Auditor-General of Queensland

Executive Summary

Report to Parliament No. 2 for 2008

Results of 2006-07 Audits of Local Governments, including Aboriginal Shire and Torres Strait Island Councils

1. Executive Summary

1.1 Auditor-General's overview

This report is my second report to Parliament for 2008. It deals specifically with the results of the audits of local governments including Aboriginal Shire and Torres Strait Island councils for the 2006-07 financial year which were completed and certified by audit at the date of this report.

The *Local Government (Community Government Areas) Act 2004* brought Aboriginal councils under the *Local Government Act 1993*. These councils are no longer differentiated from shire councils under the Local Government Act. Because of their transition to accrual accounting and reporting in line with local governments and the changes resulting from the local government reform process, I have included the audit results of both the Aboriginal Shire and Torres Strait Island councils with the results from other local governments in this report.

2006-07 audit results

My 2006-07 audits of local governments, Aboriginal Shire and Torres Strait Island councils revealed that significant improvements continue to be required in the systems and processes used by councils and management in the achievement of their objectives.

Uncertainty about the continued financial viability of local governments was an issue which contributed to the Government's decision to implement a reform process. Sustainability of local governments is inextricably linked to the existence of effective control processes and I am concerned that the issues identified from the 2006-07 audits may carry over into the councils which have been created through the amalgamation of two or more councils.

Within the local government sector, the majority of high risk audit issues raised by my auditors with the councils concerned the value of non-current assets. Councils own significant infrastructure assets such as road networks, water supply and sewerage facilities, major plant and equipment, and buildings. Five local government audits for 2006-07 were qualified (refer Section 2.4.1) because the way certain non-current assets included in their financial statements were valued did not comply with the requirements of the Australian Accounting Standards. In these circumstances the valuations were considered to be unreliable and the overall effect on the financial statements

could not be quantified.

The 2006-07 audit findings indicate the continued problems which local governments have with the development and maintenance of quality systems for the financial management of these assets. Planned and effective long term service and infrastructure levels based on accurate and complete accounting records and asset management practices contribute to a council's financial sustainability by minimising the need for large rate and charges increases to fund unscheduled replacements or renewals of assets.

While financial statements for only 18 of the 37 Aboriginal Shire and Torres Strait Island councils and associated entities have been finalised to date, on average, seven moderate to high risk audit issues have been raised for each of these 18 entities. The audit issues result from the use of poor systems or processes to manage and control transactions associated with expenditure, revenue, inventories and assets. This number is significant and shows that there has been little improvement in financial management over the past 12 months, despite ongoing initiatives by the Department of Local Government, Sport and Recreation (DLGSR) including the appointment of financial controllers at eight councils. This is discussed further in Section 2.3.2.

At four Aboriginal Shire councils and four Torres Strait Island councils, financial controllers have been appointed to assist the councils to monitor the financial operations and budget as well as to establish systems of internal controls and to address issues raised by my auditors (Section 4.3.3). In my opinion, these financial controllers could add further value to the councils by facilitating the financial statement preparation process and ensuring the quality of the draft financial statements prior to these statements being presented to my auditors. Even so, these financial controllers are only a short term solution to these problems and there needs to be a strategy to develop skills within or associated with the councils to enable the competent management of these functions.

The ongoing use of consultants or contractors to carry out accounting functions and prepare financial statements in local governments and in Aboriginal Shire and Torres Strait Island councils has been an issue included in a number of previous reports to Parliament (Section 3.1.2). While I acknowledge that qualified accounting staff are difficult to attract and retain, particularly in regional and remote areas, councils need to have strategies in place to ensure that capacity is being built within or is readily available to

councils. This may involve the consideration of alternatives such as shared service arrangements between a number of councils.

At the date of this report, financial statements for 2006-07 had not been finalised and auditor's opinions issued for eight local government entities, ten Aboriginal Shire council entities and nine Torres Strait Island council entities. Financial statements for two entities were still outstanding for 2005-06. The late completion of financial statements indicates poor accountability as well as potentially poor financial control. Timeliness of financial statements is discussed further in Section 2.5.

Financial statements for abolished councils

I hold some concern about the capacity for the financial reporting responsibilities of the recently abolished local governments for the period from 1 July 2007 to 14 March 2008 to be addressed. I have received reports of reduced staffing resources occurring at some councils prior to the amalgamations. During this period staff were focused on transitional processes with less attention being paid to the normal day-to-day governance practices and reporting requirements. Notwithstanding the closure of the councils on 14 March 2008, the normal accounting and auditing standards continued to apply to the abolished councils and financial statements supported by good quality working papers will be expected to be available to the external auditors. I may be left with no option but to issue a qualified auditor's opinion if my auditors are unable to obtain sufficient and appropriate audit evidence to support the financial statements presented for audit (Section 4.2.1).

For their 2007-08 financial statements, nine Torres Strait Island councils and five Aboriginal Shire councils are required to change from the modified cash basis of reporting to accrual reporting. Ten of these councils have been amalgamated and this represents a significant change in reporting responsibilities for the financial reporting period for the councils (Section 4.3.1).

Key areas warranting attention by the newly created councils

The 2006-07 audits have highlighted a number of key areas warranting attention by the newly created councils.

These include:

- the alignment of accounting and financial policies across the operations of the new council

- the consolidation of information systems and implementation of robust internal and external reporting practices
- the recruitment and selection of key financial accounting and asset accounting staff to provide the capacity for sound financial management practices
- the training and development of key financial management staff
- the revaluation of non-current assets brought over from the abolished councils at carrying value and the establishment of reliable opening balances for the new council's assets and liabilities
- the consideration of the continued operation of existing enterprise or commercial activities.

Timely finalisation is required of the proposed performance evaluation and reporting approval process for the councils by the DLGSR. These areas are discussed in more detail in Section 4 of this report.

While there are 12 Aboriginal Shire councils and 24 other councils not affected by the reform process, the principles of good financial management and the development and use of quality systems should also be addressed by them.

I recognise the significant efforts of the Department in the reform process to date. However, now that the amalgamated councils are in place, there remains a critical number of issues to be addressed by both the individual local governments and the Department in its legislative role.

I will continue monitoring the reform implementation and will provide the Parliament with further updates particularly on the results of the audits of the abolished councils throughout 2008.

Better practice for achieving successful amalgamations

Recently the New South Wales Audit Office (NSWAO) tabled a report titled *Managing departmental amalgamations: Department of Commerce and Department of Primary Industries*. This report was accompanied by a *Better Practice Guide: Implementing Successful Amalgamations*.

While dealing with departmental amalgamations, the better practice guide outlines four phases of an amalgamation and some key questions which I believe are relevant for councils to consider when planning, implementing and determining

the success of the amalgamation process. With the permission of the NSWAO, I have reprinted these principles in Appendix 6.1.

These principles should be considered in conjunction with other better practice documents available to assist in achieving successful amalgamations such as the Local Government Managers Australia Queensland Inc.'s *Management of Change Toolkit*.

Effect of the changes to local governments on audit

Appendix 6.2 shows the local government areas as they existed for the period covered by this report before amalgamation.

For the 2007-08 financial year, I am required to complete the audits of the financial statements of the abolished councils for the period 1 July 2007 to 14 March 2008. The first financial reporting period for the newly created regional councils will be from 15 March 2008 to 30 June 2009. In the short term, the local government reform process will impact on the timing of when the final audits of the amalgamating councils will be undertaken.

To assist the newly created local governments, I have ensured that the auditor for the new council is also the auditor for the associated merging local governments. This will preserve audit knowledge and facilitate value-added advice during the transition process.

QAO staff will undertake the audits of the Torres Strait Island and Northern Peninsular Area regional councils in 2007-08 with a first audit visit scheduled in September 2008. The initial visit will include an assessment of the governance, control environment and accounting practices and procedures adopted and implemented by the new councils. These audit assessments will provide the new councils with an early opportunity to consider an independent assessment of the effectiveness of the internal control and accounting environment.

Further audit activity

In the coming months, I intend to conduct a performance management systems audit which will cover the framework and systems used by local governments to administer the various grants and funding they provide to local businesses and organisations.

While the final scope and coverage of the audit is currently being finalised, it will include examining whether systems

and frameworks are in place for the planning, resourcing and monitoring of grants and funding.

Specific aspects which may be included are:

- Is the governance framework for administering grants and funding consistent with the council's corporate plan, operational plan and revenue policy?
- Are appropriate systems and processes in place for measuring the performance and evaluating the administration of grants and funding?
- Is the reporting of grants consistent with sound public administration?
- Are regular monitoring and management reporting in place to assess the costs and benefits of services delivered under discretionary funding?

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