

**Consideration of the Queensland Audit
Office Report to Parliament 16 for 2014–15**
Results of audit: Local government entities
2013–14

Report No. 16, 55th Parliament
Infrastructure, Planning and Natural Resources Committee
December 2015

Infrastructure, Planning and Natural Resources Committee

Chair	Mr Jim Pearce MP, Member for Mirani
Deputy Chair	Mr Michael Hart MP, Member for Burleigh
Members	Mr Glenn Butcher MP, Member for Gladstone Mr Shane Knuth MP, Member for Dalrymple Mrs Brittany Lauga MP, Member for Keppel Mr Lachlan Millar MP, Member for Gregory
Staff	Ms Erin Pasley, Research Director Ms Margaret Telford, Principal Research Officer Ms Mary Westcott, Principal Research Officer Ms Marion O'Connor, Acting Executive Assistant
Contact details	Infrastructure, Planning and Natural Resources Committee Parliament House George Street Brisbane Qld 4000
Telephone	+61 7 3553 6621
Fax	+61 7 3553 6699
Email	ipnrc@parliament.qld.gov.au
Web	www.parliament.qld.gov.au/ipnrc

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Chair's foreword

This report provides the committee's consideration of the *Queensland Audit Office Report to Parliament 16 for 2014-15 – Local government entities 2013–14*.

On behalf of the committee, I thank the Auditor-General and staff of the Queensland Audit Office, and the Department of Infrastructure, Local Government and Planning for their assistance with the committee's examination.

I commend the report to the House.

A handwritten signature in black ink that reads "Jim Pearce". The signature is written in a cursive style with a large, stylized initial "J".

Jim Pearce MP

Chair

December 2015

Abbreviations

department	Department of Infrastructure, Local Government and Planning
QAO	Queensland Audit Office
QR	Queensland Rail

Recommendation

Recommendation 1

The committee recommends the Legislative Assembly notes the contents of this report.

1 Introduction

1.1 Role of the committee

The Infrastructure, Planning and Natural Resources Committee was established by the Legislative Assembly on 27 March 2015 and consists of government and non-government members.

The committee's areas of portfolio responsibility are:¹

- Transport, Infrastructure, Local Government, Planning and Trade
- State Development, Natural Resources and Mines.

1.2 Role of the Auditor-General and Queensland Audit Office

The Auditor-General is an independent Officer of the Queensland Parliament and is the external auditor of state and local government public sectors.

The Auditor-General examines and reports to Parliament on the efficiency and effectiveness of public sector finances and administration. The Auditor-General is supported by the Queensland Audit Office.

The Auditor-General undertakes both financial audits and performance audits. Financial audits provide advice on the financial statements of public sector entities. Performance audits encompass broader objectives, including evaluating whether an entity, program or initiative has achieved its objectives in an economical and efficient manner.

1.3 The referral and the committee's examination

Section 94(1)(a) of the POQA provides that a portfolio committee has responsibility within its portfolio areas for—

- (a) the assessment of the integrity, economy, efficiency and effectiveness of government financial management by—
 - (i) examining government financial documents, and
 - (ii) considering the annual and other reports of the auditor-general.

Standing Order 194B provides the Committee of the Legislative Assembly (CLA) shall as soon as practicable after a report of the Auditor-General is tabled in the Assembly, refer that report to the relevant portfolio committee(s) for consideration.

On 5 May 2015, the Queensland Audit Office Report to Parliament 16 for 2014-15 – Results of audit: Local government entities (QAO report) was tabled in the Legislative Assembly and referred to the committee for consideration.

A portfolio committee may deal with this type of referral by considering and reporting on the matter and making recommendations about it to the Assembly.²

On 28 October 2015, the committee held a public briefing with officers of the QAO. Following the briefing, the committee followed up with the Department of Infrastructure, Local Government and Planning (the department) in relation to the implementation of the report's recommendations. The department's response is provided in the Appendix to this report.

A copy of the transcript of the public briefing is available from the committee's website.

¹ Schedule 6 of the *Standing Rules and Orders of the Legislative Assembly*, effective from 31 August 2004 (amended 17 July 2015).

² *Parliament of Queensland Act 2001*, s 92(3).

2 Queensland Audit Office Report to Parliament 16 for 2014-15 – Local government entities 2013-14

2.1 Audit scope

Pursuant to section 40 of the *Auditor-General Act 2009*, the QAO undertakes an audit of the annual financial statements of all public sector entities, including local governments and their controlled entities and prepares an auditor's report. The Auditor-General issues an audit opinion on the financial statements of each council and their related entities.³ This process provides assurance about the reliability of the financial reports and monitors compliance with legislative requirements.

2.2 Key findings and conclusions

2.2.1 Results of financial audits

The local government sector consists of 182 entities, including 77 councils and 105 entities they control. Only 154 entities are required to prepare financial statements. The other entities are classified as non-reporting under the accounting standards.

In 2013–14, one council received a qualified audit opinion, which represents an improved understanding of accounting requirements; however, eight councils had unfinished audits (compared to two unfinished audits in 2012–13). Historically, unfinished audits can indicate significant issues that may result in a qualified opinion. The QAO is working with the eight councils and one related entity to finalise the outstanding audits.⁴

Of the completed statements, 139 (96%) unmodified opinions were issued and six (4%) qualified opinions were issued. Emphasis of matter paragraphs were included with 25 unmodified audit opinions.

2.2.2 Significant financial reporting issues

The QAO report stated that there are many significant financial reporting risks and issues that were common across the local government sector. These issues related to:

- asset management
- de-amalgamations
- deficiencies in contract management – i.e. not having a system for documenting decisions made in relation to contracts such as to renew, extend or re-tender
- processes for monitoring supplier performance
- procurement and contracting practices.⁵

³ In accordance with Australian auditing standards, one or more of the following audit opinion types is issued:

- An **unmodified opinion** is issued where the financial statements comply with relevant accounting standards and prescribed requirements.
- A **qualified opinion** is issued when the financial statements as a whole comply with relevant accounting standards and legislative requirements but with particular exceptions.
- An **adverse opinion** is issued when the financial statements as a whole do not comply with relevant accounting standards and legislative requirements.
- A **disclaimer of opinion** is issued when the auditor is unable to express an opinion as to whether the financial statements comply with relevant accounting standards and legislative requirements.

The Auditor may also include an emphasis of matter paragraph to highlight a matter to the reader, but this does not modify the audit opinion.

⁴ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 18-19.

⁵ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 25.

The QAO report suggested that the benefits of robust asset management were not clearly understood across the sector. This is because plans were not regularly updated and annual asset valuation processes continually identify significant asset data errors. As at 30 June 2014, only 60% of councils have up-to-date asset management plans. Assets represent the largest portion of a council's financial statement. The sector manages \$72.1 billion worth of infrastructure assets. Therefore, effective asset management is essential for a council's financial sustainability.⁶

The QAO report suggested that 'the Department of Infrastructure, Local Government and Planning had not addressed the robustness and maturity of council asset management plans and could take a stronger role in educating and guiding councils where they are not advanced in asset management practices.'⁷

The QAO recommended that the department assists councils in improving asset management practices by:

- providing opportunities for training and mentoring
- helping to source external expertise
- producing better practice guidelines.⁸

In responding to the QAO's report, the department stated:

The Department will continue to undertake activities in this area when required and will ensure that the importance of asset management is emphasised in future councillor induction training. The Department has been active in this area to date...⁹

In responding to the committee's request for additional information, the department advised:

- The Department is currently conducting a number of sessions around the state for candidates intending to contest the 2016 local government elections. These sessions highlight the roles and responsibilities of councillors including the obligations of councillors to ensure that local government and community assets are managed sustainably.
- After the 2016 local government elections, the Department will conduct councillor induction training, which will include training in the importance of asset management.
- In the 2014-15 year, the Department held six one-day workshops around the state, attended by 176 local government finance officers from 69 councils. These workshops included content and discussion on asset management practices and management.
- Queensland Treasury Corporation (QTC) released its Whole of Life Costing Tool and Project Management Framework. QTC has provided training and assistance to councils in the use of the tool and framework, and is supported by the Department.¹⁰

Committee comment

The committee is satisfied with the department's approach to raising awareness of good asset management and notes that improvements in this area will require a long-term commitment from councils.

2.2.3 Timeliness and quality of financial statements

The *Local Government Act 2009*, *Local Government Regulation 2012* and *City of Brisbane Act 2010* require councils to provide their financial statements and a current-year financial sustainability

⁶ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, pp 26-27.

⁷ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 28.

⁸ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 38.

⁹ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 72.

¹⁰ Department of Infrastructure, Local Government and Planning, correspondence dated 6 November 2015.

statement to the QAO by a date agreed between a council's Chief Executive Officer and the Auditor-General to enable the QAO to complete their audit by 31 October.

Fifty-two councils met the legislative deadline this year, which is nine more than last year.¹¹ However, the report concluded that there are systemic issues at a number of councils, which reduced their ability to deliver timely financial reporting, and that most local councils did not make financial reporting a priority. A total of 17 councils did not meet the legislative deadline for the second year in a row. Of those, eight councils did not meet the reporting deadline for the last three consecutive years. The report suggested that the trend was likely to continue as there was no legislative consequence for not meeting the deadline.¹²

The common reasons for missing the legislative deadline were asset valuation issues, availability of critical staff and delays in implementing new financial accounting systems.¹³

In relation to quality, in 51 of the 69 audited councils, adjustments were made to financial statements provided to audit. Material adjustments to and errors in financial statements are regularly identified in asset data.

In order to improve quality and timeliness, the QAO stated:

For the first time this year, we have included in our report an assessment of each council's financial governance. This is in the form of a traffic light report which allows comparison to be made against like councils. The assessment covered the timeliness of financial statements, the quality of statements provided to audit, the number of significant control issues raised and our assessment of councils' financial sustainability.¹⁴

...

We also felt it was a good way to shine some light on some of the areas that have not changed over time. You mentioned timeliness and quality, and the volume of internal control issues that we have reported we have been reporting for some time. We felt that having that traffic light report and bringing that front and centre might be a way to encourage some change in that area.¹⁵

The report also highlighted that councils appeared to prioritise reporting where financial implications were attached to deadlines, such as the requirement to submit recovery grant acquittals to the federal government by 31 October 2014. Accordingly, the QAO recommended the department consider introducing incentives or penalties to improve compliance with legislative deadlines.¹⁶

The department advised:

The Department does not support the inclusion of legislative penalties for councils that do not meet the timeframes for the completion of general purpose financial statements. Ultimately, councils are held to account by their community for their performance.¹⁷

The department advised that it would continue to work with councils to strengthen compliance with legislative requirements such as assisting councils that have been consistently late, and in more serious cases, appoint Financial Controllers where councils demonstrate they are not performing properly or complying with Local Government Acts.¹⁸

¹¹ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 42.

¹² QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 40 & 44.

¹³ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 43.

¹⁴ Public briefing transcript, Brisbane, 28 October 2015, p 5.

¹⁵ Public briefing transcript, Brisbane, 28 October 2015, p 6.

¹⁶ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 45-46.

¹⁷ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 73.

¹⁸ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 73.

Further, incentives under the State Government Financial Aid program are provided to Indigenous councils that attain an unqualified audit result. The program involves those councils receiving half-yearly payment in advance rather than quarterly to assist with cashflow management.¹⁹

The department further advised the committee that factors beyond the control of councils may arise and inhibit the ability to meet required timeframes. Additionally, extension of time requests for sign-off on audits would only be granted in extraordinary circumstances.²⁰

Committee comment

The committee acknowledges that timely and accurate financial reporting is of utmost importance and that, ultimately, councils are accountable to their communities. The committee supports the continued use of the ‘traffic light’ model as a method of highlighting the issues and achievements in relation to timeliness and quality of financial statements.

The committee also notes that the appointment of audit committees assists with the timely completion of financial statements. It has been a requirement for all local governments to have an audit committee from 1 July 2014.

While it is too soon to draw any firm conclusions on the impacts associated with these changes, the committee notes that the QAO is hopeful that they will contribute to positive change.

The committee will re-examine these issues following the QAO’s next report to Parliament.

2.2.4 Internal control frameworks

Internal controls include systems, policies and activities established by councils to ensure effectiveness and efficiency in their operations, reliability of financial reporting and compliance with legislation. The QAO assesses internal control frameworks as part of the financial audit and any issues raised with management. These issues are generally linked with the timeliness and quality of financial statements.

During 2013–14, the QAO reported 565 significant control weaknesses to management. While this is a reduction on last year’s number, there were still nine unfinished audits at the time the report was completed. Therefore, the QAO expected the results to be similar to last year. Most issues identified related to weaknesses in control activities — procedures established to protect assets, ensure reliable accounting records, promote efficiency and encourage adherence to the organisation’s policies.²¹

These types of issues are highlighted in the QAO’s ‘traffic light’ model as part of its audit.

2.2.5 Financial sustainability

Councils are required to prepare a current-year financial sustainability statement to be audited. The statement includes three measures of financial sustainability:

1. Operating surplus ratio – the extent to which operating revenues raised covered operating expenses.
2. Net financial liabilities ratio – the extent to which a council’s operating revenues can service its net liabilities while maintaining its assets and community service levels.
3. Asset sustainability ratio – asset sustainability approximates the extent to which a council is replacing its assets as these assets reach the end of their useful lives. The ratio indicates the

¹⁹ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 73.

²⁰ Department of Infrastructure, Local Government and Planning, correspondence dated 6 November 2015.

²¹ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, pp 49-51.

extent of spending on existing assets through renewal, restoration and replacement compared with depreciation expense.

The Auditor-General provides an opinion on whether the statement has been calculated correctly. The Auditor-General does not provide an opinion about the appropriateness of the ratios or the council's future sustainability.

The key findings included:

- For 2013–14, one out of the 66 continuing councils audited to date spent more than they earned. Of these, 24 also reported operating deficits in 2012–13.
- Only 27 of 69 councils achieved an average operating surplus (that is, above zero); 16 of these were rural/remote and resources councils. This disproportionate result is primarily attributed to the lucrative sales revenue generated from the Department of Transport and Main Roads for repairing damaged state-owned road infrastructure in regional areas.
- The deterioration in average operating surplus ratios from 2012–13 results from changes in federal government funding time frames and councils' reclassification of operating and capital grants following improved understanding of departmental guideline definitions.
- Councils continued to misinterpret the asset renewal definition—usually resulting in asset upgrades being misclassified as renewals or renewals being misclassified as repairs and maintenance expense.
- South-east Queensland and coastal councils have less infrastructure asset value per person compared to other segments.²²

As stated above, the report identified that a number of councils continued to experience delays in finalising supporting documentation for calculating the asset sustainability ratio due to a misinterpretation of the asset renewal definition. The report suggested that the department could provide more descriptive guidance to alleviate such difficulties.²³

Accordingly, the QAO recommended that the Department of Infrastructure, Local Government and Planning provides descriptive guidance on how to calculate renewals for the asset sustainability ratio and that the guidance include examples from council experience as well as advice on how to distinguish between capital and operating grants.

The department advised:

Advice on how to distinguish between capital and operating grants and practical examples on calculating the asset sustainability ratio were included in the Tropical Council Illustrative Financial Statements for 2014-15. Six one-day workshops on the Illustrative Statements were held around the state, attended by 176 local government finance officers from 69 councils. The workshops included guidance and practical examples on calculating the asset sustainability ratio.²⁴

Recommendation 1

The committee recommends the Legislative Assembly notes the contents of this report.

²² QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 57.

²³ QAO Report to Parliament 16 for 2014-15 – Local government entities 2013-14, p 64.

²⁴ Department of Infrastructure, Local Government and Planning, correspondence dated 6 November 2015.

Appendix – Correspondence received from the Department of Infrastructure, Local Government and Planning



Department of Infrastructure,
Local Government and Planning

Our ref: DGC15/1382

Your ref: 11.9C

6 NOV 2015

Mr Jim Pearce MP
Chair
Infrastructure, Planning and Natural Resources Committee
Parliament House
George Street
BRISBANE QLD 4000

Dear Mr Pearce

Thank you for your letter of 29 October 2015 about the implementation of the Auditor-General's recommendations as set out in his Reports 16 and 19 to Parliament.

Over the past six months the Department of Infrastructure, Local Government and Planning (the Department) has been active in a number of initiatives and actions to implement the Auditor-General's recommendations. A summary of these actions is as follows.

Report 16: 2014-15 Results of audit: Local government entities 2013-14.

Recommendation 1: The Department of Infrastructure, Local Government and Planning assists councils in improving asset management practices.

- The Department is currently conducting a number of sessions around the state for candidates intending to contest the 2016 local government elections. These sessions highlight the roles and responsibilities of councillors including the obligations of councillors to ensure that local government and community assets are managed sustainably.
- After the 2016 local government elections, the Department will conduct councillor induction training, which will include training in the importance of asset management.
- In the 2014-15 year, the Department held six one-day workshops around the state, attended by 176 local government finance officers from 69 councils. These workshops included content and discussion on asset management practices and management.
- Queensland Treasury Corporation (QTC) released its Whole of Life Costing Tool and Project Management Framework. QTC has provided training and assistance to councils in the use of the tool and framework, and is supported by the Department.

Level 12, Executive Building
100 George Street Brisbane
PO Box 15009 City East
Queensland 4002 Australia
Telephone +61 7 3452 7009
Website www.dilgp.qld.gov.au
ABN 251 66 523 889

Recommendation 2: The Department of Infrastructure, Local Government and Planning considers introducing measures (such as incentives and/or penalties) that would improve councils' compliance with their legislative financial reporting deadlines.

- As indicated in the Department's response to this recommendation, the introduction of penalties for councils that do not meet statutory timeframes is not supported. It is acknowledged that factors beyond the control of councils may arise and inhibit the ability to meet planned or required timeframes.
- For the 2014-15 financial reporting period, the Department is actively working with councils that continue to exceed legislative deadlines. This action includes holding these councils to account and ensuring that extension of time requests for sign-off on the audit of 2014-15 general purpose financial statements or adoption of the annual report are only granted in extraordinary circumstances.

Recommendation 3: The Department of Infrastructure, Local Government and Planning provides descriptive guidance on how to calculate renewals for the asset sustainability ratio. This guidance should include examples from council experience as well as advice on how to distinguish between capital and operating grants.

- Advice on how to distinguish between capital and operating grants and practical examples on calculating the asset sustainability ratio were included in the Tropical Council Illustrative Financial Statements for 2014-15. Six one-day workshops on the Illustrative Statements were held around the state, attended by 176 local government finance officers from 69 councils. The workshops included guidance and practical examples on calculating the asset sustainability ratio.

Report 19 2014-15: Fraud Management in Local Government.

Recommendation 1: The Department of Infrastructure, Local Government and Planning pursues amendment of the Local Government Regulation 2012 and the City of Brisbane Regulation 2012 to require loss as a result of fraud to be a reportable loss to the Auditor-General and to the Minister responsible for local government; and councils to keep written records of alleged and proven losses arising from fraud.

- Regulatory changes to implement this recommendation commenced on 16 October 2015.
- All local governments must now report fraud related losses to the Auditor-General and the Minister for Local Government within six months of the loss occurring and in accordance with the following thresholds:
 - for Brisbane City Council reporting thresholds are set at \$500 for cash and \$5,000 for other property, in line with the same thresholds for State Government Departments under the *Financial and Performance Management Standard 2009*
 - for all other local governments, reporting thresholds are set at \$500 for cash and \$1,000 for other property, given the majority of frauds will involve amounts less than \$5,000.
- In addition, under the provisions of the *City of Brisbane Regulation 2012* and the *Local Government Regulation 2012*, all local governments are now required to keep written records of alleged and proven losses of fraud, which must include:
 - a description of the asset and its value
 - the cause of the loss
 - action taken to deal with the loss
 - approval for writing off the loss if applicable.

Recommendation 2: All councils assess themselves against findings in this report as a priority and, where needed, develop, revise or update their policies and procedures for fraud and corruption management; fraud and corruption control plans; fraud risk assessments; and data analytics capability for fraud detection.

- This recommendation is for local governments to implement and the Department will monitor progress and compliance with new reporting requirements.
- On 19 August 2015, the Honourable Jackie Trad MP, Deputy Premier, Minister for Transport, Minister for Infrastructure, Local Government and Planning and Minister for Trade, wrote to each mayor requesting that the Auditor-General's recommendations be implemented without delay.
- On the same date, I also wrote to each local government's chief executive officer requesting the same.
- In addition, I have notified each local government that I will be seeking a progress report in relation to the implementation of these recommendations by August 2016.

If you require further information, I encourage you to contact Mr Gary Kleidon, Acting Director, Finance and Funding, Local Government and Regional Services in the Department on 3452 6760 or by email at gary.kleidon@dilgp.qld.gov.au.

Yours sincerely



Stephen Johnston
Acting Director-General

