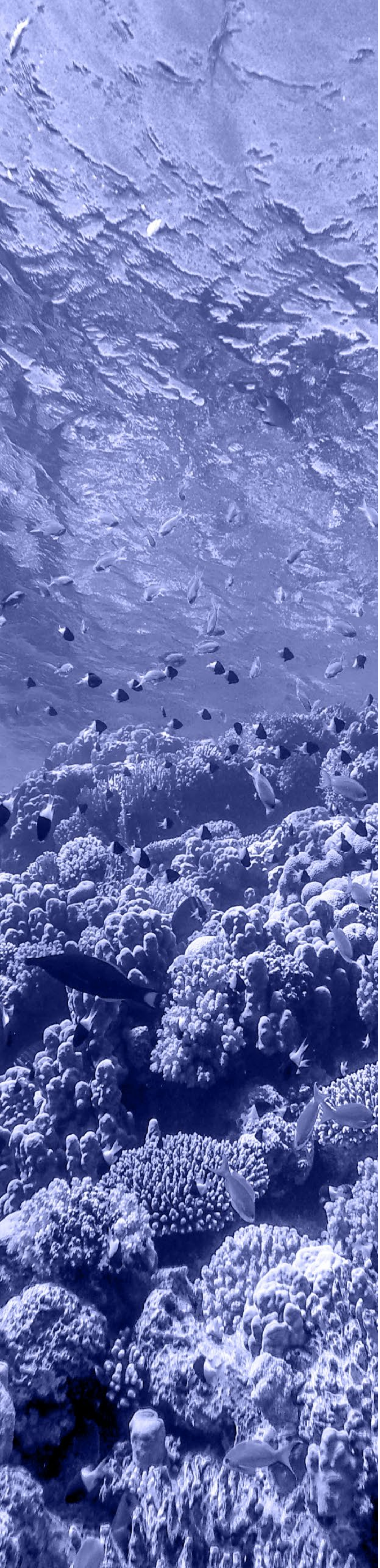


Gladstone Regional Council

2020 Closing report

11 November 2020

Queensland Audit Office
Better public services

11 November 2020

Ms Leisa Dowling
Chief Executive Officer
PO Box 29
GLADSTONE QLD 4680

Dear Ms Dowling

2020 Closing report

We present to you our closing report for Gladstone Regional Council ("council") for the financial year ended 30 June 2020. It includes the results of our audit, identified audit misstatements, and other matters.

Our audit was largely conducted in accordance with our external audit plan issued 19 February 2020. We performed additional procedures over the impairment of assets related to Gladstone Airport Corporation. We confirm that up to the date of this report we have maintained our independence obligations in relation to our conduct of this audit.

Based on the information that has been assessed as part of our audit, we expect to issue an unmodified audit opinion.

We will be issuing a report to parliament incorporating your council. In this report, we will comment on the results of our audit of your financial report, performance and sustainability matters, any significant internal control issues we identified, and the overall results of the local government sector, including, major transactions and events. This report is prepared in accordance with the *Auditor-General Act 2009*.

We are keen to hear your views about the audit services we provide and will seek your feedback via an online survey. This survey will help us understand what is working well and where there are opportunities for us to improve our engagement with you.

If you have any questions or would like to discuss the audit report, please contact me on 07 3257 8568 or Will Fellowes on 07 3257 8309.

Yours sincerely

Steven Bosiljevac
Contact Audit Partner

Will Fellowes
Contract Audit Director

Enc

cc. Kerry Phillips, Chair Audit Risk and Improvement Committee
Cr Matt Burnett, Mayor

1. Summary

This closing report documents our audit of Gladstone Regional Council's financial statements for the year ended 30 June 2020, including how we have responded to significant financial reporting risks.

The final audit opinion is subject to the completion of the financial statement audit process. Key aspects still to be finalised are included in highlights below.

Highlights

Expected audit opinion

We expect to issue an unmodified opinion on the financial statements.

Financial statement preparation process

The financial statement preparation process has been considered in the context of the significant issues identified with the valuation of GAC related assets in 2019/20.

Year-end close process	Timeliness	Quality
Not implemented	Legally compliant	No significant adjustments

Internal control environment

Control environment	Risk assessment	Control activities	Information and communication	Monitoring controls
Effective	Effective	Partially effective	Partially effective	Effective

Refer to Section 5 Audit Issues for further details

Materiality $2.098m

Increase of $0.148m to planning materiality based on 30 June draft results.

Estimated final fees

External audit plan: $156,000

We have incurred additional costs due to work performed to assess impairment of GAC assets, including the use of specialists. We will advise the final fee in our final management letter.

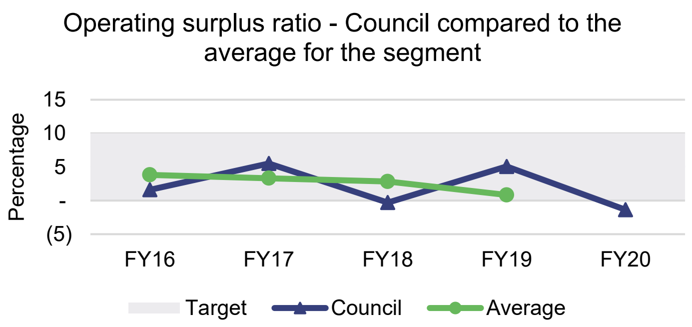
Outstanding audit matters

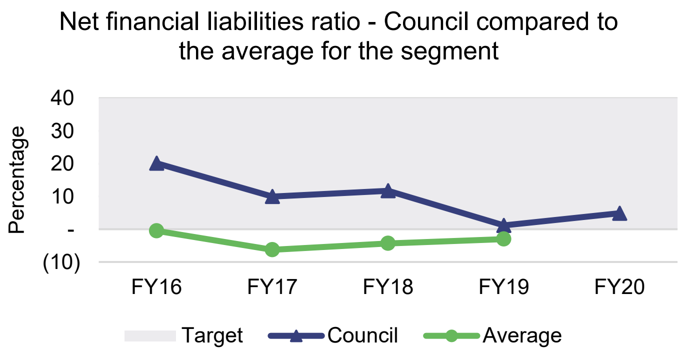
Item	Responsibility
Financial statements review—quality check over final version	Audit
Finalisation of Gladstone Airport Corporation audit. This relates to consolidation into the council's financial statements to ensure completeness and accuracy of disclosures	Management and Audit
Finalisation of technical review of the airport impairment treatment	Audit
Subsequent events update—review of transactions to date of signing	Management and Audit
Management representation letter—to be signed with the financial statements	Management
Financial report certification—signing of the financial statements by management following adoption by the council	Management and Audit

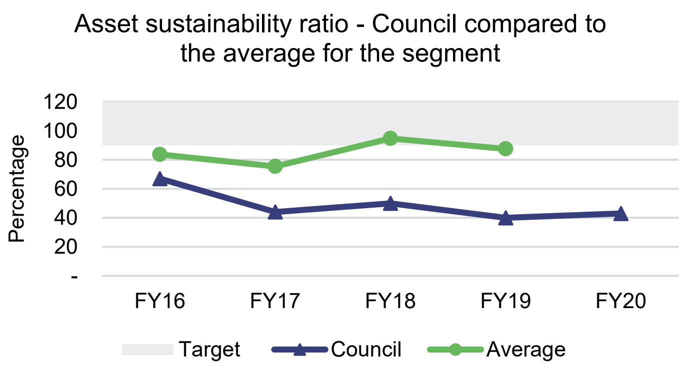
2. Financial sustainability assessment

The table below details our assessment of your financial sustainability and is based on the results of your asset sustainability, operating surplus and net financial liabilities ratios. Our likely 2020 assessment of council's overall financial sustainability risk is **moderate risk**

Refer to Appendix D for guidance on how these ratios are calculated and our financial sustainability risk rating definitions.

Operating surplus ratio	Commentary
	Council's five-year **average** operating ratio is 2.1%. This is within the target range. The average operating surplus ratio indicates that Council has a healthy operating surplus ratio and can generate reasonable levels of funding from its own source revenue that it can fund ongoing operations as well as capital projects with some level of debt funding.

Net financial liabilities ratio	Commentary
	Council's net financial liabilities ratio as at 30 June 2020 is 4.87%. This is within the target range. The net financial liabilities ratio indicates that Council's capital structure is very strong. This, combined with an operating surplus ratio of 2.1%, allows council to service any borrowings that it may need for any future capital projects.

Asset sustainability ratio	Commentary
	Council's average asset sustainability ratio is 48.8%. This is outside the target range and has consistently been below the segment average. The average asset sustainability ratio indicates that Council may not be in a position to replace its assets as they near the end of their useful life. As such, council may encounter a reduction in the asset's service levels and/or useful lives previously expected.

3. Update on emerging risks

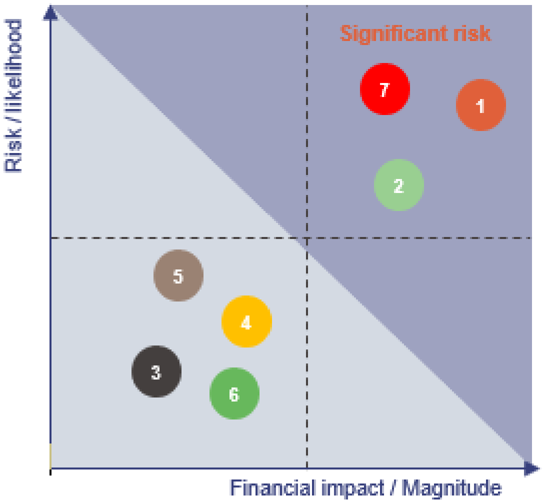
In our interim letter dated 10 June 2020, we had identified the potential areas of concerns and associated risks that arose from COVID-19. The table below provides our understanding of the impact areas of concern and associated risks had on Gladstone Regional Council and our conclusion:

Area of concerns and associated risk	Audit conclusion
Going concern Material uncertainties that cast significant doubt on the ability to continue as a going concern, such as the extent of the effect on future revenue and costs and the unknown duration of the event. Several revenue streams such as airport fees and charges and other recurrent income may reduce. Timing of cash inflows may also be impacted.	There were no significant impacts on the going concern assumption arising from the COVID-19 pandemic for the Council. We note that working capital levels may be impacted by decisions to extend the discount period for ratepayers and reduce creditor payment times. We considered going concern in relation to Gladstone Airport Corporation in addition to Council. There are currently sufficient cash reserves to service debts as and when they fall due for at least 12 months from the date of their financial statements. Management will continue to monitor the airports operations and performance.
'Everyday' internal controls Most entities have expanded to working from home to support social distancing. With any change in working arrangements comes an increased risk of controls failing, particularly manual controls and where controls previously operated with a high level of management oversight within an office environment.	Through our planning work and testing over key controls we note that there is not a high number of manual controls in place and therefore the risk of control breakdowns is not considered to be of higher risk for management.
Information technology and cyber security Entities' exposure to cyber security risks increases in vulnerable and uncertain times as their resources are focused on being re-deployed to address critical matters. There is also a risk that identifying cyberattacks may be potentially delayed causing financial and/or reputational risks.	There have been no significant cyber security breaches identified or communicated to audit during the year.
Valuation of property, plant and equipment Economic uncertainty and imposed community restrictions may impact the ability of valuers to accurately perform comprehensive and/or desktop valuations and meet the fair value measurement requirements of AASB 13.	Comprehensive valuations were undertaken over the RDTI asset class in addition to the airport assets from an impairment perspective due to COVID-19. Finalisation of the valuation was not impacted significantly by COVID-19. However, there were some delays in reporting as a result of travel restrictions. The airport valuation process was a comprehensive and technical matter that was in part due to COVID-19.
Accounting for leases As a result of COVID-19, some entities (those accounting for as a lessee in a lease) may receive 'rent holidays' and other exemptions from their lessors. This could have an impact on the accounting of the right of use assets and the associated liabilities.	Council does not have significant lease balances as a result of AASB 16 (as lessee) therefore there was no material impact arising from rental concessions provided by lessors.
Impairment of receivables There is an increased likelihood that debtors may take longer to pay and, in some instances, not be able to pay their obligations at all.	We note that there was not a significant impact on receivables identified through the audit process nor was there an increased amount of debtor provisions raised.
Financial statement disclosure Several disclosures in the financial statements will be impacted**.**	The financial statements include disclosures where appropriate in relation to COVID-19 and its impacts. These disclosures are considered appropriate in the context of GRC and its operations.

4. Audit conclusions

Areas of audit significance

We identified the areas of your financial report that we considered to be at significant risk of material error. The risk map below sets out the identified areas of audit significance.



Risk 1 – Valuation and depreciation of infrastructure assets

Risk 2 – Risk of fraud in revenue recognition

Risk 3 – Provisions (including landfill)

Risk 4 – Financial sustainability reporting

Risk 5 – Adoption of new accounting standards

Risk 6 – Probity and propriety considerations

Risk 7 – Impairment of carrying value of assets

Our overall conclusions on these key risk areas are outlined in the table below.

Risk	Description	Audit conclusion
1	Valuation and depreciation of infrastructure assets	We have obtained sufficient appropriate audit evidence over the valuations to ensure material compliance with the requirements of AASB 16 *Property, Plant and Equipment,* AASB 13 *Fair Value Measurement* and AASB 136 *Impairment,* noting that the only comprehensive valuation undertaken in FY20 was for the RDTI asset class. The valuation resulted in a net increment in fair value of the class of $319m at the council level and $268m at a consolidated level. We performed comprehensive audit procedures over the valuations which was detailed in our audit plan which included work over the completeness and existence of assets. An unadjusted misstatement has been raised reflecting the indexation assessment that was not taken to account in FY20. This amounted to an unadjusted revaluation increment of $14.5m. In addition, there were $61m of identified assets that were not previously recognised. This was raised as a financial reporting matter in Appendix A2. Refer to the audit adjustments summarised in Appendix B for details.
2	Risk of fraud in revenue recognition	We have obtained sufficient appropriate audit evidence over material revenue streams through a combination of controls testing and substantive test of details. There were no audit adjustments relating to this risk.
3	Provisions including landfill	We have obtained sufficient appropriate audit evidence over leave and landfill provisions through substantive test of details and testing of key assumptions in the calculations. There were no audit adjustments relating to this risk.
4	Financial sustainability reporting	We have obtained sufficient appropriate audit evidence over financial sustainability reporting through recalculation of the relevant ratios and work performed over associated areas of the financial statements. No audit adjustments have been identified relating to this risk.

4. Audit conclusions cont'd

Risk	Description	Audit conclusion
5	Adoption of new standards	We have obtained sufficient appropriate audit evidence over material revenue streams and leasing arrangements on adoption of the new accounting standards. A comprehensive review was undertaken over revenue contracts and technical papers by management. Key disclosures were also reviewed for the revenue standard. We note that there were no material lease adjustments recognised, however we performed work over the calculations, key assumptions and completeness of leasing arrangements to ensure this position was appropriate. Refer below for further details on the new standards.
6	Probity and propriety considerations	Our audit procedures throughout the process incorporated considerations around probity and propriety, particularly around the procure to pay process and related party transactions given the nature of the risk. Our audit procedures did not identify any specific issues around this risk area.
7	Impairment of carrying value of assets	This risk area was identified as a result of COVID-19 and other indicators of impairment with assets associated with the Gladstone Airport Corporation (GAC). The financial statement line items impacted are as follows (values are prior to impairment adjustments): - Investment in GAC held at cost of $71.9m - Shareholder loan receivable of $33.7m - GAC property, plant and equipment of $84.2m (WDV) Management engaged an independent expert to develop an enterprise valuation of GAC to determine the impact on the carrying values of the investment held at cost and other assets associated with GAC. In addition, the valuer provided a fair value valuation on the infrastructure asset class for the purposes of consolidation into GRC's financial statements. The valuation resulted in an enterprise value (recoverable amount) of $37.9m, which was the mid-point in a range of scenarios. This was determined using a discounted cash flow model using a 10-year forecast approved by the Board of GAC. The recoverable amount of $37.9m, meant that the carrying value of the cash generating unit of the airport (determined to be the investment at costs of $71.9m and the shareholder loan of $33.7m) was required to be reduced to $37.9m taking into consideration surplus cash in the business. Accordingly, an impairment expense was recognised of $55.2m and taken against the investment at cost. Management assessed the loan for expected credit losses under AASB 9 *Financial Instruments* and deemed that no losses should be recognised. Management considered the free cash flows out to 2045 which is when the full repayment of the principal amount would be required to be paid out based on the use of a 15-year option period within the agreement. Using the mid-point of the scenarios that management modelled, the free cash available to pay out the loan would be $1.2m less than the principal amount. Given the nature of the loan arrangement with GAC and the ability for renegotiation, this has not been raised as a judgemental adjustment. In addition to the impairment charge against the investment, a further adjustment was made to the airport's property, plant and equipment value both at the GAC and GRC level. This was a combination of a tangible revaluation using a current replacement cost methodology and an economic obsolescence adjustment to reflect the reduction in the enterprise value. This resulted in a net decrement from tangible revaluation of $4.42m and economic obsolescence adjustments of $44.29m. These adjustments reduced the asset revaluation surpluses for the relevant classes at the GRC level, as the assets are held at fair value. A further $0.77m adjustment was made to the plant and equipment asset class through to the impairment expense line as that asset class is held at cost. In total, this process has reduced the net result by $55.97m and net assets by $104.68m. A significant control deficiency has been raised in relation to monitoring of the carrying value of assets associated with the airport in Appendix A1. Audit adjustments are summarised in Appendix B.

4. Audit conclusions cont'd

Adoption of new accounting standards

In 2019/20, GRC mandatorily adopted the following accounting standards:

- AASB 15 – *Revenue from Contracts with Customers*
- AASB 1058 – *Income of Not-for-Profit Entities*
- AASB 16 – *Leases*

What are the changes to the revenue standards?

There is a new accounting standard for not-for-profits related to contributions. This standard was effective from 1 July 2019 for GRC with the impact being the determination of whether contributions should be recognised up-front when they are received or deferred until they are used for specified purposes. The AASB introduced this guidance to address concerns that not-for-profits were recognising revenue too early, and also to align not-for-profit accounting to the new revenue recognition for for-profit entities. The standard states that a contribution can be deferred if there is a legally enforceable contract with the provider and there is sufficient detail in the contract as to how the contribution must be spent.

The key impact of these standards was to defer prepaid rates revenue onto the balance sheet, where historically rates paid in advance were recognised as revenue on receipt. This is further disclosed in Note 32 to the financial statements.

What are the changes to the leases standard?

The second area of change is leases, which was also effective from 1 July 2019 for GRC. The principal change with the new leases standard is to remove the distinction that existed between an operating lease and a finance lease, and treat all leasing transactions consistently. The new leasing standard will bring all leases on balance sheet, which will gross up assets and liabilities.

Fundamentally, all leases in place at any entity will be recorded in the balance sheet as a non-current "right of use" asset with an associated lease liability (separated into current and non-current components). The income statement (statement of profit or loss and other comprehensive income) will show the lease expense as depreciation (relating to the right of use asset) and interest relating to the lease liability rather than rent expense being shown as an operating expense.

Managements review of its lease arrangements did not identify any material leasing arrangement where council is lessee. An adjustment on transition date of $1.615m was made in the financial statements. This is further disclosed in Note 32 to the financial statements.

Other areas of audit significance

Description	Audit conclusion
Management override of controls	We have performed several procedures in relation to the risk of fraud resulting from management override of controls, including the review of journal postings. We have not identified any fraudulent or inappropriate activity throughout the audit process.

4. Audit conclusions cont'd

Consolidation accounts—controlled entities

The audit of Gladstone Airport Corporation is being finalised. The valuations undertaken have also had a similar impact at the controlled entity, mainly in relation to property, plant and equipment and income tax equivalents.

The total carrying value of GAC's property, plant and equipment prior to impairment at 30 June 2020 was $84.3m and based on the valuation an adjustment of $49.5m was required to reduce the balance down to $34.8m. This included a combination of fair value adjustments (for buildings held at fair value) and impairment adjustments for other asset classes taken against both the revaluation reserve in equity to the extent it had sufficient surplus available and as impairment expense. There are also tax implications of these adjustments impacting the deferred tax balances and income tax expense / benefit.

A separate closing report will be issued to the Board of GAC detailing similar conclusions reached and control findings in relation to this matter.

Provision of financial reporting support to controlled entity

The composition of GAC's finance team is considered appropriate for the size and nature of the corporation and its day to day operations. However it was identified through the financial reporting process in 2019/20 that GAC requires support in the statutory reporting process given there are areas of complexity (e.g. asset valuations, tax equivalents and general purpose financial statement preparation) that would be aided by support from GRC during the key reporting periods.

Council should consider establishing a process where support is provided to GAC during the key financial reporting periods. This could be provided through a service level agreement if deemed appropriate.

Other audit opinions

In conjunction with our 2019/20 audit of Council, we will issue audit opinions on special purpose financial reports prepared for the following programs:

- Roads to Recovery
- CQ Bushfires
- Gladstone Community Legal Advice Program
- Community and Individual Support Program

Audit materiality

Our audit materiality thresholds have been reassessed based on your year-end financial statement balances and have changed since we communicated those in the external audit plan.

We used these thresholds in assessing misstatements.

Overall	Performance	Reported misstatements	Specific—property, plant & equipment
$2.098m	$1.783m	$0.21m	$104.4m
[per external audit plan $1.95m]	[per external audit plan $1.65m]	[per external audit plan $0.2m]	[per external audit plan $104.4m]

SENSITIVE

4. Audit conclusions cont’d

Evaluation of misstatements

At the date of this report, we have identified corrected misstatements that resulted in a decrease in net assets of $104.68m and a decrease in net results amounting to $55.97m. This relates directly to the impairment of the airport related assets.

At the date of this report, we have identified uncorrected misstatements that resulted in an increase in net assets of $13.05m with no change in net results relating to an immaterial unadjusted indexation movement and our judgement of expected credit losses of the shareholder loan.

Details of these corrected and uncorrected misstatements are included in Appendix B to this closing report.

Evaluation of disclosure misstatements

At the date of this report, we have identified misstatements in disclosures that required correction to the financial statements. These were in relation to the significant impairment adjustments made in relation to the airport.

There were no uncorrected disclosure misstatements identified in the financial statements. Details of these corrected and uncorrected disclosure misstatements are included in Appendix B to this closing report.

5. Audit issues

Internal controls

This table summarises our reporting on significant deficiencies/deficiencies in internal controls. See Appendix A for details.

	Number of significant deficiencies		Number of deficiencies		Rating
	Current year	Prior year unresolved	Current year	Prior year unresolved	
Control environment *Structures, policies, attitudes and values that influence daily operations*	-	-	-	-	Effective
Risk assessment *Processes for identifying, assessing and managing risk*	-	-	-	-	Effective
Control activities *Implementation of policies and procedures to prevent or detect errors and safeguard assets*	-	1*	1	-	Partially effective
Information and communication *Systems to capture and communicate information to achieve reliable financial reporting*	1	-	1	-	Partially effective
Monitoring activities *Oversight of internal controls for existence and effectiveness*	-	-	-	-	Effective

Effective
No significant deficiencies identified

Partially effective
One significant deficiency

Ineffective
More than one significant deficiency

* Note that the issue 19IR-1 is included in the assessment due to the issue related to asset management plans not resolved until year-end.

Financial reporting issues and other matters

This table summarises our financial reporting and other issues raised in the current year and those carried forward from prior years. See Appendix A for details.

	Financial reporting issues—risk ratings			Other matters*
	High	Moderate	Low	
Current year				
Unresolved	-	-	-	-
Resolved	-	-	-	-
Prior year				
Unresolved	-	1	-	-
Resolved	-	-	-	1

* We only track resolution of other matters where management has committed to address the item raised.

SENSITIVE

6. Audit assessments

Effectiveness of financial statements preparation process

Our assessment of the effectiveness of your financial statement preparation process involved considering three components: your year-end close process, the timeliness of your financial statements, and the overall quality of your financial statements. We assessed these based on the criteria disclosed in the external audit plan. These are further explained below.

We assessed the outcomes of your year-end close processes, based on the dates outlined below, unless we agreed an earlier date in your financial reporting timetable.

Year-end close processes	Timeliness of certification of financial statements	Quality of draft financial statements
30 JUN Your rating: 🔴 Not implemented	Your rating: 🟡 Legally compliant	Your rating: 🟡 No significant adjustments
We assessed the outcomes of your year-end close processes, based on the agreed dates in the external audit plan: • finalising non-current asset valuations - 31/07 (actual: 14/09) • Shell financial statements completed - 19/06 (actual: 19/06) • Complex/contentious accounting issues resolved - 19/06 (actual: 22/10) • Work-papers reviewed and available for audit - 14/09 (actual: 14/09) • Final draft financial statements completed - 14/09 (actual: 30/10) 2 out of 5 milestones were met. We note that a number of these targets were not met as a result of the significant impairment issues that were dealt with.	We assess the timeliness of financial statements by comparing the date the independent auditor's report was issued against the legislative deadline of 31 October. GRC sought an extension from the minister to which was granted. This therefore allowed council to address the impairment matter appropriately.	We assess the quality of financial statements based on the materiality of the adjustments (including material prior period adjustments) made to figures and note disclosures between the first draft of the financial statements provided to audit and the version that is certified. We have not included in our assessment the significant adjustments from the impairment adjustments processed in October. These have been captured in the year-end close processes rating for the date the final draft financial statements were completed. Other changes to the financial statements were not considered significant and therefore an amber rating has been given.

Our ratings criteria

🟢 Fully implemented All key milestones achieved	🟢 Timely Audit opinion issued on or before 13 October 2020	🟢 No adjustments No adjustments were required
🟡 Partially implemented Three to four milestones achieved	🟡 Legally compliant Audit opinion issued between 14 October and 31 October 2020 or meet approved ministerial extension	🟡 No significant adjustments Immaterial adjustments to financial statements
🔴 Not implemented Less than three milestones achieved	🔴 Untimely Audit opinion issued after 31 October 2020	🔴 Significant adjustments Material adjustments to financial statement components were required

7. Other required information

We are required to report certain matters to those charged with governance. The table below provides a summary of the matters usually communicated at the end of our audit.

Matters for QAO to consider	How these were addressed
Disagreements with management	During our audit, we received full co-operation from management and had no unresolved disagreements over the application of accounting principles and the scope of our audit.
Significant difficulties	We did not encounter any significant difficulties during the audit outside of the impairment matter that we worked with management in resolving.
Compliance with laws and regulations	We did not identify any instances of non-compliance with laws and regulations that may have a material effect on the financial report.
Matters significant to related parties	We did not note any significant matters in relation to related parties during the audit.
Changes to accounting policies	We confirm there were no significant changes to accounting policies during the period, except for those changes arising from the adoption of the new accounting standards.
Other matters significant to the oversight of the financial reporting process	We have raised one significant deficiency about the monitoring and assessment of indicators of impairment (refer Appendix A1). There is also commentary in Section 4 of this report relating to support required for GAC's financial reporting processes. We otherwise did not note any significant matters in relation to the financial reporting process during the audit.
Fraud and illegal acts	We have made enquiries of management regarding: • knowledge of any fraud or suspected or alleged fraud affecting the entity involving management, employees who have significant roles in internal control, or others where fraud could have a material effect on the financial report • knowledge of any allegations of fraud, or suspected fraud, affecting the financial information. We did not become aware of any fraud or illegal acts during our audit.
Other information in the entity's annual report	We have not undertaken audit procedures to verify other information in the entity's annual report as required by Australian Auditing Standard ASA 720 *The Auditor's Responsibilities Relating to Other Information*. Our review will examine whether annual report financial information and non-financial information is not inconsistent with the financial report.

Appendix A1—Internal control deficiencies

The following table details control deficiencies and other matters identified since our last interim report dated 10 June 2020. It includes a response from management.

Our risk ratings are as follows—refer to Internal controls rating definitions for more detail.

Significant deficiency **Deficiency** **Other matters**

Significant deficiencies

20CR-1 – Monitoring and assessment of indicators of impairment COSO component – information and communication

Based on the outcome of the airport related impairment adjustments it was evident that there is no formalised process established to monitor and assess whether there are any indicators of impairment of the carry values of the airport assets. This includes the investment held at cost, the physical assets and other related items such as the shareholder loan that is relevant for both GRC and GAC financial reporting purposes.

The impairment of these assets took a significant amount of council resources through the financial reporting process and may have been mitigated by the early identification of a significant issue with the asset values.

Implication

Potential for material impairment adjustments, including both impairment charges and reversals, in the future that are not identified and accounted for in a timely manner.

QAO recommendation

It is recommended that management:

1. Establish a process that assesses and identifies indicators of impairment (or reversals) based on the requirements of AASB 136 *Impairment of Assets*
2. Prepare an annual position paper based on the established process that outlines these considerations. Management now have a comprehensive position paper considering the key factors and underlying calculations of value in use that can be utilised
3. Coordinate with GAC to ensure there are no other factors that might impact an impairment assessment (e.g. unusual passenger numbers or forecasts or significant planned capital maintenance projects)
4. Like the PPE asset valuation process, provide ARIC with this position paper to ensure an appropriate level of oversight and review at the governance committee level is maintained.
5. Engage with external experts as deemed appropriate if there are any significant indicators of impairment or reversals of impairment identified

Management response

Agreed. Management will work with GAC to undertake a yearly impairment review process.

Responsible officer: Mark Holmes

Status: Work in progress

Action date: 30 June 2021

Deficiencies

20CR-2 QAO interim and final reports not tabled at ordinary Council meetings
COSO component: Information and communication

Historically, QAO's interim and final reports are tabled and discussed at the first available Audit, Risk and Improvement Committee meeting. We understand that Councillors regularly attend these meetings.

However, section 213 of the *Local Government Regulation 2012* (the Regulation) requires the Mayor of a local government to present a copy of the auditor-general's 'observation report' at the next ordinary meeting of the local government. QAO's interim and final reports are these observation reports.

The requirement to table reports of audit observations from the auditor-general at ordinary council meetings is to ensure transparency and accountability of Council regarding audit findings.

Implication

By not tabling these reports to the subsequent Council meeting, Council it is not in compliance with the Regulation. In addition, it may not allow Councillors to consider the findings contained within the reports.

QAO recommendation
We recommend tabling both the interim and final management reports at the next ordinary meeting of Council after receiving each report.

Management response
Agreed. Management will table both the interim and final management reports at the next ordinary meeting of Council after receiving each report

Responsible officer: Mark Holmes

Status: Work in progress

Action date: 1 December 2020

Appendix A1—Internal control deficiencies cont’d

Deficiencies

20CR-3 Improvement of the three-way-match process required
COSO component: Control activities

The fundamental process around three-way matching of purchase orders to invoices and delivery dockets has been identified as a matter for further development, both as an underlying process and business education issue and system utilisation issue. The fundamental process of timely invoice input against purchase orders has not been fully embedded due to processes of pushing invoices out to the relevant business units prior to input into the system.

Implication

Completeness of payables and accruals if invoices are not processed in a timely manner. In addition, this matter could cause delay in payment to creditors which is both a business and reputational issue.

QAO recommendation

Develop processes for the input of invoices on receipt against purchase orders for work flowing in the system for approval and ensure system capabilities are in line with business expectations.

Management response

Management is currently working with TechOne to develop a new system process to enable invoices to be entered into the system upon receipt. Phase 1 development and testing is currently underway.

Responsible officer: Mark Holmes

Status: Work in progress

Action date: 31 March 2021

Appendix A2—Financial reporting issues

The following tables detail financial reporting issues identified through our audit since our last interim report dated 10 June 2020. It includes a response from management.

Our risk ratings are as follows—refer to Financial reporting issues rating definitions for more detail.

High Medium Low

Medium risk issues

20CR-4 - Asset valuations – RDTI assets not previously recognised

Observation

As part of the 2019/20 comprehensive valuation process of the RDTI asset class it was identified that some specific sub-classes had assets recognised that were not previously recorded. This related to stormwater culverts, kerbs and retaining walls. The total amount of these identified assets is $61m and of this $55m relates to culverts and headwalls, $3m relates to retaining walls and $3m relates to kerbs.

The derivation of this issue is the 2015/16 valuation and componentisation process where there were inconsistencies in the componentisation and upload into myData in addition to the allocation of road drainage (e.g. culverts and headwalls) unit rates being applied in pre-2015/16 valuations but not in the post valuation allocations.

The asset team undertook a comprehensive review of the data sets to identify the source of the issue and to quantify its impacts. The 2019/20 valuation experts were also involved in this process.

This matter, given its nature, was considered by management and audit in the context of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* in relation to whether this constitutes a prior period error requiring retrospective restatement and AASB 116 *Property, Plant and Equipment* in relation to the treatment and disclosure within the financial statements.

Based on the work performed by management over the adjustments and the audit procedures performed over completeness and existence of assets contained within the register it was considered immaterial for prior period restatement. On that basis, the adjustments were processed through the asset revaluation surplus as part of the current year valuation.

Implication

There is a risk of material misstatement in the completeness and existence of assets held by council. In addition, there are asset management consequences if a complete understanding of the asset portfolio is not known.

QAO recommendation

It is recommended that management continues with its data cleansing and verification program, particularly considering comprehensive valuations are being performed across a number of asset classes in 2020/21.

Management response

Agreed. Management will continue with it's data cleansing and verification program throughout 2020/21.

Responsible officer:	Manager Asset Governance
Status:	Work in progress
Action date:	30 June 2021

Appendix A3—Matters previously reported

The following table summarises all control deficiencies, financial reporting issues and other matters that we have raised this year and those issues raised in in prior years but are not yet resolved.

Reference	Rating	Issue	Status/Comment action date
Internal control issues			
19IR-1		**Asset management plans are outdated** Council has not completed updating its asset management strategy and asset management plans with the existing plans a number of years old.	Resolved at year end The asset management plans have been finalised and distributed by management.
Financial reporting issues			
18FR-1		**Asset valuations – RDTI assets resulting in material adjustments** We noted that material adjustments were needed to correct the value of RDTI assets in the prior period.	Re-raised This is part of a continual improvement program. We note that through the comprehensive valuation process over the RDTI assets a number of assets that were not previously recorded were identified. This matter was not material to the financial statements therefore process through the current period valuation. Further information in relation to this matter is provided in Appendix A2.
Other matters			
19CR-1		**Reporting on controlled entities and beneficial enterprises** It was noted that Council does not: • Have a formal policy on establishing controlled entities or beneficial enterprises (or being a party to such enterprises). • Always provide financial information on beneficial enterprises to Council as part of reporting. • Specifically refer to beneficial enterprises in Council's conflict of interest policies.	Resolved The policy has been developed and distributed by management.

SENSITIVE

Appendix A4—Our rating definitions

Internal controls rating definitions

	Definition	Prioritisation of remedial action
Significant deficiency	A significant deficiency is a deficiency, or combination of deficiencies, in internal control that requires immediate remedial action. Also, we increase the rating from a deficiency to a significant deficiency based on: • the risk of material misstatement in the financial statements • the risk to reputation • the significance of non-compliance with policies and applicable laws and regulations • the potential to cause financial loss including fraud, or • where management has not taken appropriate timely action to resolve the deficiency.	This requires immediate management action to resolve.
Deficiency	A deficiency arises when internal controls are ineffective or missing, and are unable to prevent, or detect and correct, misstatements in the financial statements. A deficiency may also result in non-compliance with policies and applicable laws and regulations and/or inappropriate use of public resources.	We expect management action will be taken in a timely manner to resolve deficiencies.
Other matter	An other matter is expected to improve the efficiency and/or effectiveness of internal controls, but does not constitute a deficiency in internal controls. If an other matter is not resolved, we do not consider that it will result in a misstatement in the financial statements or non-compliance with legislative requirements.	Our recommendation may be implemented at management's discretion.

Financial reporting issues rating definitions

	Potential effect on the financial statements	Prioritisation of remedial action
High	We assess that there is a high likelihood of this causing a material misstatement in one or more components (transactions, balances and disclosures) of the financial statements, or there is the potential for financial loss including fraud.	This requires immediate management action to resolve.
Medium	We assess that there is a medium likelihood of this causing a material misstatement in one or more components of the financial statements.	We expect management action will be taken in a timely manner.
Low	We assess that there is a low likelihood of this causing a material misstatement in one or more components of the financial statements.	We recommend management action to resolve; however, a decision on whether any action is taken is at management's discretion.

Appendix A5—Information on internal controls

What is internal control?

‘Internal control’ is the processes, systems, records and activities that your entity designs, implements and maintains to provide you with reasonable assurance about the achievement of organisational objectives regarding:

- reliability of financial reporting
- effectiveness and efficiency of operations
- compliance with applicable laws and regulations.

Your governing body and executive management collectively are responsible for preparing reliable financial statements in accordance with generally accepted accounting principles. They are similarly responsible for maintaining effective internal control over financial reporting.

Our assessments of your internal control framework

The auditing standards that we must comply with require us to understand and assess those aspects of your internal control that relate to our financial statement audit objectives. In the planning phase of our audit, we sought to understand and evaluate how controls are designed and implemented. We communicated to you the results of our analysis in our external audit plan.

If we decide that we can rely on your controls, we must then test them to confirm they operated effectively. The results of our testing may highlight deficiencies in your internal controls. We assess whether any identified deficiencies in internal control constitute, individually or in combination, a significant deficiency in internal control.

Limitations of our reporting on internal control deficiencies

No system of internal control can provide absolute assurance about the absence of error or compliance. Even in the absence of identified control weaknesses, inherent limitations in your internal controls over financial reporting may not prevent or detect material misstatements.

Appendix B—Misstatements

In total, the effect of the corrected misstatements on the consolidated group accounts has resulted in a decrease in net result of $55.97 million reflecting the impairment expense for both the investment in GAC and plant and equipment, and a decrease in net assets of $104.68 million.

Summary of corrected misstatements

The following misstatements were identified during the audit and have subsequently been corrected by management in the financial statements.

#	Details	Statement of comprehensive income Increase/(decrease) $m	Statement of financial position Increase/(decrease) $m
1	Impairment expense	(55.20)	–
	Investment at cost	–	(55.20)
	Impairment of council's investment in GAC held at cost		
2	Impairment expense	(0.77)	–
	Asset revaluation surplus / other comprehensive income	(48.71)	–
	Property, plant and equipment	–	(49.48)
	Reflect impairment of the GAC assets at consolidated level		
	Total	**(104.68)**	**(104.68)**

Appendix B—Misstatements cont'd

Summary of uncorrected misstatements

During the course of our audit, we identified the following uncorrected misstatements and requested that they be corrected. Management has concluded that these matters are not material and do not propose adjustment. Should the audit, risk and improvement committee concur with management and elect not to adjust, we consider the misstatements are not material either to the financial statements as a whole or to individual line item presentations.

#	Details	Statement of comprehensive income	Statement of financial position
		Increase/(decrease) $m	Increase/(decrease) $m
1	Property, plant and equipment	–	14.25
	Asset revaluation surplus / other comprehensive income	14.25	–
	Application of unadjusted revaluation indices across asset classes not comprehensively valued based on materiality		
	Total	**14.25**	**14.25**

Summary of corrected / uncorrected disclosure misstatements

During the course of our audit, we identified the following disclosure misstatements that were corrected by management:

- Required disclosures in accordance with AASB 136 *Impairment of Assets* and AASB 13 *Fair Value Measurement* as a result of the impairment of the airport. These have been reflected in the following notes:
  - Note 1 – Significant accounting policies
  - Note 10 – Impairment
  - Note 12 – Receivables
  - Note 14 – Investment in controlled entity
  - Note 16 - Property, plant and equipment
  - Note 33 – Financial instruments and financial risk management

There were no uncorrected disclosure misstatements.

Appendix C—Next year planning considerations

We identified the following financial reporting matters during the current year audit for consideration in planning next year's audit.

Next year audit planning considerations	Potential effect on financial statements	Potential effect on audit
Comprehensive valuations are being undertaken across a number of asset classes in FY2021. Key to success of the valuation process is early engagement with valuers and earlier processing of the results.	The valuation of a number of asset classes can have a significant impact on the financial statements, including asset values, disclosures and timeliness of the financial reporting process.	Significant valuations are a complex and time-consuming audit process. Early engagement with the audit team is essential to ensure no significant issues arise at the end of the reporting process.
Ongoing impact of COVID-19	Potential change in the carrying amount of GAC assets, both at a Council and consolidated level.	Continue to review potential indicators of impairment or reversal of impairment.

Appendix D—Assessment of Financial Sustainability

Assessment of financial sustainability

Section 169(5) of the *Local Government Regulation 2012* outlines the following relevant measures of financial sustainability for all Queensland local governments must report on:

Sustainability measure	Purpose	How is it measured?	Target
Operating surplus ratio	The Operating Surplus Ratio indicates the extent to which operating revenues raised cover operating expenses.	*Net operating result/Total operating revenue (excluding capital items)*	Between 0% and 10% per annum
Net financial liabilities ratio	The Net Financial Liabilities Ratio indicates the extent to which operating revenues (including grants and subsidies) can cover net financial liabilities (usually loans and leases).	*(Total Liabilities – current assets)/Total operating revenue*	< 60% per annum
Asset sustainability ratio	The Asset Sustainability Ratio indicates the extent to which assets are being replaced as they reach the end of their useful lives.	*Capital Expenditure on replacement of assets (renewals)/Depreciation*	> 90% per annum

We assigned a risk rating to each measure using the below criteria.

Risk rating measure for Individual Ratios	Operating surplus ratio	Net financial liabilities ratio	Asset sustainability ratio
Higher	Less than negative 10% (i.e. losses) Insufficient revenue is being generated to fund operations and asset renewal	More than 80% Potential long term concern over ability to repay debt levels from operating revenue	Less than 50% Insufficient spending on asset replacement or renewal resulting in reduced service levels and increased burden on future ratepayers
Moderate	Negative 10% to zero A risk of long term reduction in cash reserves and inability to fund asset renewals	60% to 80% Some concerns over the ability to repay debt from operating revenue	50% to 90% Irregular spending or insufficient asset management practices creating a backlog of maintenance/renewal work
Lower	More than zero (i.e. surpluses) Well positioned to fund operations and asset renewals	Less than 60% No concern over the ability to repay debt from operating revenue	More than 90% Likely to be sufficiently replacing or renewing assets as they reach the end of their useful lives

Appendix D—Assessment of Financial Sustainability cont'd

Our assessment of financial sustainability risk factors does not take into account council's long-term forecasts or credit assessments undertaken by Queensland Treasury Corporation. We calculate the overall financial sustainability risk assessment using the ratings determined for each measure using the criteria in the table below.

Risk level	Detail of risk
Higher risk 🔴	Higher risk of sustainability issues arising in the short to medium term if current operating income and expenditure policies continue, as indicated by average operating deficits (losses) of more than 10 per cent of operating revenue.
Moderate risk 🟡	Moderate risk of sustainability issues over the longer term if current debt financing and capital investment policies continue, as indicated by: • current net financial liabilities more than 80 per cent of operating revenue or • average asset sustainability ratio over the last 5 years is less than 50 per cent or • average operating deficits (losses) over the last five years of between two and 10 per cent of operating revenue or • realising two or more of the individual ratios for moderate risk assessments (per the table opposite).
Lower risk 🟢	Lower risk of financial sustainability concerns based on current income, expenditure, asset investment and debt financing policies.

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