement</li> <li>• capital works statement.</li> </ul> <p>The statements include a comparison between the original approved budget and the actual results for the financial year.</p> <p>A supporting narrative statement is also prepared explaining any material variances between actual and budgeted results.</p>	✓	✓	—
Performance (non-financial)	<p>Key performance indicators set by each council for each strategic activity specified in the annual budget.</p> <p>The performance statement reports actual results achieved against targets for each performance indicator, with an explanation of material variances.</p>	✓	—	—

Source: Victorian Auditor-General's Office.

The Act requires annual reports to be submitted to the Minister for Local Government by 30 September each year. An annual report must contain the audited financial, standard and performance statements, as applicable. To enable the results of associated subsidiary companies, trusts and joint ventures to be consolidated in the relevant councils' annual report, these entities must report in a shorter time frame than councils.

For the performance statement, councils must set measures and targets for key performance indicators before the start of the financial year. These indicators and targets are included in the published budgets and submitted to the Minister for Local Government by 31 August each year. A qualified audit opinion is issued if the performance statement has not been prepared in accordance with the published budget, or if the budget did not contain key performance indicators and targets for the performance statement.

# 2 Common internal control weaknesses

## At a glance

### Background

As part of our financial audits, we assess internal controls that affect the reliability of financial reporting. We bring weaknesses found during an audit to the attention of management, audit committee and council or board, as appropriate.

### Findings

- Across the 79 councils, common control weaknesses related to:
  - masterfile changes at 31 councils (39 per cent) for payroll and accounts payable systems
  - bank reconciliations at 14 councils (18 per cent)
  - information technology disaster recovery plans at 12 councils (15 per cent).
- No common control weaknesses were identified through our audits of the regional library corporations and other local government entities.

### Recommendation

Local government entities should assess their policies and procedures against the commonly identified internal control weaknesses to assess if they are operating in a reliable, efficient and cost-effective manner.

## 2.1 Introduction

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All local government sector entities are required to have adequate internal controls to maintain the reliability of their financial reporting, the efficiency and effectiveness of their operations and compliance with all relevant laws and regulations.

As part of the annual financial statement audits, we focus on internal controls relating to financial reporting and assess whether entities have managed the risk that their financial statements will be incomplete and inaccurate. Poor controls diminish management's ability to achieve their entities' objectives, comply with relevant legislation, and also increase the risk of fraud.

Our interim audits found instances where internal controls should to be strengthened. These were reported to the management and audit committee of each entity.

While there were a wide range of issues reported to the 79 councils, common areas of weakness were:

- masterfile changes for payroll and accounts payable systems
- bank reconciliations
- information technology (IT) disaster recovery plans.

No common control weaknesses were identified through our audits of the 12 regional library corporations and 13 other local government entities.

## 2.2 Masterfile changes

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It is important that councils have procedures and controls to mitigate the risk that the data in payroll and accounts payable masterfiles is incorrect and/or fraudulent. A key part of mitigating this risk is to independently produce and check a masterfile change report against supporting documentation.

Weaknesses with controls in the payroll and accounts payable systems relating to the management of masterfile changes were found at 31 councils (39 per cent) as follows:

- not producing masterfile change reports to allow changes to be verified
- missing masterfile change reports
- no independent officer reviewing masterfile changes to ascertain if the masterfile contains the correct information.

## 2.3 Bank reconciliations

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Bank reconciliations are a core financial control that mitigates the risk that fraudulent or incorrect transactions will be processed through a council's bank account.

Bank reconciliation control weaknesses were identified at 14 councils (18 per cent), as follows:

- reconciliations were not being completed on time
- poor segregation of reconciliation preparation and review duties
- reconciliations with unresolved variances, some of which are longstanding.

Reconciliation issues with payroll, accounts payable, accounts receivable and fixed assets were also raised at 10 councils (13 per cent).

## 2.4 Information technology disaster recovery plans

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A comprehensive and fully tested IT disaster recovery plan provides the best assurance that a council will be able to continue to operate and provide essential services to the community in the event of a disaster.

Weaknesses in the IT disaster recovery plans raised with 12 councils (15 per cent) did not:

- have IT disaster recovery plans
- systematically review plans
- test plans.

### **Recommendation**

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1. Local government entities should assess their policies and procedures against the commonly identified internal control weaknesses to assess if they are operating in a reliable, efficient and cost-effective manner.



# 3 Controls over declarations of interest

## At a glance

### Background

We used a cyclical approach to review internal controls relating to significant annual financial report balances and disclosures, consistent with Australian Accounting Standards. This year we reviewed controls over declarations of interest and gifts.

### Findings

- Councillors at three councils (4 per cent) did not complete the required returns specified by the *Local Government Act 1989* (the Act).
- Fifty-seven councils (72 per cent) did not have a council approved policy covering the completion of declarations of interest returns by councillors.
- Eleven councils (14 per cent) do not have an approved gifts policy that builds on the Act.
- Fifty-four of the 68 councils (79 per cent) with an approved gifts policy specified a dollar threshold for declaring gifts, up to \$220. Specifying a dollar threshold in this way can result in councillors and staff not complying with the Act's requirement to declare all gifts with a cumulative value of more than \$200 over five years.

### Recommendations

- Local government entities should have a comprehensive declaration of interest policy that builds on the requirements of the *Local Government Act 1989*, including disclosure of conflicts of interests and the maintenance of the register of interests.
- Local government entities should have a comprehensive gifts policy that builds on the requirements of the *Local Government Act 1989*.



## 3.1 Introduction

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The *Local Government Act 1989* (the Act) specifies the role of a council is ‘to provide governance and leadership for the local community through advocacy, decision making and action’.

We used a cyclical approach to review internal controls relating to significant annual financial reporting balances and disclosures, consistent with Australian Auditing Standards. This year we conducted a high-level review of the management controls at the 79 councils relating to:

- declarations of interest
- declarations of gifts.

These controls are important because councillors and council employees should act, and be seen to act, honestly and impartially at all times.

## 3.2 Declarations of interest

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Amendments to the *Local Government Act 1989*, which took effect in December 2008, introduced revised requirements for declarations of interest.

The Act’s requirements are explained in *Conflict of Interest in Local Government: A Guide* published by the Department of Planning and Community Development in February 2009. The guide contains detailed examples of when the legislation should be applied, who the legislation affects and what action is required.

As stated in the guide, conflicts of interest rules are important because:

*‘A person in public office has a conflict of interest when they have a personal or private interest that might compromise their ability to act in the public interest. A conflict of interest can exist even if no improper action results from it.’*

*‘A failure to resolve a conflict can create an appearance of impropriety that can undermine confidence in the relevant person or in the council.’*

Further, the Department of Planning and Community Development issued *Register of Interest Guide Primary and Ordinary Returns* in June 2009, which provides further guidance and complements the *Conflict of Interest in Local Government: A Guide*.

The Act applies to all councillors, council officers, committee members who are not councillors or council officers, and contractors who provide works or services to council under a contractual arrangement. Once a potential or actual conflict of interest is identified, the person affected is responsible for declaring and mitigating the conflict, as detailed in section 79 of the Act.

Section 81 of the Act requires councillors and specified staff to lodge declaration of interest returns. There are two types of returns:

- **primary returns**—to be completed by a councillor within 30 days of being elected to office and by staff and councillors when appointed to a special committee
- **ordinary returns**—to be completed every six months by a councillor.

The returns must be submitted to the chief executive officer (CEO) who must collate them in a register of interests, which she or he maintains.

Seventy-six councils (96 per cent) have complied with the requirements to complete primary and ordinary returns for councillors. However, councillors at three councils (4 per cent) did not complete the returns in line with the Act.

While individual councillors are responsible for completing the ordinary and primary returns, CEOs should monitor the returns received to confirm that all returns have been completed in the required time frame.

### Council policies

Figure 3A shows the good practice elements of a declaration of interest policy as set out in the joint publication, *Managing Conflicts of Interest in the Public Sector*, by the New South Wales (NSW) Independent Commission Against Corruption and the Queensland (QLD) Crime and Misconduct Commission. This joint publication was used as a primary source by the State Services Authority to develop its policy framework for the Victorian sector.

Twenty-two councils (28 per cent) have a council approved policy covering the completion of declaration of interest returns by councillors and staff. Three of these 22 policies do not include key elements, such as the time frames required for the completion of ordinary and primary returns.

Councils should implement an internal policy to inform councillors, employees and other appropriate council persons of the requirements of the Act regarding the declaration of interest. This is important due to the significant complexity of the Act, which contains detailed specifications of the varying circumstances that can result in a conflict of interest, and the related responsibilities of councillors, employees and other persons. The policy should incorporate key elements of good practice, as set out in Figure 3A.

**Figure 3A**  
**Good practice elements of a declarations of interest policy**

Area	Content
Introduction	The policy should explain: <ul style="list-style-type: none"> <li>• <b>its purpose</b>—why it was drafted and what it intends to achieve</li> <li>• <b>its application</b>—who it applies to and the range of possible conflicts of interest</li> <li>• <b>relevant legislation</b>—any laws or regulations that oblige officers to disclose and/or manage conflicts of interest.</li> </ul>
Definitions	The policy should define and explain the different types of interests and gifts, and give examples of situations that may give rise to conflicts.
Responsibilities	The policy should name the officer responsible for overseeing its implementation and should define the officer’s functions. The officer should have sufficient authority to make the decisions necessary to implement the policy.
Procedures	The policy should describe the process that officers must follow if they are offered or receive a gift or think they have or might have a conflict of interest. It should include procedures for declaring and managing interests and gifts, and the record keeping required for each type of conflict.
Breaches	The policy should explain the consequences of breaching it.
Privacy	The policy should detail how the privacy of information disclosed under the policy will be handled.

Source: Victorian Auditor-General’s Office and *Managing Conflicts of Interest in the Public Sector*, jointly published by the NSW Independent Commission Against Corruption and the QLD Crime and Misconduct Commission.

## Recommendation

2. Local government entities should have a comprehensive declarations of interest policy that builds on the requirements of the *Local Government Act 1989*, including disclosure of conflicts of interests and the maintenance of the register of interests.

## 3.3 Declarations of gifts

Section 81(7)(e) of the Act requires councillors and staff to declare gifts received in the last five years if they total more than \$200, as part of the requirement to declare conflicts of interest.

To build on the Act, and to provide clarity for staff and councillors around the legislative requirements relating to declarations of gifts, councils should have their own policy on this area. Ideally such policy should either stand alone or be included in codes of conduct for councillors and staff.

Eleven councils (14 per cent) do not have an approved gifts policy. This means that councillors and staff will be less likely to have a clear understanding of council's policy position and their responsibilities.

Sixty-eight councils (86 per cent) have an approved gifts policy. An analysis of these policies against the good practice criteria shown in Figure 3A indicates councils are including the following elements in their policies:

- details of who the policy applies to
- definitions of gifts that must be declared
- process that officers must follow if they are offered or receive a gift
- procedures for declaring and managing gifts.

The policies could be improved by including:

- consequences of breaching the policy
- who is responsible for collating and recording gifts received in a central register.

In addition, 54 of the councils with an approved policy had specified a dollar threshold for declaring gifts up to \$220. Specifying a dollar threshold in this way can, however, result in councillors and staff not complying with the Act's requirement to declare all gifts with a cumulative value of more than \$200 over five years.

Councils should have systems to monitor the cumulative value of gifts received on an ongoing basis.

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## Recommendation

3. Local government entities should have a comprehensive gifts policy that builds on the requirements of the *Local Government Act 1989*.
-



# 4 Controls over information technology change management

## At a glance

### Background

The effectiveness of internal controls over business processes and the reliability of financial reporting are assessed during audits. This year, a focus of our audit was information technology (IT) change management controls.

### Findings

- Fifty-one councils (65 per cent) did not have an approved IT change management policy.
- Eleven of which outsourced all or part of their IT services without having a policy for in-house IT services. These councils had not reviewed and accepted their providers' IT change management policies.

### Recommendation

Local government entities should have a comprehensive information technology change management policy.

## 4.1 Introduction

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Councils use many information technology (IT) systems in their daily operations. It is important that these systems operate effectively to provide comprehensive, relevant and accurate data and reporting and efficiently, using rigorous, timely and cost-effective processes and procedures.

Ongoing demands on IT systems and solutions require councils to regularly change their systems. It is important that these changes are in line with documented and approved policies and procedures.

This chapter reports on the results of our audit of the IT change management policies of the 79 councils.

## 4.2 Information technology change management

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IT change management policies assist councils to reliably plan, authorise and test changes to their IT software or hardware before implementation. Policies also provide criteria for assessing the success of any changes completed. Change management is an essential component of the IT governance arrangements for the efficient and effective functioning of IT systems.

IT change management policies should set out the procedures for changes to IT system software or hardware. The policy should include full testing and approval of all changes before being implemented. These policies should be approved by councils.

Figure 4A shows the good practice elements of an IT change management policy.

**Figure 4A**  
**Good practice elements of an IT change management policy**

Area	Content
Introduction	<p>The policy should explain:</p> <ul style="list-style-type: none"> <li>• <b>its purpose</b>—why it was drafted and what it intends to achieve</li> <li>• <b>its application</b>—who and what it applies to</li> <li>• <b>relevant requirements</b>—including any related government/industry policies or guidelines.</li> </ul>
Responsibilities	<p>The policy should name the officer responsible for overseeing IT change management and should define the officer's functions. The officer should have sufficient authority to make the decisions necessary to implement the policy.</p>
Procedures	<p>The policy should describe the process that officers must follow, including:</p> <ul style="list-style-type: none"> <li>• the life cycle for all IT changes; initiation, development, testing and implementation</li> <li>• roles and responsibilities for authorisation and implementation at each phase of the life cycle</li> <li>• procedures for developing, documenting, approving and prioritising change requests which take account of the risk, impact and business benefit of the request. This includes how to reverse unsuccessful changes and respond to emergency changes</li> <li>• minimum standards for testing and quality assurance of changes.</li> </ul>

Source: Victorian Auditor-General's Office.

Fifty-one councils (65 per cent) did not have an approved IT change management policy. These councils are not mitigating the significant risk of unnecessary and unsuccessful changes being made to their IT systems.

While overall most councils did not have policies, the metropolitan and regional city councils performed better than the shire councils. The 28 councils with an approved policy comprised:

- nine out of seventeen (53 per cent) inner metropolitan councils
- six out of fourteen (43 per cent) outer metropolitan councils
- six out of eleven (55 per cent) regional city councils
- three out of fifteen (20 per cent) large shire councils
- four out of twenty-two (18 per cent) small shire councils.



For councils with a policy, the missing good practice elements most evident were:

- five (18 per cent) did not require requested changes to be supported by a risk/benefit assessment
- ten (36 per cent) did not address the authorisation and implementation of emergency changes.

### Oversight of outsourced IT change management

Councils can choose to outsource some, or all, of their IT services. This can result in a third-party provider making changes to council IT systems. In these cases, a council is relying on the strength of the provider's IT change management policies. When councils outsource functions, they remain accountable for the performance and quality of information in outsourced systems. This is particularly important when preparing financial statements, as councils need to have confidence in the reliability and completeness of financial system information. The performance of outsourced functions, therefore, needs to be monitored by councils so that they can detect and manage any performance risks.

Twenty-nine councils (37 per cent) rely on third-party providers' IT change management processes. Of these councils, 18 did not have IT change management policies.

Of the 18 councils without IT change management policies, 11 have also not reviewed and adopted their providers' policies. These councils cannot be assured that their provider has mitigated the significant risks involved in making IT changes, or that the council is protected against the potentially serious adverse consequences of incorrect changes.

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### Recommendation

4. Local government entities should have a comprehensive information technology change management policy.
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# 5 Financial reporting framework

## At a glance

### Findings

- During the 2009–10 financial year, the presentation of financial statements has changed, with a new format for the operating statement and greater disclosure when comparative information from previous periods is restated.
- The utility and consistency of financial reporting across the sector is reduced by the lack of timely coordination and guidance in the adoption of consistent approaches for presenting income and expenditure in the comprehensive income statement and valuing land under roads. Inconsistent approaches were adopted in these respects in the 2008–09 financial reports and it is evident this situation will continue in 2009–10.
- The AASB 1004 *Contributions* requirement that funds from non-exchange transactions, such as grants and developer contributions are recognised on receipt rather than as expended, has introduced volatility in operating results.

### Recommendation

The Department of Planning and Community Development should facilitate provision of timely guidance to local government entities to achieve consistency and comparability in financial reporting across the sector.

## 5.1 Change to financial reporting framework

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During the 2009–10 financial year, the significant change to the financial reporting framework in local government was the revision of Australian Accounting Standard AASB 101 *Presentation of Financial Statements*.

## 5.2 Presentation of financial statements

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AASB 101 *Presentation of Financial Statements* includes a new concept 'total comprehensive income' in the operating statement. This represents the changes in equity during a period, other than changes resulting from transactions with owners. This means that income and expense items previously recognised directly in equity will now be shown on the comprehensive operating statement. The most prevalent effect is expected to relate to reporting asset revaluation increments and decrements.

Other changes in AASB 101 include:

- the statement of changes in equity must be presented in a separate financial statement, rather than a note to the financial report
- a balance sheet is required at the beginning of the earliest comparative period, following a change in accounting policy, the correction of an error, or the reclassification of items in the financial statements. In these circumstances, an entity must present details for three financial years in the balance sheet and related notes.

This standard was mandatory for all entities preparing general purpose financial reports for 30 June 2010.

### 5.2.1 Presentation of the comprehensive income statement

The comprehensive income statement is required as part of the general purpose financial statements and must comply with Australian Accounting Standards. AASB 101 allows different ways of presenting income and expenditure in the comprehensive income statement, provided that it results in more relevant information for users, which includes assisting with comparisons between entities.

In 2008–09 different approaches were adopted for presenting income and expenditure, and it is evident this will continue in 2009–10. The Department of Planning and Community Development (DPCD) issued its *Local Government Model Financial Report 2010* on 3 June 2010. While this provides for a consistent presentation of the comprehensive income statement it was effectively too late for the 30 June 2010 reporting cycle. Comprehensive income statements, which adopt different approaches of presenting income and expenditure, are less meaningful and useful when assessing performance across the sector.

## 5.3 AASB 1051 *Land Under Roads*

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AASB 1051 *Land Under Roads* was applied to councils with reporting periods beginning on or after 1 July 2008. The standard required councils to choose one of four possible methods for valuing and recognising land under roads, which resulted in large variations in the reported value of land under roads across the 79 councils in 2008–09. This situation is expected to continue in 2009–10. In 2009, we recommended that DPCD provide guidance to councils about how to improve the utility and comparability of financial information across councils. Although DPCD accepted this recommendation, this guidance is yet to be issued.

## 5.4 Emerging accounting standards

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The International Accounting Standards Board (IASB) and the AASB are working on several projects as a result of:

- the review of accounting standards at an international level, following the global financial crisis
- the IASB and the US's Financial Accounting Standards Board (FASB) focus on converging the requirements of international financial reporting standards and US generally accepted accounting principles
- the AASB's renewed focus on developing and improving the relevance of financial reporting standards for the public sector
- the AASB's proposals for differential financial reporting.

The proposed change to the treatment of non-exchange transactions, which we expect will have the greatest impact on local government sector reporting, is outlined below.

### 5.4.1 Income from non-exchange transactions

The definition and accounting treatment of non-exchange transactions, such as government grants and developer contributions, has been a contentious issue for a number of years. In a non-exchange transaction, an entity either:

- receives value from another entity without providing approximately equal value to that party in exchange, for example, road funding grants from the Commonwealth
- gives value to another entity without receiving approximately equal value in exchange from that party, for example, applying developer's contributions to provide recreation facilities for the community at large.

The current requirements in AASB 1004 *Contributions* generally result in volatility in reported financial performance driven by the timing of when funds are received, notwithstanding that the ongoing operations and underlying financial position remain steady over time. This reduces the usefulness of the financial statements for users making decisions about resource allocation and management accountability.

In response, the AASB and the New Zealand Financial Reporting Standards Board (FRSB) issued a joint exposure draft ED 180 Income from *Non-exchange Transactions* (Taxes and Transfers) in June 2009, to replace AASB 1004.

The proposals in the exposure draft are likely to generally result in the deferral of the recognition of income and an increase in the recognition of liabilities, which will reduce year-on-year volatility in entities' net results and financial positions.

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### **Recommendation**

5. The Department of Planning and Community Development should facilitate provision of timely guidance to local government entities to achieve consistency and comparability in financial reporting across the sector.

# Appendix A.

## Acronyms and glossary

### Acronyms

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AASB Australian Accounting Standards Board

RLCs Regional library corporations

### Glossary

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#### Auditor's opinion

Positive written expression within a specified framework indicating the auditor's overall conclusion on the financial report based on audit evidence obtained.

#### Council

A council consists of its councillors, who are the elected representatives of people who are residents in the council's district or ratepayers of the council.

#### Disaster recovery plan

A plan that details the policies, processes and procedures to enable an organisation to recover their critical IT infrastructure and systems after a disaster.

#### Equity or net assets

Residual interest in the assets of an entity after deduction of its liabilities.

#### Financial report

Structured representation of the financial information, which usually includes accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period in accordance with a financial reporting framework.

#### Financial year

A period of 12 months for which a financial report is prepared.

### Internal controls

Processes affected by an entity's structure, work and authority flows, people and management information systems, designed to assist the entity accomplish specific goals and objectives. Internal control is a means by which an entity's resources are directed, monitored and measured. It plays an important role in preventing and detecting error and fraud and protecting the entity's resources.

### Local Government Act 1989

The Local Government Act 1989 states that the purpose of councils is to provide a democratic, efficient and effective system of local government in Victoria. The Act gives councils powers that will enable them to meet the needs of their communities, to provide for an accountable system of local government and reform the law relating to local government in Victoria.

### Masterfile

A database that holds details which are fairly static (for example, address and bank account details).

### Qualification

A qualification is issued when the auditor concludes that an unqualified opinion cannot be expressed due to one of the following reasons:

- disagreement with those charged with governance
- conflict between applicable financial reporting frameworks
- limitation of scope.

A qualified opinion shall be expressed as being except for the effects of the matter to which the qualification relates.

### Unqualified audit opinion

An unqualified audit opinion is an expression by the auditor stating that the entity has followed all accounting rules appropriately and that the financial report is an accurate representation of the entity's financial condition. Also referred to as a clear audit opinion.



## Appendix B.

# *Audit Act 1994* section 16— submissions and comments

### Introduction

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In accordance with section 16(3) of the *Audit Act 1994* a copy of this report was provided to the Department of Planning and Community Development with a request for comments or submissions.

The comments and submissions provided are not subject to audit nor the evidentiary standards required to reach an audit conclusion. Responsibility for the accuracy, fairness and balance of those comments rests solely with the agency head.



## Submissions and comments received

### **RESPONSE provided by the Secretary, Department of Planning and Community Development**



### **Department of Planning and Community Development**

Ref CSEC001945

Mr D D R Pearson  
Auditor-General  
Victorian Auditor General's Office  
Level 24, 35 Collins Street  
**MELBOURNE VIC 3000**

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Melbourne Victoria 3000  
GPO Box 2392  
Melbourne Victoria 3001  
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Dear Mr Pearson

#### **LOCAL GOVERNMENT: INTERIM RESULTS OF THE 2009–2010 AUDITS**

Thank you for your letter of 30 July 2010 seeking the Department of Planning and Community Development's comments on the proposed report 'Local Government: Interim Results of the 2009–2010 Audits'.

The Department has reviewed the proposed report and notes the series of five recommendations contained within it, along with comments on the financial reporting framework for local government in Victoria.

The Department supports the first recommendation, which deals with internal controls. Following the tabling of the report in Parliament, the Department will write to all councils drawing their attention to your findings and recommendation, and in doing so reinforce the importance of IT disaster recovery planning in the context of the governance of Information & Communications Technology (ICT Governance) and Business Continuity Management (BCM).

The Department notes the second recommendation, that councils should have comprehensive declaration of interest policies. Given the specificity of the *Local Government Act 1989* (the Act) regarding conflicts of interest and the provision of detailed guidelines by the Department, in writing to councils about the report, the Department will advise councils that, should they wish to adopt declaration of interest policies, their policies must be consistent with the Act. The Department will further recommend that council policies should be based on the Guidelines issued by the Department.

With regard to the finding in relation to the completion of interest returns, I will bring this to the attention of the Local Government Investigations and Compliance Inspectorate.

The Department supports the third recommendation, that councils should have comprehensive gifts policies. The Department will recommend to councils that the most appropriate place for gifts policies is in the respective Codes of Conduct for Councillors and Council staff.

The Department supports the fourth recommendation which deals with IT change management.

The Department notes the fifth recommendation, that it should facilitate provision of timely guidance to local government entities to achieve consistency and comparability in financial reporting across the sector.



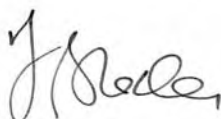
**RESPONSE provided by the Secretary, Department of Planning and Community Development – continued**

The Department will continue to support councils through the provision of timely and comprehensive guidance on a range of matters. For example, the Department in conjunction with the Local Government Finance Professionals (FinPro) and your Office prepares the 'Model Financial Report' which assists local government finance practitioners with the preparation of the year-end financial statements and associated notes. The Model also encourages consistency in the way in which local government financial statements are prepared. The most recent update of the Model Financial Report was issued to all councils on 3 June 2010.

With regard to the appropriate treatment of land under roads, the Department will be providing specific guidance on this shortly.

Please contact John Watson, Executive Director Local Government Victoria on 9651 7233 or by e-mail on [john.watson@dpcd.vic.gov.au](mailto:john.watson@dpcd.vic.gov.au) should you wish to discuss this matter further.

Yours sincerely



**Yehudi Blacher**  
**SECRETARY**

Encl.

# Auditor-General's reports

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## Reports tabled during 2010–11

<b>Report title</b>	<b>Date tabled</b>
Portfolio Departments: Interim Results of the 2009–10 Audits (2010–11:1)	July 2010
Taking Action on Problem Gambling (2010–11:2)	July 2010

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