



## **AGENDA**

### **AUDIT COMMITTEE MEETING**

**TO BE HELD ON**

**TUESDAY, 8 MAY 2018**

**5.30<sup>PM</sup>**

**SHIRE COUNCIL CHAMBERS**



## Terms of Reference

### Objectives of Audit Committees

The primary objective of the audit committee is to accept responsibility for the annual external audit and liaise with the local government's auditor so that Council can be satisfied with the performance of the local government in managing its financial affairs.

Reports from the committee will assist Council in discharging its legislative responsibilities of controlling the local government's affairs, determining the local government's policies and overseeing the allocation of the local government's finances and resources. The committee will ensure openness in the local government's financial reporting and will liaise with the CEO to ensure the effective and efficient management of the local government's financial accounting systems and compliance with legislation.

The committee is to facilitate –

- the enhancement of the credibility and objectivity of internal and external financial reporting;
- effective management of financial and other risks and the protection of Council assets;
- compliance with laws and regulations as well as use of best practice guidelines relative to audit, risk management, internal control and legislative compliance;
- liaise with the Office of the Auditor General and the appointed auditor in all matters pertaining to the annual audit as required and forward any recommendations arising to council for their resolution; and
- the provision of an effective means of communication between the external auditor, the CEO and the Council.

### Powers of the Audit Committee

The Audit committee is to report to Council and provide appropriate advice and recommendations on matters relevant to its term of reference. This is in order to facilitate informed decision-making by Council in relation to the legislative functions and duties of the local government that have not been delegated to the CEO.

The committee is a formally appointed committee of council and is responsible to that body. The committee does not have executive powers or authority to implement actions in areas over which the CEO has legislative responsibility and does not have any delegated financial responsibility. The committee does not have any management functions and cannot involve itself in management processes or procedures.

### Membership

The committee will consist of all elected members of council. All members shall have full voting rights.

The CEO and employees are not members of the committee.

The CEO or his/her nominee is to be available to attend meetings to provide advice and guidance to the committee.

The local government shall provide secretarial and administrative support to the committee.

### Meetings

The committee shall meet at least annually.

Additional meetings shall be convened at the discretion of the presiding person.

## Reporting

Reports and recommendations of each committee meeting shall be presented to the next ordinary meeting of the Council.

The committee shall report annually to the Council summarising its activities during the previous financial year.

## Duties and Responsibilities

The duties and responsibilities of the committee will be -

- a. Provide guidance and assistance to Council as to the carrying out of the functions of the local government in relation to audits;
- b. Meet with the auditor once in each year and provide a report to Council on the matters discussed and outcome of those discussions;
- c. Liaise with the CEO to ensure that the local government does everything in its power to –
  - o assist the auditor to conduct the audit and carry out his or her other duties under the *Local Government Act 1995*; and
  - o ensure that audits are conducted successfully and expeditiously;
- d. Examine the reports of the auditor after receiving a report from the CEO on the matters to –
  - o determine if any matters raised require action to be taken by the local government; and
  - o ensure that appropriate action is taken in respect of those matters;
- e. Review the report prepared by the CEO on any actions taken in respect of any matters raised in the report of the auditor and presenting the report to Council for adoption prior to the end of the next financial year or 6 months after the last report prepared by the auditor is received, whichever is the latest in time;
- f. Review the scope of the audit plan and program and its effectiveness;
- g. Review the local government's draft annual financial report, focusing on –
  - o accounting policies and practices;
  - o changes to accounting policies and practices;
  - o the process used in making significant accounting estimates;
  - o significant adjustments to the financial report (if any) arising from the audit process;
  - o compliance with accounting standards and other reporting requirements; and
  - o significant variances from prior years;
- h. Consider and recommend adoption of the annual financial report to Council. Review any significant changes that may arise subsequent to any such recommendation but before the annual financial report is signed;
- i. Address issues brought to the attention of the committee, including responding to requests from Council for advice that are within the parameters of the committee's terms of reference;
- j. Seek information or obtain expert advice through the CEO on matters of concern within the scope of the committee's terms of reference following authorisation from the Council;
- k. Review the annual Compliance Audit Return and report to the Council the results of that review; and
- l. Consider the CEO's biennial reviews of the appropriateness and effectiveness of the local government's systems and procedures in regard to risk management, internal control and legislative compliance, required to be provided to the committee, and report to the Council the results of those reviews.

**1 Declaration of Opening**

The Shire President to declare the meeting open.

**1.1 Recording of Those Present**

Cr K J Chappel	President
Cr D S Carslake	Deputy President
Cr DS Agar	
Cr J M Coaker	
Cr D B Collins	
Cr K Stokes	
Mr C Linnell	Chief Executive Officer
Mrs J Goodbourn	Executive Manager Corporate & Community Services
Ms E Cuthbert	Economic Development Manager
Mrs S Adams	Executive Assistant to CEO

**1.2 Apologies**

**1.3 Approved Leave of Absence**

**1.4 Welcoming of Visitors to the Meeting**

**1.5 Announcements by the Presiding Member without Discussion**

**2 Declaration of Interest**

Members are to declare financial, proximity and indirect interests.

**3 Confirmation of Minutes of Previous Meetings**

4.1 Audit Committee Meeting – 15 February 2018

**4 Public Statements, Petitions, Presentations and Approved Deputations**

Teleconference with RSM Bird Cameron and the Office of the Auditor General to discuss the proposed Audit Planning memorandum.

**5 Method of Dealing with Agenda Business**

**6 Reports**

**6.1 Report from Executive Manager Corporate & Community Services**

<b>Item No/ Subject:</b>	<b>6.1 Audit Planning Memorandum</b>
<b>Date of Meeting:</b>	<b>8 May 2018</b>
<b>Date &amp; Author:</b>	<b>27 April 2018 – Jenny Goodbourn</b>
<b>Responsible Officer:</b>	<b>Jenny Goodbourn – Executive Manager Corporate &amp; Community Services</b>
<b>Applicant/Proponent:</b>	<b>Jenny Goodbourn</b>
<b>File Number:</b>	<b>FM.AUD.1</b>
<b>Previous minute/s &amp; Reference:</b>	

### **SUMMARY**

The accounts and annual financial statements of a local government for each financial year are required to be audited by an independent auditor appointed by the Auditor General.

### **DECLARATION OF INTEREST**

Nil

### **ATTACHMENTS**

Attachment 1 – 6.1a Draft Audit Planning Memorandum

### **BACKGROUND INFORMATION**

In the past each Local Government appointed an independent auditor for a three year period to carry out the annual audit. With effect from the 2017/2018 financial year the Office of the Auditor General has taken over the audit responsibility for all Local Governments in WA. We were advised by the Auditor General on 13 February that he had approved RSM Bird Cameron to carry out the audit for the year ended 30 June 2018 on his behalf.

### **OFFICER'S COMMENT**

As part of the new audit process the audit committee has to meet with the Auditor and a representative of the Office of the Auditor General to review the Audit Planning Memorandum. The primary purpose of the Audit Planning Memorandum (APM) is to brief the Audit Committee on the proposed approach to the audit of the financial report of the shire.

The APM is a key tool used by the auditor (RSM) to meet their responsibilities in communicating with those charged with governance of the shire.

The APM was discussed at the presentation earlier in the meeting and is now presented for recommendation of adoption by the audit committee.

### **COMMUNITY CONSULTATION**

Nil

### **COUNCILLOR CONSULTATION**

Yes

### **STATUTORY ENVIRONMENT**

Local Government Act 1995

### **POLICY IMPLICATIONS**

Nil

### **FINANCIAL IMPLICATIONS**

Budget allocation

### **STRATEGIC IMPLICATIONS**

Shire of Morawa Strategic Community Plan

4.3 A local government that is respected, professional and accountable.

### **RISK MANAGEMENT**

Establishment of appropriate internal controls and procedures minimises the risk of oversight and loss to the Shire of Morawa.

### **VOTING REQUIREMENTS**

Simple Majority

### **OFFICER'S RECOMMENDATION**

That the Audit Committee resolve to recommend to Council to adopt the Audit Planning Memorandum as presented as part of the annual audit process.

## **7. Closure**

The President to declare the meeting closed

**ASSURANCE & ADVISORY SERVICES**



**SHIRE OF MORAWA**

Audit Planning Memorandum

30 June 2018



**THE POWER OF BEING UNDERSTOOD**  
AUDIT | TAX | CONSULTING



## CONTENTS

1.	PURPOSE OF THE AUDIT PLANNING MEMORANUM .....	2
2.	KEY ENGAGEMENT INFORMATION .....	2
3.	BACKGROUND AND GENERAL INFORMATION.....	3
4.	REPORTING AND DELIVERABLES .....	3
5.	MILESTONE MEETINGS.....	4
6.	TERMS OF ENGAGEMENT.....	4
7.	STAKEHOLDERS RELATIONSHIP .....	5
8.	CURRENT YEAR DEVELOPMENTS.....	7
9.	AUDIT APPROACH TO THE KEY AUDIT AREAS.....	7
10.	HIGH RISK MATERIAL (HRM) BALANCES .....	9
11.	OTHER CRITICAL DISCLOSURES IN THE FINANCIAL REPORT .....	11
12.	CONTROLS.....	11
13.	FRAUD RISK.....	13
14.	OTHER AUDIT MATTERS .....	14
15.	IMPLICATIONS OF ACCOUNTING STANDARDS.....	14
16.	TIMETABLE .....	15
17.	APPENDIX A: SUMMARY CORPORATE STRUCTURE .....	18
18.	APPENDIX B: LOW RISK AREAS .....	19
19.	APPENDIX C: ADDITIONAL INFORMATION CONTACTS.....	23



## 1. PURPOSE OF THE AUDIT PLANNING MEMORANUM

The primary purpose of this Audit Planning Memorandum (APM) is to brief the Audit Committee on our proposed approach to audit the financial report of the Shire of Morawa (the Shire) for the year ending 30 June 2018. This memorandum forms the basis for discussion at the meeting scheduled for 8 May 2018 and is a key tool for discharging our responsibilities in relation to communicating with those charged with governance.

## 2. KEY ENGAGEMENT INFORMATION

### 2.1. Key Shire of Morawa financial report stakeholders

Ratepayers	Shire of Morawa
Minister for Local Government	The Hon. David Templeman MLA
Shire President	Karen Chappel
Chief Executive Officer	Chris Linnell
Executive Manager Corporate & Community Services	Jenny Goodbourn

### 2.2. Key Office of the Auditor General personnel

Auditor General	Caroline Spencer
Director Financial Audit	Subha Gunalan

### 2.3. Key RSM Australia personnel

Director	David Wall
Principal	Travis Bate
Supervisor	Deon Marcus



## 3. BACKGROUND AND GENERAL INFORMATION

### 3.1. Background

The Shire of Morawa is situated in the North Midlands area of Western Australia.

With the construction of a multi million-dollar health centre, excellent education options and first rate sporting facilities Morawa's community services are also thriving. Predominantly an agricultural based Shire, Morawa boasts excellent tourism facilities and attractions (particularly during the Spring wildflower season), a rich history, great business incentives and an active mining industry that has only recently been redeveloped.

In recent years tourism has played an increasingly important role in our Economic Development.

### 3.2. Shire Council and Executives

Please refer to Appendix A for the current Shire Council and Executives.

### 3.3. Governance

The Shire of Morawa is governed by an independent Council. Councillors are elected by the constituents and serve a two or four year term. At the end of this term the councillor's position will be open for re-election. The Council in turn appoints a Chief Executive Officer to advise and provide information to Council in relation to the local government's functions and ensure the resources of the local government are effectively and efficiently managed.

### 3.4. Regulation

In terms of financial reporting, the Shire is subject to the *Local Government Act 1995* (the Act) and the *Local Government (Financial Management) Regulations 1996* (the Regulations)

## 4. REPORTING AND DELIVERABLES

### 4.1. Financial report and audit opinion

The annual statutory financial report will be general purpose financial statements for the financial year ended 30 June 2018, prepared in accordance with the Australian Accounting Standards (as they apply to local governments and not-for-profit entities), other authoritative pronouncements of the Australian Accounting Standards Board and the financial reporting provisions of the *Local Government Act 1995* (the Act) and the *Local Government (Financial Management) Regulations 1996* (the Regulations).

The Auditor General's audit report will be prepared in accordance with the *Local Government Act 1995*, *Local Government (Audit) Regulations 1996* and Australian Auditing Standards and include the audit opinion on the annual financial report.

The auditor's report will be sent to the President and CEO of the Shire and the Minister for Local Government in accordance with the *Local Government Act 1995*. The Shire is required to publish the auditor's report with the annual financial report on its website. If the Auditor General has reported other significant matters, then the Shire is required to report the action it has taken about the matters to the Minister and to publish a copy of that report on its website.

### 4.2. Statutory compliance and audit opinion

The Auditor General is also required to report if her Office becomes aware of any instance where the Shire did not comply with the requirements of the Act and the Regulations as they relate to the financial report.

### 4.3. Management Letters

Significant findings, emerging issues and their recommended resolution that arise during the audit will be progressively discussed and communicated to the CEO and EMCCS. Any weaknesses in controls, which may be identified during the current year audit, will be highlighted in the management letter to the CEO following the conclusion of the preliminary and final audits.

Prior year management letter points will be followed up as part of the current year audit procedures. During the current year audit procedures, we will determine if any control weaknesses highlighted during the prior year audit have been properly resolved.

## 5. MILESTONE MEETINGS

### 5.1 Entrance meeting

The entrance meeting will be held with the CEO, EMCCS and the Audit Committee. The meeting will mainly cover the presentation and discussion of the APM.

### 5.2 Preliminary audit findings meeting

The preliminary audit findings meeting will mainly cover the presentation and discussion of the significant control matters as reported in the preliminary audit management letter, if any, with the CEO, EMCCS and Audit Committee.

### 5.3 Final audit closing meeting

Any significant accounting issues and findings noted during the final audit will be discussed with the CEO and EMCCS.

### 5.4 Exit meeting

The exit meeting with the Audit Committee will mainly cover the presentation and discussion of the audit closing report, which will outline any significant audit related matters concerning the financial report, management letters and improvement suggestions for future audits.

## 6 TERMS OF ENGAGEMENT

### 6.1 Arrangements

Audits are not an absolute guarantee of the accuracy or reliability of the Shire's information and may not have identified all matters of significance. This is because the work undertaken to form an opinion is permeated by judgement and most audit evidence is persuasive rather than conclusive. In addition, there are inherent limitations in any audit, including the use of testing, the effectiveness of internal control structures and the possibility of collusion.

Primary responsibility for the detection, investigation and prevention of irregularities rests with the Shire's management. Consequently, it is the Shire's management who remains responsible for keeping proper accounts and maintaining adequate systems of internal control, preparing and presenting the financial report, complying with the Act and the Regulations.

Under the *Auditor General Act 2006*, audit staff have unrestricted access to information held by the Shire, irrespective of any restrictions on disclosures imposed, such as secrecy provisions.

Confidentiality of audit files and working papers is required under the *Auditor General Act 2006*. The Office of the Auditor General is an 'exempt agency' under the *Freedom of Information Act 1992*.

The signed contract between the Office of Auditor General (OAG) and RSM contains strict confidentiality clauses.

## 6.2 Management representation letter

The audit plan assumes that the CEO will be able to sign a management representation letter. The letter would be signed at the same time as the annual financial report is signed.

As in the previous year, we will rely on the CEO signing the management representation letter as evidence to confirm:

- (a) The CEO has fulfilled their responsibility for the preparation of the financial report in accordance with the applicable financial reporting framework, including their fair presentation;
- (b) The CEO has provided us with access to all relevant information necessary or requested for the purpose of the audit; and
- (c) All transactions have been recorded and are reflected in the financial report.

## 7 STAKEHOLDERS RELATIONSHIP

### 7.1 Auditor General

The *Local Government Amendment (Auditing) Act 2017* makes legislative changes to the *Local Government Act 1995* to provide for the auditing of local governments by the Auditor General. The Act allows the Auditor General to contract out some or all of the financial audits, but all audits will be the responsibility of the Auditor General and OAG. It also allows for performance audits, which will examine the economy, efficiency and effectiveness of any aspect of local government operations.


The Act also places an obligation on local governments to publish their annual report, including their annual financial report and auditor's report, on their website.

The Auditor General has been given the mandate to:

- (a) Audit the annual financial report of WA local governments, related entities and subsidiaries;
- (b) Conduct performance audits of local governments;
- (c) Perform supplementary audits requested by the Minister; and
- (d) Report to Parliament on the results of financial and performance audits.

Parliament has appointed the Auditor General as it expects this will raise the standards of accountability for local governments to a level more consistent with public sector entities. This follows recommendations by the Public Accounts Committee and the Corruption and Crime Commission that the Auditor General be appointed the auditor of all local governments.

This change brings Western Australia in line with most other Australian jurisdictions and New Zealand.



The mandate to do performance audits starts on the date of proclamation – 28 October 2017. The Auditor General has already begun planning his first local government performance audit, including:

- (a) Local Government Procurement
- (b) Timely Payment of Suppliers
- (c) Controls Over Corporate Credit Cards

Performance audits primarily focus on the effective and efficient management and operation of public sector programs and activities. Topics are selected by the Auditor General following a comprehensive process, which may also include requests for audits from Parliament, the government or the broader community.

Further details of the performance audits can be found on the Auditor General website.

There is a staged transition for financial audits. As existing audit contracts expire, responsibility will transition to the Auditor General. There are 139 local governments and 9 regional councils in Western Australia. The Auditor General will audit 46 local governments for the 2017-18 financial year. By financial year 2020-21, all local governments will be audited by the Auditor General, regardless of whether or not existing audit contracts have expired.

## 7.2 RSM's relationship with OAG and the Shire

RSM has been contracted by the Auditor General to perform the audit of the financial report of the Shire of Morawa.

Our services will be conducted under the overall direction of the Auditor General, who will retain responsibility for forming the audit opinion and issuing the audit report to the Shire of Morawa. The contract requires RSM to use its audit approach and methodology. The engagement by the OAG of RSM is for the financial year ending 30 June 2018, with an option to extend the term for a further two years at the Auditor General's sole discretion.

RSM is required to report any matter to the Auditor General, which may affect the Auditor General's responsibilities under sections 15 and 24 of the *Auditor General Act 2006*. RSM is to provide a report to the Auditor General to enable the Auditor General to:

- (a) Form the opinion in relation to the Shire's financial report;
- (b) Report any audit findings, significant control weaknesses and any other relevant matters to the Auditor General; and
- (c) Report any significant non-compliance with relevant legislation.


To comply with the Auditor General's contractual terms, RSM will be required to form an opinion and report to the Auditor General as to whether the Shire's financial statements are in accordance with part 6 of the *Local Government Act 1995*, other relevant legislation as applicable, and any other requirement specified in writing by the Auditor General, including:

- (a) Gives a true and fair view of the financial position of the Shire as at 30 June 2018 and of its performance for the year ended on that date;
- (b) Complies with Australian Accounting Standards (including the Australian Accounting Interpretations); and
- (c) Is prepared in accordance with the requirements of Part 6 of the Act and the Regulations.

## 7.3 Independence

The Auditor General is an independent officer of the Western Australia Parliament, appointed under legislation to examine, on behalf of Parliament and Western Australia taxpayers, the management of resources within the public sector. The Auditor General is not subject to control or direction by either Parliament or the government. In conducting the audit, the Auditor General, his staff and delegates will comply with all applicable independence requirements of the Australian accounting profession.

RSM International audit methodology requires that we conduct an annual re-evaluation of our independence prior to the commencement of each assignment. We have fully satisfied ourselves that we do not have any actual or perceived conflict of interests.



We are fully compliant with our Ethics and Independence Policies, which are verified and tested each year by our Partner Responsible for Ethics and Independence. Each year we are required to submit certain information to our Partner Responsible for Ethics and Independence, which is analysed and subjected to a series of stringent tests. This system has been extensively reviewed by the Australian Securities and Investments Commission and found to be in accordance with Australian Auditing Standards, the *Corporations Act 2001* and better practice.

## 8 CURRENT YEAR DEVELOPMENTS

The Shire has advised that there have been no major developments during the financial year that may affect our audit approach and procedures.

## 9 AUDIT APPROACH TO THE KEY AUDIT AREAS

### 9.1 Risk assessment

Key audit areas are those areas that, in RSM's professional judgment, present the most significant risk in our audit of the financial report.

As part of our audit approach we have conducted an initial financial report risk assessment to determine whether any of the risks identified are, in our judgment, significant or high. A significant or high risk is an identified and assessed risk of material misstatement in the financial report that, in our judgment is a key audit area and requires special audit consideration.

Our assessment of key audit areas is based upon:

- (a) Discussion with the CEO and EMCCS;
- (b) The complexity of transactions within each area;
- (c) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of uncertainty;
- (d) The degree of susceptibility to fraud risk; and
- (e) Consideration of any relevant matters that may be discussed at our entrance meeting on the 8 May 2018.

### 9.2 Materiality

The scope of our audit is also influenced by the application of materiality. The planning materiality level will be calculated and determined using the RSM audit methodology. The amount may be adjusted during the audit, depending on the results of our audit procedures. In line with OAG'S policy, we have not disclosed the amount of planning materiality.

### 9.3 RSM approach to auditing high risk material (HRM) balances

RSM's approach to HRM balances is to follow a hierarchy, which starts with testing of controls, then moves to substantive analytical review procedures and then finally testing of details. Based on our prior year's audit experience and knowledge, we have assessed that we can rely on internal controls at the Shire, which effectively means we can then rely on a moderate level of analytical review and limited testing of details. This controls based approach is both efficient and effective.

<b>Audit Reliance</b>	<b>High</b>			
	<b>Medium</b>			
	<b>Low</b>			
		<b>Controls</b>	<b>Substantive analytical review</b>	<b>Test of details</b>
<b>Audit technique</b>				

#### 9.4 RSM audit approach to low risk material (LRM) items

There are many LRM balances in the Shire's financial report, such as employee expenses, cash and cash equivalents and certain elements of property, plant and equipment.

RSM's approach to LRM balances is synchronised with our approach to the audit of HRM balances. Based on our prior year's audit experience and knowledge, we have assessed that we can rely on internal controls at the Shire, which effectively means we can rely on a low level of analytical review and very focused testing of details. Again, this controls based approach is both efficient and effective.

<b>Audit reliance</b>	<b>High</b>			
	<b>Medium</b>			
	<b>Low</b>			
		<b>Controls</b>	<b>Substantive analytical review</b>	<b>Test of details</b>
<b>Audit technique</b>				

RSM audit procedures for LRM items are listed in Appendix B.

#### 9.5 Professional scepticism

We approach all our audits with a degree of professional scepticism as required by Australian Auditing Standards and the *Auditor General Act 2006*. In addition, professional scepticism is a key component of delivering an effective public sector audit. *ASA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards* defines professional scepticism as 'an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence'.

Professional scepticism is particularly relevant in areas that involve management assumptions and/or estimates. It is also critical when evaluating audit evidence to reduce the risk of the auditor:

- (a) Overlooking unusual circumstances; and
- (b) Over generalising when drawing conclusions from observations using inappropriate assumptions in determining the nature, timing and extent of evidence gathering procedures and evaluating the results thereof.

## 10 HIGH RISK MATERIAL (HRM) BALANCES

Using the 2016/17 financial report as a guide and referring to the RSM calculated materiality amount and risk assessment, RSM has identified the following potential **high-risk material** balances for the current financial year:

High risk area	30 June 2017 balance	30 June 2016 balance
<b>Revenue and receivables cycle</b>		
Rates	1,664,137	1,450,696
Trade and other receivables	702,288	1,406,479
<b>Purchases and payment cycle</b>		
Material and contracts	4,373,167	2,302,155
Property, Plant and Equipment (additions)	1,415,291	570,399
Infrastructure (additions)	2,700,965	1,851,430
<b>Fixed assets cycle</b>		
Infrastructure	44,071,710	42,483,353

### 10.1 Revenue cycle – rates/ trade receivables

#### 10.1.1 Reasons why RSM considered this area high risk

Revenue is measured by taking into account multiple elements, for example rates transactions are calculated by the application of a rate in the dollar to the Gross Rental Value (GRV), which is in turn determined by dividing the required rate collection amount by the total valuations on the roll. GRV's vary between the various property types, such as residential, commercial and industrial. The GRV is supplied by Landgate. Depending upon the use of the property Landgate can also value property under an Unimproved Valuation (UV) category. Furthermore, rates revenue represents a significant portion of the Shire's annual operating income and is an important revenue stream in terms of the Shire's cash flows.

In addition, further complexity and risk is associated with the requirement for the Shire to comply with Part 6, Division 6 'Rates and service charges' of the *Local Government Act 1995 (the Act)*.

Based on the above complexities and the high risk of management override, revenue recognition for rates is considered high risk.





### 10.1.2 RSM audit response

RSM audit procedures will include, among other things, assessment the Shires' effectiveness of key internal controls operating within the revenue cycle, including application controls. RSM will perform a walkthrough of the key management controls over the revenue cycle and test key management controls. RSM will review, on a sample basis, the reconciliations and calculation of rates and compare these against historical results. In order to assess the completeness of recording revenue in the correct accounting period, RSM will perform revenue cut-off testing and review credit notes.

To determine the existence of the receivable balance and the recoverability thereof as at 30 June 2018, RSM will review receivables balances on a sample basis and perform subsequent receipt testing. Furthermore, we will perform analytical procedures on rates through detailed comparison with prior year balances and budget forecasts. RSM will also determine if the disclosures in the notes to the financial report related to the Shire's revenue recognition policy are appropriate.

## 10.2 Payment Cycle

### 10.2.1 Reasons why RSM considers this area high risk

All procurement made by the Shire is subject to the requirements of the Act and Part 4 of the *Local Government (Functions and General) Regulations 1996* (the Regulations), which is the basis for the Shire's purchasing policy (the Policy). The Act and the Regulations are there to guide the Shire in delivering best practice in the purchasing of goods, services and works that align with the principles of transparency, probity and good governance. Errors, uncertainty and unrealistic timelines can undermine market confidence, discredit a purchasing process and devalue the outcome of the procurement. Due to the strict and complex requirements of the Policy, including value for money, regulatory compliance, record management, transparency and professionalism, there is potential for insufficient knowledge of the Policy's requirements or failure to comply with the Policy.

### 10.2.2 RSM audit response

RSM will review the Shire's purchasing policies and assess the effectiveness of internal controls operating within the payment cycle. In addition, we will perform a walkthrough of the key management controls over the purchase and payment cycle, including tendering, and perform tests of control on key management controls over the purchase and payment cycle. Furthermore, we will perform analytical procedures on procurement through detailed comparison with prior year balances and budget forecasts. Our testing will include an evaluation of whether the Shire's purchasing activities have complied with the Act and the Regulations.

## 10.3 Fixed Assets Cycle

### 10.3.1 Reasons why RSM considered this area high risk

Infrastructure constitutes 58.7% of the Shire's total assets as at 30 June 2017. Under regulation 17A of the *Local Government (Financial Management) Regulations 1996* the Shire's infrastructure is to be carried at fair value less accumulated depreciation and accumulated impairment losses. The Shire's infrastructure will be valued by an independent valuer appointed by the Shire. The valuations rely on the correct determination and application of significant assumptions regarding the assets' service potential, consumption curves, useful life, asset condition and residual value. These factors, in combination with the significant share of total assets, made us conclude that infrastructure is a key audit area.

### 10.3.2 RSM audit response

RSM will carry out internal control testing over the Shire's processes for determining inputs into fair value measurements and perform detailed substantive testing on a sample basis of the related fair value measurements. We will focus our testing on the key assumptions made by the valuer in determining the fair value, testing the mathematical accuracy of the calculation models, performing sensitivity analyses around the key assumption used in the models and reviewing the reference material used by the valuer to determine the Level 2 and 3 inputs.

## 11 OTHER CRITICAL DISCLOSURES IN THE FINANCIAL REPORT

RSM will also audit the following critical disclosures in the financial report:

### 11.1 Australian Accounting Standard 124 Related Party Disclosures

The Shire continues to be subject to the requirements of AASB 124 *Related Party Disclosures*. The Standard requires disclosures for senior officers' compensation and certain transactions with related parties. A review will be conducted to ensure proper accounting and disclosure of related party transactions and director and executive remuneration.

Further, Section 7.12AL of the *Local Government Act 1995* applies Section 17 of the *Auditor General Act 2006* to a local government. Section 17 requires a local government to advise the Auditor General in writing of details of all related entities that are in existence.

### 11.2 Financial ratios

Under regulation 50 of the *Local Government (Financial Management) Regulations 1996*, the annual report is to include financial ratios. Financial ratios are designed to enable users of annual financial reports to interpret more clearly the Shire's performance and financial results as well as provide a comparison of trends over a number of years.

These indicators provide a measure of the financial sustainability of local governments and complement the national criteria endorsed by the Local Government and Planning Ministers' Council. They provide for a comprehensive tool for monitoring the financial sustainability of local governments.

We will review and audit the ratios during the audit as part of our normal audit procedures.

## 12 CONTROLS

### 12.1 Internal control

Internal controls are systems, policies and procedures that help an entity reliably and cost effectively meet its objectives. Sound internal controls enable the delivery of reliable, accurate and timely external and internal reporting. The Shire is responsible for developing and maintaining its internal control framework to enable:

- (a) Preparation of accurate financial records and other information;
- (b) Timely and reliable external and internal reporting;
- (c) Appropriate safeguarding of assets; and
- (d) Prevention or detection and correction of errors and other irregularities.

The annual financial audit enables RSM to form an opinion on the Shire's financial report. An integral part of this, and a requirement of Australian Auditing Standard ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, is to assess the adequacy of an organisation's internal control framework and governance processes related to its financial reporting. While this understanding has a significant impact on our audit strategy, our audit of the Shire's financial report is not designed to assess, nor do we provide an opinion on, the effectiveness of internal controls.

We focus on the internal controls relating to financial reporting and assess whether the Shire has managed the risk that the financial report will not be complete and accurate. Poor controls diminish management's ability to achieve the organisation's objectives and comply with relevant legislation. They also increase the risk of fraud.

During our planning procedures we gained an understanding of the following components of internal control:

- (a) Control environment
- (b) Risk assessment procedures
- (c) Information systems

- (d) Control activities
- (e) Monitoring procedures

Our preliminary assessment of the internal control framework determined that the internal controls are likely to be effective in preventing or detecting and correcting material misstatements in the financial report. As such, we plan to place reliance on the key internal controls relating to the material components in the financial report to support our audit opinion.

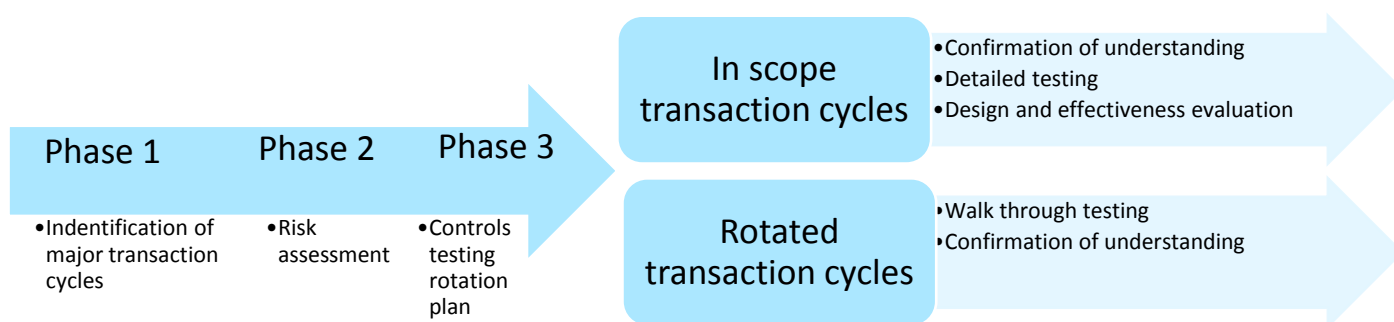
### 12.2 Significant changes to internal controls

The Shire has advised that they are not aware of any major changes to internal controls.

### 12.3 Rotation approach

In accordance with our rotational controls testing approach, we will conduct a risk assessment for each major transaction cycle during our initial engagement year. The risk assessment is benchmarked against our knowledge of each transaction cycle within the local government sector. Using the risk assessment, we design a control testing rotation plan that will bring certain transaction cycles into audit scope each year. Those cycles not in scope will be subject to our normal walkthrough procedures and confirmation of our understanding of the key controls.

Those transactions cycles in scope will be subject to detailed controls testing, including testing of the design and effectiveness of those controls.



In the current year, in addition to control testing over revenue and payment cycles, we will be testing key management controls over the cash and fixed assets cycles and rotating the control testing over the payroll cycle.

### 12.4 Generic procurement control issues

Set out below are several procurement related risks, which have been noted in past procurement audits at other public and private sector entities:

Procurement issues – Past audit issues we have observed	
<b>Planning</b>	Failure to properly plan a procurement leading to inadequate statement of requirements, failure to effectively evaluate tenderers, cost overruns and failing to meet key milestones.
<b>Contract management</b>	Poor contract documentation and failure to design, document and implement strong contract performance management policies and procedures.
<b>Invoice splitting</b>	Collusion by management and vendor to break larger invoices down into smaller amounts so that they can be approved by more junior levels of management (circumventing the delegation of authority).

## Procurement issues – Past audit issues we have observed

<b>Operational cost shifting</b>	Transferring operational costs into capital projects to avoid operational budget overruns.
<b>Excessive overhead capitalisation</b>	Shifting non-allowable overhead costs into capital projects (breach of accounting standards).
<b>Project journals</b>	Moving costs between projects using journal transactions. Often done to shift costs from an overrun project to one that is under budget (thereby avoiding management scrutiny for the overrun).
<b>Shared costs</b>	Failure to correctly allocate costs for invoices that relate to more than one project.
<b>Scope creep</b>	Attempts to expand the scope of the project. Failure to detect these attempts often reflects poor scrutiny at the approval stage and/or a failure to check that the underlying product or service falls within the scope of the project.
<b>Vendor variations</b>	Insufficient review and challenge variation requests.
<b>WIP management</b>	Failure to properly control amounts capitalised in WIP on completion of the project (or stage of a larger project) resulting in failure to properly classify components of infrastructure, property, plant and equipment and resulting in inaccurate calculation of depreciation and / or amortisation.

## 13 FRAUD RISK

Under Australian Auditing Standard ASA 240 *The Auditor's Responsibility Relating to Fraud in an Audit of a Financial Report*, when planning and performing audit procedures and evaluating the results, the auditor must consider the risk of material misstatement in the financial report as a result of fraud and error.

Although ASA240 sets out the principles and procedures we must follow, the primary responsibility for the prevention and detection of fraud and error rests with the Council and the management of the Shire. The Shire is responsible for maintaining accounting records and controls designed to prevent and detect fraud and error, and for the accounting policies and estimates inherent in the financial report.

Our audit procedures on fraud risk include the following:

- (a) Forward a copy of the fraud control checklist for self-assessment to the Shire's management prior to our final audit visit. The checklist allows us to make inquiries of management, to obtain its understanding of the risk of fraud within the Shire and to determine whether management have any knowledge of fraud that has been perpetrated on or within the entity. We will review the fraud control self-assessment by the Shire;
- (b) Review the Shires' fraud control procedures in place to reduce the risk of fraud occurring within the entity, including the Shires' code of conduct;
- (c) Understand the Shires' fraud control environment;
- (d) Understand the business rationale for significant or unusual transactions;
- (e) Review current accounting estimates for biases;
- (f) Review the appropriateness of year end accounting adjustments;
- (g) Make enquiries of management and others within the Shire; and

- (h) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures to be performed as individuals within the entity who are familiar with the audit procedures normally performed on engagements may be more able to conceal fraudulent financial reporting.

## 14 OTHER AUDIT MATTERS

### 14.1 Audit preparation checklists

To assist the Shire to gather and collate the necessary audit information and documentation, we will issue in advance of each audit visit a Preliminary Audit Preparation Checklist and a Final Audit Preparation Checklist. As the requested information will be an important part of our audit working papers, the information must be made available to RSM on the dates specified at section 16 of this memorandum. This will assist us in delivering an efficient audit and minimising interruptions to Shire staff.

### 14.2 Important changes in governance, management or internal control environments

The Shire has advised that there are no major changes to its governance, management or internal control environment that may significantly impact the 30 June 2018 financial report.

### 14.3 Cumulative knowledge of accounting and computer systems and any expected changes

The Shire has represented that they are not aware of any significant changes to the accounting and computer systems.

## 15 IMPLICATIONS OF ACCOUNTING STANDARDS

We have assessed the implications of accounting standards and interpretations that will impact the Shire's financial report in the coming financial years. The table below illustrates the standards and interpretations, which have been issued but are not yet effective, that may impact the Shire in the period of initial application.

### 15.1 Application dates of applicable standards and interpretations

Reference	Summary	Effective date to Shire
<b>AASB 9 <i>Financial Instruments</i></b>	Addresses the classification, measurement and de-recognition of financial assets and financial liabilities, and introduces new rules for hedge accounting. In December 2014, the AASB made further changes to the classification and measurement rules and introduced a new impairment model. These latest amendments now complete the new financial instruments standard. The standard is not applicable to the Shire until the reporting year ending 30 June 2019.	1 July 2018
<b>AASB 15 <i>Revenue from Contracts with Customers</i></b>	Replaces AASB 118 Revenue which covers contracts for goods and services, and AASB 111 Construction contracts which covers construction contracts. Establishes the principle that revenue is recognised when control of a good or service transfers to a customer - so the notion of control replaces the existing notion of risks and rewards. The standard is not applicable to the Shire until the reporting year ending 30 June 2020.	1 July 2019

Reference	Summary	Effective date to Shire
<b>AASB 16 Leases</b>	AASB 16 introduces a single lease accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. The standard is not applicable to the Shire until the reporting year ending 30 June 2020.	1 July 2019
<b>AASB 1058 Income of Not-for-Profit Entities</b>	AASB 1058 has made complementary changes to the existing AASB 1004 <i>Contributions</i> , and has also added new guidance <i>AASB 15 Revenue from Contracts with Customers</i> to clarify its application in the not for profit sector.	1 July 2019

## 15.2 Assessment on the implications of accounting standards and interpretations

The Shire's management is required to assess the impact of the new standards and interpretations on its financial report. A detailed assessment is being conducted by the Shire and will be appropriately disclosed in the financial report for each new accounting standard. We will review the Shire's assessment and relevant disclosures.

## 16 TIMETABLE

Phase	Task	Indicative Time Frame	Action
<b>Planning</b>	Preliminary planning phase, document and update overall audit approach and plan	April 2018	RSM
	Issue draft APM to Shire and OAG for consideration	24 April 2018	RSM
	Entrance meeting with Shire and OAG, presentation and discussion of final APM	8 May 2018	RSM/Shire/OAG
<b>Preliminary audit fieldwork</b>	Issuing of Preliminary Audit Checklist	16 April 2018	RSM
	Based on risk assessment, performance of cyclical controls testing, walkthrough of major business cycles and review of key reconciliation procedures	21 – 22 May 2018	RSM
	Assessment of status of Management Letter points raised, if any, for the year ended 30 June 2017		
	Performance of substantive tests for revenue and expenditure cycles for the 9 months ended 31 March 2018		

Phase	Task	Indicative Time Frame	Action
<b>Preliminary audit reporting</b>	Issuing of draft Preliminary Management Letter to Shire for consideration and comment.	28 May 2018	RSM
	Return of draft Interim Management Letter to RSM with commentary	30 May 2018	Shire
	Issuing of Final Interim Management Letter to Shire and OAG	1 June 2018	RSM
<b>Draft Financial Report</b>	The Shire submits draft financial report as per the Act deadline	30 September 2018	Shire
<b>Final Audit Fieldwork</b>	Issuing of Final Audit Checklist	31 August 2018	RSM
	Provision of trial balance as at 30 June 2018 to RSM	30 September 2018	Shire
	Performance of substantive tests for revenue and expenditure cycles for the 3 months ended 30 June 2018	17 – 18 October 2018	RSM
	Performance of substantive tests for balance sheet accounts as at 30 June 2018		
	Assessment of status of Management Letter points raised at the interim audit for the year ended 30 June 2018		
<b>Final Audit Reporting</b>	Issuing of draft Final Management Letter for the year ended 30 June 2018 to Shire for consideration and comment	23 October 2018	RSM
	Return draft Final Management Letter for the year ended 30 June 2018 to RSM with commentary	25 October 2018	Shire
	Preparation of OAG Signing Review Memorandum	26 October 2018	RSM
	Review of audit file by OAG	1 November 2018	OAG
	Issue draft Management Representation Letter and draft Financial Report to Shire for consideration and comment	1 November 2018	RSM
	Closing Report issued	1 November 2018	RSM

Phase	Task	Indicative Time Frame	Action
	Exit Meeting with Shire	7 November 2018	RSM/Shire/OAG
	Issue final Management Representation Letter and approve Financial Report	7 November 2018	Shire
	Independent Contract Auditor's Report issued	7 November 2018	RSM
	OAG to sign and issue the Audit Report	14 November 2018	OAG





## 17 APPENDIX A: SUMMARY CORPORATE STRUCTURE

The corporate structure for the Shire of Morawa as at 31 March 2018 is as follows:

### 17.1 Council

- Karen Chappel, Shire President
- Dean Carslake, Deputy Shire President
- Jane Coaker, Councillor
- Ken Stokes, Councillor
- Darren Agar, Councillor
- Debbie Collins, Councillor

### 17.2 Executive team

- Chris Linnell, Chief Executive Officer
- Jenny Goodbourn, Executive Manager Corporate and Community Services
- Sam Appleton, Executive Manager Development and Administration
- Paul Buist, Principal Works Supervisor

## 18 APPENDIX B: LOW RISK AREAS

<b>Key Auditable Area: Revenue and Receivables Cycle</b>		
	30 June 2017 balance \$	30 June 2016 balance \$
Operating Grants, Subsidies & Contributions	6,026,656	2,243,040
Fees and Charges	762,018	735,323
Other Revenue	153,973	202,664
Non-operating Grants, Subsidies & Contributions	2,265,831	1,291,028
Key Audit Approach	Review and assess the effectiveness of key internal controls operating within the revenue and receivables cycle, including application controls. Perform walkthroughs and test key management controls over the revenue and receivables cycle. Obtain confirmation for grants received from local government authorities where possible. Perform revenue cut-off tests and review credit notes to determine the completeness of revenue recording, in the correct accounting period. Consider the appropriateness of the disclosures in the notes to the financial report related to the Shire's revenue recognition policy.	

<b>Key Auditable Area: Purchases Cycle</b>		
	30 June 2017 balance \$	30 June 2016 balance \$
Utility charges	503,598	292,392
Insurance expenses	200,120	214,099
Other expenditure	126,586	142,062
Key Audit Approach	Review and assess the effectiveness of key internal controls operating within the purchases cycle. Perform walkthroughs and test key management controls over the purchases cycle. Perform analytical procedures on utilities, insurance and other expenditure through detailed comparison with prior year and forecasted balances. Perform tests of detail on other expenditure on a sample basis.	

**Key Auditable Area: Payroll Cycle**

	30 June 2017 balance \$	30 June 2016 balance \$
Employee costs	1,582,206	1,965,357
Employee benefits provisions	411,048	383,062
Key Audit Approach	Perform walkthroughs of the payroll cycle. Review the reconciliation between payroll system and general ledger to determine if it is reasonable. Assess the adequacy of payroll exception reporting. Perform substantive analytical reviews of monthly payroll costs, with comparison to the previous year's costs. Obtaining adequate explanation for significant variances. Test the completeness of employee entitlement provisions.	

**Key Auditable Area: Cash Cycle**

	30 June 2017 balance \$	30 June 2016 balance \$
Unrestricted cash and cash equivalents	141,085	104,087
Restricted cash and cash equivalents	6,997,139	6,308,522
Interest Earnings	172,463	171,813
Borrowings	452,596	519,339
Interest Expense	22,752	20,945
Key Audit Approach	Review and assess the effectiveness of key internal controls operating within the cash cycle. Perform walkthroughs of the cash cycle. Review bank reconciliations for long outstanding and unusual items. Obtain bank confirmations as at year end. Analyse year end interest bearing liability balances and determine the correct apportionment between current and non-current portions. Confirm year-end balances of interest bearing liabilities with finance providers. Test on a sample basis that credit card transactions comply with the Shire's credit card purchasing policy.	

**Key Auditable Area: Inventory Cycle**

	30 June 2017 balance \$	30 June 2016 balance \$
Inventories	1,118	1,335
Key Audit Approach	Perform walkthroughs over the inventory cycle. Perform analytical review procedures. Consider the incidence of potentially obsolete and slow-moving inventories. Determine the appropriateness of the basis of inventory valuation in terms of the Shire's accounting policies.	

**Key Auditable Area: Fixed Assets Cycle**

	30 June 2017 balance \$	30 June 2016 balance \$
Property, Plant & Equipment	23,105,106	26,518,884
Depreciation & Amortisation	1,470,054	1,501,236
Key Audit Approach	Review and assess the effectiveness of key internal controls operating within the fixed asset cycle. Perform walkthroughs of the fixed assets cycle. Analyse year end balances for each major asset class in comparison with prior period balances. Review management's impairment assessment at year end. Perform testing of a sample of fixed asset additions and disposals. Review capital work-in-process expenditure and discuss with management the progress and expected completion of significant projects. Review accounting treatment for repairs and maintenance costs to determine correct classification of expenditure. Review overall presentation in the financial report.	

**Key Auditable Area: Payables**

	30 June 2017 balance \$	30 June 2016 balance \$
Trade and other payables	165,459	358,161
Key Audit Approach	Perform substantive analytical review procedures and review the calculation of material accruals. Review subsequent payments after year end. Determine the correct apportionment between current and non-current balances. Review presentation in the financial report.	

**Key Auditable Area: Equity**

	30 June 2017 balance \$	30 June 2016 balance \$
Retained Surplus	34,337,219	32,282,013
Reserves – Cash Backed	6,997,139	6,308,522
Reserves – Asset Revaluation	32,654,985	36,971,563
Key Audit Approach	Determine if cash backed reserves agree with restricted cash resources. Determine the basis for any movements in the asset revaluation reserve in terms of <i>AASB 116 Property, Plant and Equipment</i> .	



**Key Auditable Area: Compliance with the Act and Regulations**

Key Associated Risks	Failure to comply with the Act and the Regulations.
Key Audit Approach	Assess compliance with the <i>Local Government Act 1995</i> , Australian Accounting Standards and other applicable regulations. Review of the monthly financial reports and annual budgets and consideration of key performance indicators. Review of Minutes (Council and Audit Committee). Review of Financial Interests Register. Review of Tenders Register.

## 19 APPENDIX C: ADDITIONAL INFORMATION CONTACTS

<b>David Wall</b>	<b>Subha Gunalan</b>
RSM Australia	Office of the Auditor General
Level 32, Exchange Tower	7 <sup>th</sup> Floor, Albert Facey House
2 The Esplanade	469 Wellington Street
Perth Western Australia 6000	Perth Western Australia 6000
Tel: +61 8 9261 9387	Tel: + 61 8 6557 7716

**THE POWER OF BEING UNDERSTOOD**  
**AUDIT | TAX | CONSULTING**

RSM Australia Pty Ltd is a member of the RSM network and trades as RSM. RSM is the trading name used by the members of the RSM network.

Each member of the RSM network is an independent accounting and consulting firm each of which practices in its own right. The RSM network is not itself a separate legal entity of any description in any jurisdiction.

The RSM network is administered by RSM International Limited, a company registered in England and Wales (company number 4040598) whose registered office is at 11 Old Jewry, London EC2R 8DU.

The brand and trademark RSM and other intellectual property rights used by members of the network are owned by RSM International Association, an association governed by article 60 et seq of the Civil Code of Switzerland whose seat is in Zug.

© RSM International Association

**rsm.com.au**

Liability limited by a scheme approved under professional standards legislation

