Parliamentary Committees

Consideration of the Auditor-General's Report 17 for 2015-16: Results of audit – local government entities 2014-15

Report No. 33, 55th Parliament

Infrastructure, Planning and Natural Resources Committee

September 2016

Infrastructure, Planning and Natural Resources Committee

Chair	Mr Jim Pearce MP, Member for Mirani
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Staff	Dr Jacqueline Dewar, Research Director
	Ms Margaret Telford, Principal Research Officer
	Ms Mary Westcott, Principal Research Officer
	Ms Marion O'Connor, Acting Executive Assistant
	Ms Carla Campillo, 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

Acknowledgements

The committee thanks the Queensland Audit Office for their assistance with this inquiry.

Contents

Chair's foreword

This report presents the committee's consideration of the Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*.

On behalf of the committee, I thank the Queensland Audit Office for its report and for briefing the committee.

I commend the report to the House.

Jim Pearce MP
Chair

September 2016

Abbreviations

AASB	Australian Accounting Standards Board
DILGP	Department of Infrastructure, Local Government and Planning
QAO	Queensland Audit Office
POQA	*Parliament of Queensland Act 2001*

Recommendation

Recommendation 1

The committee recommends the House notes the contents of this report.

1 Introduction

1.1 Role of the committee

The Infrastructure, Planning and Natural Resources Committee (the committee) is a portfolio committee established by the *Parliament of Queensland Act 2001* (POQA) and the Standing Orders of the Legislative Assembly on 27 March 2015.[1] It consists of government and non-government members.

The committee's areas of portfolio responsibility are:

1. Infrastructure, Local Government and Planning and Trade and Investment
2. State Development and Natural Resources and Mines
3. Housing and Public Works.[2]

1.2 Role of the Auditor-General and Queensland Audit Office

The Auditor-General is an independent statutory officer appointed by the Governor in Council under the *Auditor-General Act 2009.* The Auditor-General is supported by the Queensland Audit Office.[3]

The Auditor-General undertakes both financial audits and performance audits of public sector entities. Financial audits provide an opinion 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.[4] The Auditor-General must report to the Legislative Assembly on each audit conducted of a public sector entity.[5]

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 that the Committee of the Legislative Assembly 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 24 May 2016, the Auditor-General's *Report 17 for 2015-16: Results of audit - local government entities 2014-15* (Auditor-General's report) was tabled in the Legislative Assembly and referred to the committee for consideration.[6]

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.[7]

The committee held a public briefing on 31 August 2016 at which the Queensland Audit Office briefed the committee on the Auditor-General's report.

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1 *Parliament of Queensland Act 2001*, s 88 and Standing Order 194.

2 Schedule 6 of the *Standing Rules and Orders of the Legislative Assembly*, effective from 31 August 2004 (amended 16 February 2016).

3 *Auditor-General Act 2009*, ss 6, 9.

4 Queensland Audit Office, 'Our business' (accessed 9 May 2016); *Auditor-General Act 2009*, ss 30, 37A.

5 *Auditor-General Act 2009*, s 60.

6 Queensland Parliament, Record of Proceedings, 24 May 2016, pp 1895, 1978.

7 *Parliament of Queensland Act 2001*, s 92(3). See also *Parliament of Queensland Act 2001*, s 79.

2 Auditor-General's Report 17 for 2015-16: Results of audit – local government entities 2014-15

2.1 Financial audits of local governments

The Queensland Auditor-General audits the financial statements of local governments and related entities each year. The audit opinion is qualified when part or all of the financial statement does not comply with legislative requirements and/or Australian accounting standards.[8]

For the 2014-15 financial statements, the Auditor-General reported that he issued:

- 140 unmodified audit opinions
- ten qualified audit opinions – four for councils and six for local government entities.[9]

The number of qualified audit opinions was consistent with the prior year.[10]

At the time the Auditor-General reported, four councils and one related entity had not finalised their 30 June 3015 financial statements.[11]

2.2 Significant financial reporting issues

The Auditor-General's report highlighted issues relating to 'asset management planning, and weaknesses in disclosure of council business activities and related parties.'[12]

2.2.1 Asset management planning

Each local government is required to prepare and adopt a long-term asset management plan.[13] A long-term asset management plan enables councils to understand 'what the long-term gain is and the optimal either replacement or renewal strategies for [council's] assets'.[14]

Despite the requirement to prepare and adopt a long-term asset management plan, 'only 37 per cent of councils were considered to have up-to-date asset management plans', which is 'significantly less than the 60 per cent of councils' that had them at 30 June 2014.[15] The QAO provided its view of the reason for the decline:

> *I think the numbers are sliding primarily because a number of councils see asset management plans as a compliance cost rather than some sort of value to their organisation, a business benefit, if you like, down the track.*[16]

The QAO is of the view that asset management plans provide a benefit in the long term:

> *The payoff is when they can actually sit back and say, 'By doing this plan we actually worked out we were replacing our roads too regularly and we actually saved a lot of money from this and we were able to invest that into different aspects that the community was after.'*[17]

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8 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 13.
9 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 15.
10 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 13.
11 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 13.
12 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 22.
13 *Local Government Regulation 2012*, s 167.
14 Public briefing transcript, Brisbane, 31 August 2016, p 6.
15 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 22.
16 Public briefing transcript, Brisbane, 31 August 2016, p 6.
17 Public briefing transcript, Brisbane, 31 August 2016, p 6.

The Director-General of the Department of Infrastructure, Local Government and Planning (DILGP) supported the Auditor-General's recommendation that councils give greater prioritisation to the preparation and update of long-term asset management plans that link to their long-term financial forecasts.[18]

The QAO advised that it is currently 'doing a performance audit on long-term sustainability in local government'[19] which it expects 'may give a bit more information around the sustainability and the asset management aspects'.[20]

2.2.2 Business activities of local governments

Some councils create separate entities to undertake business activities, such as providing recreation services for the community and operating cafes.[21] These business activities must be included in the council's annual report.[22]

The Auditor-General reported that a review of the 63 local government annual reports available at 31 January 2016 showed that 47 local government (75 per cent) did not provide a clear list of all the business activities they conduct.[23] As regards the reason why so many councils did not provide a clear list, the QAO advised:

> *… the legislation is a bit misunderstood or a bit confused by councils. That seems to be leading to a mismatch of what is reported. We audit the annual statements, not the audit report, and there are some things around reporting in annual reports. What represents a significant business activity is rather complex, what is just a general activity and then what should be disclosed. We found a lot of confusion with councils around what they should be doing and how they should be doing it. There are so many business activities that they run—the theatres, road contracting businesses, water services, recycling, sporting complexes, gymnasiums, shops, cafes, whatever it is. There are a lot of different businesses, and how they are disclosed and the information around that is not flowing through to the annual report. More importantly, it is probably not flowing through—and we make the point here—in terms of the quality of the internal management reporting that is coming through to the councils themselves.*[24]

The Auditor-General gave the following explanation for why local governments should be better monitoring their business activities:

> *With long-term financial sustainability being one of the biggest issues affecting the local government sector, monitoring how these business activities are operating and performing should be a high priority – from the council's perspective in terms of sustainability, and from the local community's perspective in terms of value for their rates paid.*[25]

The Director-General of the DILGP supported the Auditor-General's recommendation that councils make publicly available, through tabling in council, the financial statements of their controlled entities.[26]

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18 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, pp 32, 65.

19 Public briefing transcript, Brisbane, 31 August 2016, p 6.

20 Public briefing transcript, Brisbane, 31 August 2016, p 6.

21 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 26.

22 *Local Government Act 2009,* s 45.

23 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 26.

24 Public briefing transcript, Brisbane, 31 August 2016, pp 6-7.

25 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 27.

26 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, pp 32, 65.

2.2.3 Related party disclosures

In 2015, the Australian Accounting Standards Board (AASB) expanded the scope of AASB 124 *Related Party Disclosures* to include not-for-profit public sector entities from 1 July 2016.[27] This means that councils' financial statements will need to include

> *… all material transactions and outstanding balances between a council and its related parties. Separate disclosures on the nature of the related party relationship as well as information about the terms and conditions of those transactions and balances is required to enable users to understand the potential effect of the relationship on the financial statements. The total remuneration paid to* [key management personnel] *must also be disclosed.*[28]

The Director-General of the DILGP supported the Auditor-General's recommendation that councils act now to ensure they have the necessary information to support their 2016-17 financial statement related party disclosures by:

- developing formal policies and procedures to ensure that related party information is gathered for financial reporting purposes
- updating related party information on at least a six monthly basis, with the last update at 30 June
- consolidating the information for disclosure purposes and for consideration of materiality.[29]

2.3 Timeliness and quality of financial statements

The Auditor-General holds the view that timely and accurate financial reporting 'is essential for effectiveness in decision-making, management of public funds and the delivery of public accountability.'[30]

In 2014-15, 86 per cent of councils met the 31 October financial reporting deadline. This, the Auditor-General reported 'is the best result in the history of local government financial reporting in Queensland.'[31]

With respect to Indigenous councils, the QAO stated:

> *… a couple of the ones that have kept turning up in more recent years as having missed deadlines are some of the Indigenous councils, yet the council that has had their financial statement signed first and generally has very few problems is an Indigenous council. They have been the first signed for four years. I guess it comes back to leadership and governance within those organisations and prioritisation set by those councils. I mentioned the controlled environment before and called it the tone from the top. It is really what you find as important and what you drive through that organisation. Obviously, one particular council has focused on the internal controls and the governance and the outcome of that is that they have a very efficient and well run financial reporting process.*[32]

2.4 Internal control frameworks

Internal controls 'include the systems, policies and activities established by local governments … to ensure the effectiveness and efficiency of their operations, reliability of financial reporting and

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[27] Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 28.
[28] Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 28.
[29] Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, pp 32, 65.
[30] Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 33.
[31] Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 33.
[32] Public briefing transcript, Brisbane, 31 August 2016, p 5.

compliance with applicable legislation.'[33] The Auditor-General commented in his report that he is reporting on the same issues and weaknesses in controls each year.[34] This was reiterated at the public briefing:

> *Over a number of years we have raised a lot of issues around the internal control frameworks of councils and it does go to the heart of how councils manage their business, that governance aspect. Controls protect you against fraud, they protect you against error, and it is just good governance to have a strong internal control framework.*[35]

Most of the issues identified by the Auditor-General relate to 'weaknesses in property, plant and equipment …, expenditure, and financial reporting'.[36]

The Auditor-General's report noted the direct correlation between the number of significant control issues reported and councils' timeliness in completing their financial statements,[37] as well as correlations between significant issues raised and the stability of senior management and the effectiveness of audit committees.[38]

Indigenous and resource councils account for 62 per cent of all significant control weaknesses identified, which was up from 45 per cent in 2013-14.[39]

Thirty-one per cent of issues raised in 2014-15 remained unresolved from 2013-14.[40] The QAO elaborated:

> *The concerning point for us … is that 31 per cent of the issues we raised in the previous year we have had to raise again in this year, and that is a trend that we have seen continue over a number of years. Whilst we are making recommendations to various councils, 31 per cent of the time councils have either not taken effective action or potentially have not taken any action at all to address some of these shortcomings. The ones we have in the report are what we call significant deficiencies, so it is not just the minor sort of things; they are controls of a bigger nature that we think can have a big impact on the organisation. By not having these particular aspects of the business controlled you will leave yourself exposed to problems of any nature.*[41]

For the second year, the report included an assessment of each council's financial governance in the form of a traffic light rating which allows a comparison to be made between like councils.[42]

> *In this report on page 92 we identify the criteria for controls. We gave a red traffic light if you had greater than five significant deficiencies or at least one of the really highest deficiencies, which we called a material deficiency. That seems like a fairly lenient aspect if you need five things to get a red light. This year we have set up with our councils that we will be bringing that in to two or three to get that red traffic light, and over time we will keep trying to improve public sector performance through tightening those and at least getting councils to stretch their performance in that area. We think in combination with the traffic lights and also a good audit committee it can be very effective in trying to change that dynamic of inaction.*[43]
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> …

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33 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 39.
34 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 39.
35 Queensland Audit Office, public briefing transcript, Brisbane, 31 August 2016, p 3.
36 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 42.
37 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 41.
38 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 42.
39 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 41.
40 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 42.
41 Public briefing transcript, Brisbane, 31 August 2016, p 3.
42 Public briefing transcript, Brisbane, 31 August 2016, p 1.
43 Public briefing transcript, Brisbane, 31 August 2016, p 4.

> *Our aim over time is to tighten the criteria that we use in terms of our red, amber and green traffic lights to keep focusing and keep driving improvements from the various councils in those areas.*[44]

As regards the consequences of a council being awarded a red light, the QAO explained:

> *At the moment it is purely just included in our report, so it becomes public through our reporting process to parliament. There is no other consequence than that, but we have seen that councils genuinely do not want that outcome. Whether it is competition against your peers—because we classify councils within their peer groups in the back of the report, so South-East Queensland councils are grouped together, Indigenous councils, the coastal councils, councils—we call them resource councils—in mining communities. There is probably some competition there about what you want to achieve against your peer group, but it is also just primarily not having a red mark against your name in an auditor-general's report.*[45]

The report noted that effectively operating audit committees are recognised as a key element of good governance.[46] The QAO outlined why it considers audit committees to be important:

> [It] *is because it is about holding the organisation to account around some of these things like internal controls. Where the audit has raised the issue it is up to the management of the organisation—the council itself—to do something about that, and an audit committee is potentially a way to hold the individuals or the organisations to account or keep focus on those areas throughout the year. Even if they only meet a couple of them two or four times a year, depending on the council it is enough to keep them focused on these issues and keeps management addressing the issues to get a satisfactory outcome.*[47]

The QAO acknowledged that it may be difficult for some councils to recruit suitably qualified people to be on the audit committee but advised that there are ways that it can be done.

> *I know that in regional areas it is difficult to get people to small communities and people from within those communities. Some councils have decided to share across boundaries, so maybe take a chief financial officer from one council and put them on the audit committee of another council and they have some knowledge transfer. It is about getting different ideas as well to try and open minds to better ways of doing things. I know, for example … of one large council that invited a smaller council to come and sit there and see how their audit committee operated so they could come and just be an observer and then take that back to their community and try and roll out something better for their size, but with an understanding of how the mechanism of an audit committee was supposed to work.*
>
> *…*
>
> *… the Local Government Association of Queensland has a panel of people that can be tapped into if councils thought that was appropriate. I believe they have also offered their facilities to dial in if that was an appropriate mechanism to get the right people to join the committee rather than just a person to join the committee. We have seen in some of the Indigenous councils and some of the ones up north they have tapped into quite a range of different skill sets that you can see are gradually improving those organisations and just providing a bit more comfort to the councillors to be able to be happy with some of the decisions they are making or that extra person.*[48]

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44 Public briefing transcript, Brisbane, 31 August 2016, p 3.

45 Public briefing transcript, Brisbane, 31 August 2016, p 5.

46 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 47.

47 Public briefing transcript, Brisbane, 31 August 2016, p 3.

48 Public briefing transcript, Brisbane, 31 August 2016, p 4.

As some councils would have the option whether to have an audit committee from 1 July 2016, the Auditor-General recommended that the DILGP mandates audit committee for all councils.[49] The Director-General of DILGP stated that this would require amendment to the *Local Government Act 2009* and that he intends to consider the matter further, including ascertaining the views of the Local Government Association of Queensland.[50]

2.5 Financial sustainability

The Auditor-General's analysis of local government sustainability indicated an overall improvement in risk assessments in comparison to the previous financial year.[51] Thirty-six of the 69 non-de-amalgamated councils that were audited had a negative five year average operating surplus ratio.[52] Apart from Hope Vale Aboriginal Shire Council, Indigenous councils continued to achieve the worst results over the longer term.[53]

Of the four newly de-amalgamated councils, Noosa and Mareeba Shire Councils achieved operating surpluses in 2015, while Douglas and Livingstone Shire Councils had operating deficits.[54] Livingstone Shire Council is projecting to break even or make a surplus in the next three years whereas Douglas Shire Council is not expecting to do so.[55]

Committee comment

In the committee's report on *Auditor-General's Report 16 for 2014-15: Results of audit – local government entities 2013-14*, we noted that we would re-examine the issues relating to the timeliness and quality of financial statements in our report this year. We are pleased to see that, amongst other things, the use of the 'traffic light' model and the appointment of audit committees has resulted in timely reporting for many councils.

We do, however, have concerns about matters raised in the Auditor-General's report relating to continuing internal control weaknesses, poor long-term asset management planning, and limited reporting of councils' business entities.

We are concerned about the necessity for the Auditor-General to repeatedly report on weaknesses in councils' internal control frameworks. We support the QAO's efforts to improve councils' performance, such as tightening the traffic light rating system, because of the benefits it will result in for councils in running their operations. We note the QAO's advice that audit committees can assist councils in achieving good governance but that audit committees are no longer mandatory for some councils. We also note that the Director-General of DILGP proposes to further consider the Auditor-General's recommendation concerning audit committees. We will re-examine this issue following the Auditor-General's next report on local government entities.

We are also concerned about the insufficient long-term asset management planning undertaken by many councils. We are of the view that better asset management will ultimately benefit ratepayers as assets will be repaired or replaced at the most appropriate times.

At present, we consider that there is insufficient disclosure of the financial statements of council's controlled entities. We are of the view that greater transparency will assist councils to make better decisions regarding these entities which would result in better services for ratepayers.

We note that the Director-General of the DILGP supports the Auditor-General's recommendations regarding asset management, controlled entities' financial statements, and related party disclosures.

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49 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 48.

50 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 65.

51 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 52.

52 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, pp 49, 53.

53 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 53.

54 Auditor-General's *Report 17 for 2015-16: Results of audit – local government entities 2014-15*, p 49.

55 Public briefing transcript, Brisbane, 31 August 2016, pp 7-8.

We will re-examine these issues following the Auditor-General's next report on local government entities.

Recommendation 1

The committee recommends the House notes the contents of this report.