



25 JULY 2019

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## **Shire of Esperance**

### **AUDIT COMMITTEE**

### **NOTICE OF MEETING AND AGENDA**

An Audit Committee meeting of the Shire of Esperance will be held at Council Meeting Room on 30 July 2019 commencing at 1pm to consider the matters set out in the attached agenda.

W M (Matthew) Scott

**Chief Executive Officer**

### **DISCLAIMER**

No responsibility whatsoever is implied or accepted by the Shire of Esperance for any act, omission or statement or intimation occurring during Council or Committee meetings. The Shire of Esperance disclaims any liability for any loss whatsoever and howsoever caused arising out of reliance by any person or legal entity on any such act, omission or statement or intimation occurring during Council or Committee meetings. Any person or legal entity who acts or fails to act in reliance upon any statement, act or omission made in a Council or Committee meeting does so at that person's or legal entity's own risk.

In particular and without derogating in any way from the broad disclaimer above, in any discussion regarding any planning application or application for a licence, any statement or intimation of approval made by a member or officer of the Shire of Esperance during the course of any meeting is not intended to be and is not to be taken as notice of approval from the Shire of Esperance. The Shire of Esperance warns that anyone who has any application lodged with the Shire of Esperance must obtain and should only rely on written confirmation of the outcome of the application, and any conditions attaching to the decision made by the Shire of Esperance in respect of the application.

### **ETHICAL DECISION MAKING AND CONFLICTS OF INTEREST**

Council is committed to a code of conduct and all decisions are based on an honest assessment of the issue, ethical decision-making and personal integrity. Councillors and staff adhere to the statutory requirements to declare financial, proximity and impartiality interests and once declared follow the legislation as required.

### **ATTACHMENTS**

Please be advised that in order to save printing and paper costs, all attachments referenced in this paper are available in the original Agenda document for this meeting.

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**SHIRE OF ESPERANCE**

**AGENDA**

**AUDIT COMMITTEE MEETING  
TO BE HELD IN COUNCIL MEETING ROOM ON 30 JULY 2019  
COMMENCING AT 1PM**

**1. OFFICIAL OPENING**

**2. ATTENDANCE**

**Members**

Cr V Brown	Shire of Esperance	Presiding Member
Cr J Parsons	Shire of Esperance	
Cr S McMullen	Shire of Esperance	
Cr D Piercey, JP	Shire of Esperance	
Mr K Mills	Community Representative	

**Shire Officers**

Mr W M (Matthew) Scott	Chief Executive Officer
Mr S Burge	Director Corporate Resources
Mrs B O'Callaghan	Manager Financial Services

**Members of the Public & Press**

**3. APOLOGIES & NOTIFICATION OF GRANTED LEAVE OF ABSENCE**

**4. PUBLIC QUESTION TIME**

**5. DEPUTATIONS, PRESENTATIONS, INSPECTIONS, PETITIONS**

Nil

**6. DECLARATION OF MEMBERS INTERESTS**

**6.1 Declarations of Financial Interests – Local Government Act Section 5.60a**

**6.2 Declarations of Proximity Interests – Local Government Act Section 5.60b**

**6.3 Declarations of Impartiality Interests – Admin Regulations Section 34c**

**7. CONFIRMATION OF MINUTES**

**That the Minutes of the Audit Committee Meeting of the 5 March 2019 be confirmed as a true and correct record.**

**8. NEW BUSINESS OF AN URGENT NATURE**

Nil

## **9. MATTERS REQUIRING A DETERMINATION OF COMMITTEE**

### **Item: 9.1**

#### **Audit Report- Adverse Financial Ratio Trends**

<b>Author/s</b>	Shane Burge	Director Corporate Resources
<b>Authorisator/s</b>	Matthew Scott	Chief Executive Officer

**File Ref: D19/17361**

#### **Applicant**

Internal

#### **Location/Address**

Shire of Esperance

#### **Executive Summary**

For the Audit Committee to consider the effects and actions in addressing the financial ratios reported in the 2017/18 financial report that did not meet the minimum Department of Local Government (DLG) standards.

#### **Recommendation in Brief**

That the Audit Committee recommend that Council note the action that is taken through the Long Term Financial Plan to address the financial ratios that do not meet the Department of Local Government, Sport and Cultural Industries basic standard.

#### **Background**

The Audit Committee and Council considered the annual financial report, audit report and management letter in November 2018. In the Audit Report and Management letter (Attachment A) it was identified by the Shire's Auditor that the Operating Surplus Ratio and Asset Sustainability Ratio did not meet the DLG guideline standards.

A letter from the Department of Local Government was recently received (Attachment B) stating that a separate report had not been prepared for the Audit Committee and Council on what action the local government has taken or intends to take in respect to the matters raised by the Auditor.

#### **Officer's Comment**

It is no surprise to the Shire of Esperance that the two ratio's that were highlighted in the Auditors report of not meeting the DLG standards. The Shire of Esperance has for the past 6 years been following a long term financial plan and looking at ways to address its asset management issues. The Operating Surplus Ratio and Asset Sustainability Ratio are the two ratios that highlight the pressure that the Shire of Esperance faces with asset management.

#### **Operating Surplus Ratio**

The operational guideline on Financial Ratios describe the Operating Surplus as "a key indicator of a local government's financial performance is measured by the 'Operating Surplus Ratio'. If a local government consistently achieves a positive operating surplus ratio and has soundly based long term financial plans showing that it can continue to do so in future, having regard to asset management and the community's service level needs, then it is considered financially sustainable.

A positive ratio indicates the percentage of total own source revenue available to help fund proposed capital expenditure, transfer to cash reserves or to reduce debt. A negative ratio indicates the percentage increase in total own source revenue (principally rates) that would have been required to achieve a break-even operating result.”

The ratio is calculated by the following calculation-

$$\frac{(\text{Operating Revenue MINUS Operating Expense})}{\text{Own Source Operating Revenue}}$$

A basic standard is achieved when the ratio is between 1% and 15% (0.01 and 0.15).

An Advanced standard is achieved when the ratio is > 15% (>0.15).

The Shire of Esperance has achieved the following for the past 3 years-

	<b>2018</b>	<b>2017</b>	<b>2016</b>
Operating Surplus Ratio	(0.01)	0.03	(0.16)

The ratio is subject to a number of one off influences such as prepaid financial assistance grants and abnormal operating expenditure. The biggest influence that a large number of local governments have experienced over the past few years however is the revaluation of assets and the flow on effects that this has had to depreciation which is included as part of operating expense. This increase in depreciation has affected the Shire of Esperance significantly due to its extensive road network and therefore had an impact upon the operating surplus ratio. Depreciation has increased since 2013/14 from \$8,033,221 to 2017/18 year at \$16,165,182.

The Shire of Esperance is working at increasing revenue, decreasing operating expenditure and reviewing asset life in an attempt to improve the operating surplus ratio. Although the Shire does have a goal to obtain a small underlying operating surplus position, it is believed that the ratio calculation needs to be adjusted to allow recurring renewal capital income to be included into the ratio.

The Shire receives significant amounts of road funding specifically for road asset renewal such as Roads to Recovery and Regional Road Group that is used to fund the renewal of road assets and fund some of the depreciation that is reported in operating expenses. This capital renewal funding is however specifically excluded as part of the ratio calculation. It is believed that excluding this income from the ratio unfairly distorts the ratio as the Shire needs to include the full cost of the consumption of the assets (depreciation) for roads in the ratio but is unable to include funding from external parties as part of the operating revenue to help fund the capital renewal of the assets.

Regardless of the technicalities of the operating surplus ratio, the Shire has a long term plan that addresses asset management over the 10-year period and shows that the Shire can manage its asset renewal in a sustainable manner provided grant funding for asset renewal through Roads to Recovery and Regional Road Group is maintained at existing levels.

### **Asset Sustainability Ratio**

The operational guideline on Financial Ratios describe the Asset Sustainability Ratio as “an approximation of the extent to which assets managed by a local government are being replaced as these reach the end of their useful lives. It is calculated by measuring capital expenditure on renewal or replacement of assets, relative to depreciation expense. Expenditure on new or additional assets is excluded. Depreciation expense represents an estimate of the extent to which the assets have been consumed during that period. Measuring assets at fair value is critical to the calculation of a valid depreciation expense value.”

The purpose of the ratio is to indicate whether a local government is replacing or renewing existing non-financial assets at the same rate that its overall asset stock is wearing out.

The ratio is calculated by the following calculation-

$$\frac{\text{Capital Renewal and Replacement Expenditure}}{\text{Depreciation}}$$

The standard is met if the ratio is 90% (or 0.90)

The standard is improving if the ratio is between 90% and 110% (or 0.90 and 1.10).

The Shire of Esperance has achieved the following for the past 3 years-

	<b>2018</b>	<b>2017</b>	<b>2016</b>
Asset Sustainability Ratio	0.81	0.87	0.80

This ratio has been influenced heavily also by the increase in depreciation, similar to the operating surplus ratio. Often, when local governments have asset management pressure both the Asset Sustainability Ratio and the Operating Surplus Ratio will be both under pressure.

The Asset Sustainability Ratio is subject to timing fluctuations as assets will be renewed at the time of when they are required. This ratio is best considered over an extended period of time rather than a year on year basis when you have significant long lived assets. You will often find that this ratio may be low for a number of years and then may have it well above 100% as long lived assets are renewed. What is important is that over the long term this asset averages approx. 100% to ensure assets are renewed.

Moving forward the Council and staff need to be cognoscente of the amount of capital expenditure that is being spent on renewal rather than upgrades or new assets. Upgrades and new assets in the most part add to depreciation and therefore continue the asset replacement issues unless they are extending the useful lives.

Similar to the Operating Surplus Ratio the Shire of Esperance has a long term improvement plan on asset renewal. Towards the later years of the LTFP we see the asset management gap reduced. For longer lived assets Reserve Funds should also be taken into consideration as a strategy to ensure funds are available to replace the assets at the "optimal intervention period."

### **Consultation**

Consultation was conducted with the development of the Long Term Financial Plan which outlines the way that the Operating Surplus Ratio and Asset Sustainability Ratio would be improved.

### **Financial Implications**

Although this report in itself doesn't have financial implications, addressing the issues highlighted by a negative Operating Surplus Ratio and a low Asset Sustainability Ratio have significant issues for the Shire of Esperance.

The Long Term Financial Plan in conjunction with the Revenue Strategy are the methods that the Shire of Esperance is using to address these longer term.

### **Asset Management Implications**

Both of these ratios have issues that affect asset management that have been addressed within the report.

### **Statutory Implications**

Section 7.12A(4) of the Local Government Act 1995 outlines the actions that need to be undertaken if an audit report identified any significant matters.

### **Policy Implications**

Nil

### **Strategic Implications**

Strategic Community Plan 2017 - 2027

*Community Leadership*

A financially sustainable and supportive organisation achieving operational excellence

Provide responsible resource and planning management for now and the future

Corporate Business Plan 2017/2018 – 2020/2021

L2.11      Manage Finance

### **Environmental Considerations**

Nil

### **Attachments**

A<sup>1</sup>. Auditors Management Letter

B<sup>1</sup>. DLG Request to Consider Ratios

### **Officer's Recommendation**

**That the Audit Committee recommend that Council note the action that is taken through the Long Term Financial Plan to address the financial ratios that do not meet the Department of Local Government, Sport and Cultural Industries basic standard.**

**Voting Requirement**

Simple Majority



MVDM : MJ  
ESPE01

2 November 2018

Mr Matthew Scott  
Chief Executive Officer  
The Shire of Esperance  
PO Box 507  
ESPERANCE WA 6450

Dear Matthew

#### **SHIRE OF ESPERANCE**

We wish to advise that we have recently completed the audit of the above mentioned Council for the year ended 30 June 2018.

The Australian Auditing and Assurance Standards Board encourages auditors to issue a management letter on completion of each audit as a means of advising Council of any matters noted during the course of the audit.

Our audit involves the review of only those systems and controls adopted by the Council upon which we wish to rely for the purposes of determining our audit procedures. Furthermore, our audit should not be relied upon to disclose defalcations or other similar irregularities, although their disclosure, if they exist, may well result from the procedures we undertake. While we have considered the control environment in accordance with Australian Auditing Standards, we have not tested controls and hence do not comment on whether systems and controls are operating effectively.

We advise that we have not encountered any other matters during the course of our audit that we believe should be brought to your attention other than the following:

#### **Financial ratios**

##### *Findings:*

Under note 29 of the financial report, we note that the asset sustainability ratio and operating surplus ratio do not meet the benchmark as set out by the Department of Local Government.

##### *Recommendation:*

We recommend that Council monitors ratios in terms of the benchmarks as set out by the Department of Local Government.

*Management Comment:*

The Shire is aware of the pressure that these ratios are under. The Council is continuing to monitor and addressing these ratios through the strategies identified in the Long Term Financial Plan over the next five years.

We wish to thank the Shire of Esperance staff for their assistance during the audit.

Should you have any questions please do not hesitate to contact me.

Yours sincerely  
BUTLER SETTINERI (AUDIT) PTY LTD

A handwritten signature in black ink, appearing to read 'Marius Van der Merwe', written in a cursive style.

MARIUS VAN DER MERWE CA  
Director



Department of  
**Local Government, Sport  
and Cultural Industries**

Our ref ES3-4#03 E1915579  
Enquiries Stuart Fraser  
Phone 65521586  
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Mr Matthew Scott  
Chief Executive Officer  
Shire of Esperance  
PO Box 507  
ESPERANCE WA 6450

Dear Mr Scott

The Department of Local Government, Sport and Cultural Industries (the Department) has received the Shire's 2017-18 Audit Report from Butler Settineri (Audit) Pty Ltd dated 1 November 2017.

The Audit Report identifies matters as significant in regard to adverse trends, qualified audits and other matters. The following matter is identified as significant by the auditor:

- Significant adverse trends in the financial position of the Shire: Operating Surplus Ratio and Asset Sustainability Ratio below the Department standard.

Section 7.12A(4) of the *Local Government Act 1995* states that a local government must:  
*prepare a report addressing any matters identified as significant by the auditor in the audit report, and stating what action the local government has taken or intends to take with respect to each of those matters; and*  
*(b) give a copy of that report to the Minister within 3 months after the audit report is received by the local government.*  
*Within 14 days after a local government gives a report to the Minister under subsection (4)(b), the CEO must publish a copy of the report on the local government's official website.*

To date it appears that a report has not been received and has not been published on the Shire's official website in accordance with Section 7.12A.

As a matter of priority the Shire must prepare a report for its Audit Committee and seek council's endorsement before forwarding a copy to the Department at [audits@dlgsc.wa.gov.au](mailto:audits@dlgsc.wa.gov.au)

As this report is now overdue, the Department requires the local government to remedy this non-compliance within the next 60 days from the date of this letter.

For further information please review the Department's Circulars 05-2019 Local Government Auditing and 02-2018 Guide to Local Government Auditing Reforms (page 8) which are published on the Department's website.

Gordon Stephenson House, 140 William Street  
PO Box 8349 Perth Business Centre, WA 6849  
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Should you have any queries please contact the Department on the above email address or phone 65527300.

Yours sincerely



Narrell Lethorn  
Director Industry and Sector Regulation

28 June 2019

cc Cr Victoria Brown, President, Shire of Esperance

**Item: 9.2**

**Interim Audit Management Letter**

<b>Author/s</b>	Shane Burge	Director Corporate Resources
<b>Authorisor/s</b>	Matthew Scott	Chief Executive Officer

**File Ref: D19/17713**

**Applicant**  
Internal

**Location/Address**  
Shire of Esperance

**Executive Summary**

For the Audit Committee to consider the Interim Audit Management Letter.

**Recommendation in Brief**

Can be the full recommendation or summarised - without conditions etc

**Background**

Butler Settineri (Auditors) recently undertook its interim audit in preparation of the 30<sup>th</sup> June 2019 annual financial audit. During the interim audit a number of systems and controls were tested that the Auditor relies upon for the audit process.

During the course of the audit, they noted payroll preparation matters that needed to be brought to the attention of the Shire. This resulted in the attached management letter.

**Officer's Comment**

The Shire uses a manual timesheet process for the recording of hours worked. This process requires a large amount of data entry for our payroll officer to ensure coding of hours to correct accounts. Timesheets are completed by individual employees who are then authorised by the appropriate supervisor before being forwarded through to payroll for entry and final payment.

It was noted during the interim audit that in a couple of occasions that a staff member was not paid the amount of time as was authorised on the timesheet. The payroll officer has the ability to adjust the hours being paid without prior approval.

The Auditor has noted this as being a moderate risk to the Shire of Esperance with the implication being that employees could be paid the incorrect hours.

The recommendations to reduce this risk as advised by the Auditor is to consider implementing internal controls to ensure that any changes to timesheets are approved by the authorising officer and investigate electronic timesheets.

The Shire has already implemented internal controls to ensure any timesheet changes are approved. We are also commencing investigations about electronic timesheets with other similar local governments.

**Consultation**

Butler Settineri (Auditors)

### **Financial Implications**

Nil

### **Asset Management Implications**

Nil

### **Statutory Implications**

Nil

### **Policy Implications**

Nil

### **Strategic Implications**

Strategic Community Plan 2017 - 2027

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Corporate Business Plan 2017/2018 – 2020/2021

L2.11      Manage Finance

### **Environmental Considerations**

Nil

### **Attachments**

A<sup>1</sup>. Interim Management Letter

### **Officer's Recommendation**

**That the Audit Committee note the matters raised in the Interim Audit Management Letter and the recommendations to reduce the risk.**

### **Voting Requirement**

Simple Majority



24 July 2019

Mr Matthew Scott  
Chief Executive Officer  
Shire of Esperance  
PO Box 507  
ESPERANCE WA 6450

Dear Matthew

### SHIRE OF ESPERANCE

We wish to advise that we have recently completed the interim audit of the above mentioned Shire for the year ended 30 June 2019.

The Australian Auditing and Assurance Standards Board encourages auditors to issue a management letter on completion of each audit as a means of advising the Council of any matters noted during the course of the audit.

Our interim audit involves the review of only those systems and controls adopted by the Council upon which we wish to rely for the purposes of determining our interim audit procedures. Furthermore, our interim audit should not be relied upon to disclose defalcations or other similar irregularities, although their disclosure, if they exist, may well result from the procedures we undertake. While we have considered the control environment in accordance with Australian Auditing Standards, we have not tested controls and hence do not comment on whether systems and controls are operating effectively.

We advise that we have encountered the following matters during the course of our interim audit that we believe should be brought to your attention:

### Payroll Preparation

#### *Finding:*

We performed our audit procedures on a payroll prepared for a fortnight and found the following discrepancies:

1. The Payroll Officer was able to adjust the hours paid of an employee without obtaining an updated approved timesheet from the employee's manager.
2. When comparing hours on the approved timesheet to the hours paid we noted that one employee was over paid by .50 hours and two employees were underpaid by 2 hours.
3. The Payroll Officer enters the data from the time sheets, being hours worked and time allocation to the accounting records manually. Given the large number of employees this could lead to errors not been identified.



*Rating:* Moderate

*Implication:*

Employees could be paid the incorrect hours and internal controls in relation to management's review of the payroll may not identify the errors as the Shire has approximately 240 employees.

*Recommendations:*

Management should consider implementing internal controls to ensure that any changes to employee hours are approved by the manager before the Payroll Officer enters the hours into the payroll system.

Due to the large number of employees management could investigate an electronic application to record hours and the allocation of hours into the accounting records. The Payroll Officer could then review the data to ensure it's correct before preparing the payroll. This would provide greater data confidence of payroll information.

*Management's Comments:*

The Payroll Officer will ensure that any changes to employee hours are approved by the relevant manager in future.

Shire of Esperance will investigate an electronic system to record hours and consider whether this would be cost/efficient compared to current system.

We wish to thank the Shire of Esperance staff for their assistance during the interim audit.

Should you have any questions please do not hesitate to contact me.

Yours sincerely  
BUTLER SETTINERI (AUDIT) PTY LTD



MARIUS VAN DER MERWE CA  
Director

**10. CLOSURE**