EXECUTIVE SUMMARY

For the third time, the Victorian Auditor General has presented a separate report to Parliament on the results of their annual audit of each Council, the entities they control, and each regional library corporation.

The report also encompassed an assessment of the financial sustainability of Councils.

Mornington Peninsula Shire’s financial assessment is ‘low risk’, indicating ‘low risk of financial sustainability concerns – no high risk indicators’, the best rating available under the Auditor General’s assessment.

THE REPORT TO PARLIAMENT

The Auditor General’s report has been circulated to members of the Audit Committee and a copy has been made available to Councillors. The report is also available on the Auditor General’s web site – www.audit.vic.gov.au.

The Auditor General’s report covered three areas:

- Results of the 2009 audit;
- Effectiveness of internal controls; and
- Financial sustainability of Local Government.

In terms of financial sustainability, the assessment is on the basis of review of the same five performance indicators used last year, over five years. An additional indicator for 2008/2009 which builds on the investment gap ratio is the renewal gap.
RESULTS OF THE 2009 AUDIT

It is not proposed to examine in detail the industry wide assessment of the 2009 audits, however in summary:

- 76 of 79 councils received a ‘clear’ or unqualified audit opinions on their financial statements and standard statements as at 30 September, 2009. Ministerial extensions were provided to Manningham due to an office fire, Murrindindi due to the bushfire and Mildura has subsequently been completed on 20 October, 2009; and

- Two Councils had their performance statement qualified (Moorabool Shire and Hepburn Shire, by virtue of not setting targets against which it could be measured).

Further, Manningham City, Mildura Rural, Murrindindi Shire councils’ statements were not complete as at 30 September, 2009.

This Council has consistently achieved the certification of statements by 30 September, 2009.

We have implemented the Auditor General’s past recommendations to facilitate a timely year end process. This has been achieved through processes such as automated processes for preparing ‘shell’ financial, standard and performance statements and closing off asset capitalisations and asset valuations at an interim balance date prior to year end. We also have taken on board previous comments by the Auditor General and developed reporting practices to generate financial information with minimal manual intervention (contracts register reports are one example).

The recommendations in relation to results of audits were as follows.

| 1. | Local Government Victoria, a division of Department of Planning and Community Development (DPCD), should review submitted budgets of each council against the requirements of the Local Government Act 1989 and initiate remedial action when non-compliance occurs. |
| 2. | DPCD should provide guidance to entities within local government sector to improve the utility and comparability of the financial information across the sector. |

Department of Planning and Community Development response to recommendation 1:

“It has not been the role of Local Government Victoria (LGV) to review the detailed content of councils’ adopted budgets. However, the Institute of Chartered Accountants in Australia, in association with LGV, prepares and updates a model budget each year which many councils use. The model budget includes a compliance checklist.

The Local Government Investigation and Compliance Inspectorate formed on 1 September, 2009 will as part of its compliance regime include spot audits of submitted budgets against compliance with the requirements of the Local Government Act 1989.”

Mornington Peninsula Shire Council supports the recommendation. Apart from using the Institute of Chartered Accountant’s best practice guide for reporting local government budgets as a basis for the Shire budget, our current process now sees the Chief Executive Officer and Principal Accounting Officer providing a checklist of legislative compliance to the Audit Committee.
RESULTS OF THE 2009 AUDIT  (CONT’D)

Department of Planning and Community Development response to recommendation 2:

“Each year LGV coordinates the review and preparation of the model financial report to assist local government finance practitioners with the preparation of the year end financial statements and associated notes. The model financial report assists local government practitioners in the preparation of consistent, comparable and high quality financial statements. In 2009, CPA Australia undertook this work in cooperation with LG and FinPro.


On the specific issue of guidance provided by DPCD regarding the recognition and measurement of the value of land under roads, LGV has worked cooperatively with FinPro and the Municipal Group of Valuers to provide advice to the sector on this matter.

The most recent advice provided to the sector in May 2009, advised councils that “FinPro and the Municipal Group of Valuers have been working with the Valuer-General and LGV to determine a methodology that is cost effective, easily applicable and covers the spectrum of possible outcomes”.

This approach was taken in the knowledge that a consistent national approach to the valuation of land under roads had yet to be agreed by the Valuer-Generals in each of the States and Territories at the time the above advice was prepared, and so a definitive position was not able to be presented.

In the absence of a nationally consistent approach having been determined LGV will prepare guidance for councils regarding the recognition and measurement of the value of land under roads.”

The Mornington Peninsula Shire Council supports the recommendation. Although our approach to land under roads is consistent with the majority of councils, the differing choices made by councils on the recognition and measurement of land under roads, though permitted by the accounting standard, have led to a reduction in comparability across the sector.

EFFECTIVENESS OF INTERNAL CONTROLS

Common Control Weaknesses

The Auditor General identified control weaknesses common to a number of Councils, including the absence of preparation and review of reconciliations and controls over masterfile amendments.
EFFECTIVENESS OF INTERNAL CONTROLS  (CONT’D)

Common Control Weaknesses  (Cont’d)

The recommendation in relation to control weaknesses were as follows.

3. Councils should prepare and review reconciliations on a timely manner when preparing financial reports to address the risk of errors going undetected or uncorrected.

4. Proper and appropriate level of authorisation and review of all data changes must be present to reduce any opportunities for inappropriate actions.

Our current practice is consistent with the recommendations.

The finance unit’s operating procedures includes many internal control measures. Specifically in response to recommendation 3, all Balance Sheet items are reconciled and reviewed on a monthly basis, i.e. Investments, Debtors and Liabilities including creditors, payroll, trust accounts etc. This ensures that at year-end, any errors have been detected and corrected and thus minimising material misstatements in the financial reports.

The Auditor General’s contractor (as part of the audit) considers the internal control framework as part of their audit procedures. To the extent that they examined certain aspects of the internal control framework, they found that those elements of control were adequate to enable the financial report to be properly prepared.

Management have responsibility for maintaining internal controls that prevent or detect fraud or error and to ensure regulatory compliance. The Audit Committee is informed by management of any fraud or material errors. The Auditor General’s contractor commented (2008/2009) that – “we have not identified any further areas of material fraud risk or exposure”.

The internal control framework comprises various systems, processes and activities that may be categorised under the following headings:

- Control environment;
- Risk management;
- Control activities;
- Information and communication; and
- Monitoring and review.

During the audit, the auditor observed that there were no significant control weaknesses or failures identified in the operation of key controls.

At the completion of the annual audit process a Management Report raising internal control issues to be addressed by Council and Officers is issued by the Auditor General. It is pleasing to note that the matters raised (2008/2909) are minor in impact and all are considered to be “low risk”.

Officers have prepared a strategy to address the various issues raised and were considered by Audit Committee, at their meeting on 21 October, 2009.
Common Control Weaknesses (Cont’d)

In response to recommendation 4:

Both Payroll and Accounts Payable functions have been the subject of Internal Audit reviews in the past, (including Electronic Funds Transfer). The audits confirmed that appropriate control measures, including segregation of duties, are in place.

Business Planning

As part of our 2008/2009 audit program, the Auditor General continued a cyclical review of significant financial management controls within councils. This year, he specifically reviewed key aspects of Business Continuity Management (BCM):

- Risk Registers;
- Business Continuity Plans; and
- Disaster Recovery Plans.

These aspects are key components in facilitating effective and efficient council operations.

The recommendations in relation to business continuity management were as follows.

5. The Department of Planning and Community Development should work with the councils to develop an effective better practice BCM, including addressing the key areas of risk registers, BCP’s and DRPs.

6. Councils should have a current risk register that is tailored to their organisation. Procedures should be in place for senior management and the audit committee to review the register monthly and quarterly respectively, and to assess its appropriateness so that the register remain current to the organisation.

7. Councils without current business continuity plan and/or disaster recovery plan should expedite initiatives to develop plans tailored to their organisation.

8. Councils should, at least annually, test their business continuity plans and DRPs to confirm that they are feasible, appropriate and reliable.

Department of Planning and Community Development response to recommendation 5:

“DPCD agrees that all councils should have effective business continuity management plans.

A current draft of Best Practice Guidelines for Local Government Audit Committees includes a role for Audit Committees to oversight business continuity planning. As part of the proposed sector wide consultation on the draft guidelines, DPCD will examine how this role can be further strengthened.”
EFFECTIVENESS OF INTERNAL CONTROLS  (CONT’D)

Business Planning  (Cont’d)

Mornington Peninsula Shire Council supports the recommendations. Whilst we have our own BCP which addresses our specific needs, any work that encourages further enhancement of BCP or CRP planning (and particularly shared disaster recovery opportunities) is beneficial.

In response to recommendations 6, 7 and 8:

Council’s Audit Committee Charter requires the Audit Committee to review a number of ‘risk’ related matters on an annual basis. This report is due to be considered by the Audit Committee in February 2010 and will address the recommendations above, including Council’s Risk Register and Business Continuity Plan.

Mornington Peninsula Shire Council supports the recommendations although, the degree and timing of involvement of the Audit Committee should be though through carefully. Whilst the Risk Registers are a ‘living document’, to have the Audit Committee reviewing the registers on a quarterly basis may not be of optimal value.

Our current Risk Registers are important components of our strategy for effective and efficient operations and we would expect that they would comply with the intent of the report recommendations.

Information Technology Security

Due to their generally heavy reliance on information systems, councils need to have effective Information Technology security controls to protect the confidentiality, integrity and availability of the data they hold and the systems they have in place. Appropriate security controls also prevent unauthorised access to, or release of, sensitive information.

As part of our 2008/2009 audit cycle, the Victorian Auditor General’s Office has undertaken a high-level review across the 79 councils focusing on the following key control areas:

- User access; and
- Information Technology security policies.

The recommendations in relation to Information Technology security were as follows.

9. Councils should prepare, formalise, document and inform users of their Information Technology security policy.

10. Councils should develop, implement and enforce a policy that:

- restricts user access of staff members to only the Information Technology systems that they require to undertake and perform their role;
- regularly reviews user access levels to ensure that they continue to be appropriate; and
- addresses password complexity and requires regular changing of passwords.
EFFECTIVENESS OF INTERNAL CONTROLS (CONT’D)

Information Technology Security (Cont’d)

Mornington Peninsula Shire Council supports the recommendations. Information Technology Security is regularly considered within the current Audit Committee Charter and a separate report on the issue is included within this meeting agenda.

FINANCIAL SUSTAINABILITY

To be sustainable, local governments need to have sufficient capacity to be able to manage future financial risks and shocks without having to radically adjust their current revenue or expenditure policies. One of the key objectives should be to maintain infrastructure assets and manage debts at an acceptable level to support future operations.

The financial sustainability analysis shows improvement for councils in 2008/2009. No council received a high-risk rating and councils with a medium risk rating reduced from 15 to eight.

The Auditor General concluded:

“Overall, the trends across the financial sustainability indicators for the local government sector displayed solid results.

The increase in overall underlying result for the sector is consistent with operating revenue increasing more than operating expenditure for 2008–09. Together with almost stable liquidity and decreasing indebtedness, the long-term financial sustainability of councils is less at risk if these trends continue.

Bridging and balancing both the investment gap and renewal gap continues to be a focus for all councils with the 2008–09 results for these ratio indicating increased spending on renewal, restoring and maintaining existing assets. However, council’s ability to continue spending on future infrastructure can only be maintained in the long term if underlying surpluses improve.”

The five key indicators used were consistent with last year plus an additional indicator for 2008/2009 which builds on the investment gap ratio is the renewal gap.

The report contains a large amount of very useful information however, it is proposed to concentrate on our Council’s performance, rather that benchmark the other 79 Councils.

For Mornington Peninsula Shire:

- Underlying result
  - Industry average for 2008/2009 = 8.0%  MPSC = 2.33%
  - Mean for Outer Metro Councils 2005 to 2009 = 5.69%
  - Mean for MPSC 2005 to 2009 = 4.50%
  - Has progressively improved over the last 10 years
  - Over five years, the Shire is the no.9 Outer Metro Council

- Liquidity
  - Industry average for 2008/2009 = 2.18  MPSC = 1.34
  - Mean for Outer Metro Councils 2005 to 2009 = 2.23
  - Mean for MPSC 2005 to 2009 = 1.39
  - Has remained consistent over the last 10 years
  - Over five years, the Shire is one of the lower Outer Metros
FINANCIAL SUSTAINABILITY (CONT’D)

- **Indebtedness**
  - Industry average for 2008/2009 = 17.2%  MPSC =37.23%
  - Mean for Outer Metro Councils 2005 to 2009 = 26.25%
  - Mean for MPSC 2005 to 2009 = 40.47%
  - Has increased then decreased slightly over the last 10 years
  - Over five years, the Shire is one of the higher Outer Metros

- **Self financing**
  - Industry average for 2008/2009 = 25.9%  MPSC = 18.87%
  - Mean for Outer Metro Councils 2005 to 2009 = 22.89%
  - Mean for MPSC 2005 to 2009 = 15.19%
  - Has remained relatively consistent over the last 10 years
  - Over five years, the Shire is one of the lower Outer Metros

- **Investment Gap**
  - Industry average for 2008/2009 = 1.45  MPSC = 1.20
  - Mean for Outer Metro Councils 2005 to 2009 = 1.44
  - Mean for MPSC 2005 to 2009 = 1.10
  - Has remained relatively consistent over the last 10 years
  - Over five years, the Shire is one of the lower Outer Metros

The Renewal Gap is a new indicator and is a natural extension of the investment gap ratio. This ratio looks at the rate of spending on existing infrastructure where as the investment gap is on total infrastructure. This ratio provides an indication if the council is spending sufficient funds to renew, restore and replace existing infrastructure.

- **Renewal Gap**
  - Industry average for 2008/2009 = 0.93  MPSC = 1.05
  - Mean for Outer Metro Councils 2005 to 2009 = 0.74
  - Mean for MPSC 2005 to 2009 = 0.73
  - Has improved over the period of reporting

The renewal gap indicator has not been incorporated into the overall sustainability risk rating for each council. This indicator is provided as additional information to assist the reader in analysing the investment gap indicator.

In summary, the report concluded that our Council is in the ‘low risk’ category, indicating “Low risk of financial sustainability concerns – no high risk indicators”, the best rating offered for a Council.
It is comforting to know that on the five broad measures the Auditor General sees as relevant, Council is assessed to be financially sustainable.

CONCLUSION

The Report to Victorian Parliament on Local Government 2009 Audits and general financial viability by the Victorian Auditor General’s Office is a most useful benchmarking tool and reminder to Local Government.

For Mornington Peninsula Shire, it is pleasing to report that by independent assessment, the Auditor General has confirmed the Shire’s financial sustainability as ‘low risk’, the best outcome a Council can achieve.

Officers support the various recommendations and will be implementing them as the year progresses.

Officer Direct or Indirect Interest

No person involved in the preparation of this report has a direct or indirect interest requiring disclosure.
RECOMMENDATION

1. That the Audit Committee receive and note:

   A. The report tabled in State Parliament by the Victorian Auditor General titled ‘Report to Victorian Parliament on Local Government 2009 Audits and General Financial Viability’; and

   B. That within the Auditor General’s report, Mornington Peninsula Shire’s financial sustainability is assessed as ‘low risk’, being the best outcome recorded for Councils.

2. That a report on the process of implementing the various recommendations made by the Victorian Auditor General be presented to the Audit Committee at the October 2010 Audit Committee Meeting.