

AUDIT CONCLUDING MEMORANDUM

Shire of Katanning

Year ended 30 June 2021



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1. Executive Summary

Introduction

Moore Australia has been engaged by the Office of Auditor General (OAG) Western Australia to perform an audit of the Shire of Katanning (the Shire)'s annual financial report for the year ended 30 June 2021.

The key purposes of this memorandum is to communicate the results of the audit with those charged with governance.

We request management and the Audit Committee to review this document to ensure that

- the Shire concurs with the matters raised, and
- there are no further significant considerations or matters that could impact the audit and the financial report.

This document is strictly confidential and although it has been made available to management and those charged with governance to facilitate discussions, it may not be taken as altering our responsibilities to the Shire arising under our audit contract with OAG.

The contents of this document should not be disclosed to third parties without our prior written consent.

Audit Status and Report

We are pleased to advise that we have completed our audit of the Shire's financial report for the year ended 30 June 2021.

We will recommend to the OAG to issue an unmodified opinion on the audit of the Shire's financial report.

In addition, we noted the following matter to be reported in accordance with Reg 10(3) of the Local Government (Audit) Regulations 1996:

- There is a significant adverse trend in the financial position of the Shire as the Operating Surplus Ratio has been below the industry benchmark and OAG threshold for the past 3 years.
- Fixed asset reconciliation between the register and the corresponding general ledger control accounts has not been performed from December 2020 to April 2021. This is a key control for ensuring the completeness and accuracy of financial data within the general ledger from which financial statements are derived. Without this reconciliation being performed on a regular basis there is an increased risk of fraud and or errors going undetected.

Key Audit Risks or Focus Areas

We identified key audit risks or audit focus areas as part of our risk assessment procedures undertaken throughout the audit.

We are pleased to advise we have satisfactorily completed our audit procedures designed to address those risks and met our audit objectives. The identified key audit risks and results of the relevant procedures performed are detailed in Section 2 of this memorandum.

Summary of Audit Differences

We did not identify any non-trivial uncorrected audit differences.

Internal Controls Relevant to Audit

We did not identify any significant deficiencies in internal controls other than those matters noted during the interim audit. The interim management letter was issued to the Shire on 29 July 2021.

Other Key Matters

We confirm we have no issues with other keys matters relating to our independence as auditor of the Shire, irregularities and illegal acts, non-compliance with laws and regulations, appropriateness of accounting policies and liaison with management.

2. Key Audit Risks and Focus Areas

As part of our risk assessment, we identified key audit risks based on our extensive knowledge of the Shire, the industry and issues faced by regional local governments. This risk assessment process is designed to ensure that we focus our audit work on the areas of highest risk.

This risk assessment and our responses have been updated throughout the engagement to ensure that all areas of material risk are addressed by our audit.

Set out below is an overview of what we have identified as the key audit risks and focus areas for the audit of the Shire's financial report for the year ended 30 June 2021. The table below also includes our audit procedures performed to address these risks together with the outcomes.

RISK AREAS	AUDIT PROCEDURES TO ADDRESS RISK	CONCLUSIONS
PROPERTY, PLANT AND EQUIPMENT AND INFRASTRUCTURE		
<p>There is a significant industry risk given the nature of assets held and judgement applied in determining fair values as well as depreciation expense.</p> <p>As at 30 June 2021, the Shire reported a total property, plant and equipment and infrastructure of \$217.7mil. No revaluation of assets were carried out during the year ended 30 June 2021.</p>	<p>Property, Plant and Equipment and Infrastructure</p> <ul style="list-style-type: none"> • Documented and tested key financial controls around Property, Plant and Equipment and Infrastructure balances. • Assessed accounting policies associated with fair value assessments and ensured they were in accordance with accounting standards. • Substantively tested samples of asset additions and disposals. • Reviewed the application of amendments to Local Government (Financial Management) Regulations 16 and 17A. • Reviewed management's impairment assessment against the Shire's circumstances. • Reviewed fair value disclosures to ensure in accordance with AASB13 requirements. <p>Depreciation and amortisation</p> <ul style="list-style-type: none"> • Reviewed depreciation policy for the various asset classes and assessed the reasonableness of rates used. • Documented and tested key financial controls around the calculation of depreciation/amortisation. • Performed depreciation recalculations based on our sampling approach. 	<p>Based on work performed, we are satisfied that the Shire's property, plant and equipment and infrastructure are fairly stated and disclosed in the 2021 financial report.</p>

2. Key Audit Risks and Focus Areas

RISK AREAS	AUDIT PROCEDURES TO ADDRESS RISK	CONCLUSIONS								
REVENUE										
<p>The Shire's main sources of revenue are:</p> <ul style="list-style-type: none"> • government grants; • rates; and • Other fee for service revenue streams. <p>Given the variety of revenue streams and performance obligations, there is a risk that revenue may not be recognised in accordance with AASB 15 and AASB 1058 which were effective from 1 July 2019.</p> <p>For the year ended 30 June 2021, the Shire has recognised:</p> <table border="1"> <tr> <td>Rates</td> <td>\$4.1mil</td> </tr> <tr> <td>Operating grants, subsidies and contributions</td> <td>\$3.0mil</td> </tr> <tr> <td>Non- Operating grants, subsidies and contributions</td> <td>\$7.1mil</td> </tr> <tr> <td>Fees and Charges</td> <td>\$1.9mil</td> </tr> </table>	Rates	\$4.1mil	Operating grants, subsidies and contributions	\$3.0mil	Non- Operating grants, subsidies and contributions	\$7.1mil	Fees and Charges	\$1.9mil	<p>We reviewed the Shire's assessment of revenue recognition with respect to the recognition requirements of AASB 15 and AASB 1058.</p> <p>Given the nature of local government grants, we substantively tested this revenue to third party documentation such as funding agreements & invoices and vouch receipt of funds in accordance with our established sampling methodology.</p> <p>We also tested the recognition of contract liabilities to ensure proper accounting with AASB 15 and AASB 1058.</p> <p>For rates, and fees & charges, we documented and performed walkthroughs of the key financial controls. We also performed substantive tests of details utilising our sampling methodology. In addition, we performed analytical review to obtain the required level of assurance.</p> <p>We also reviewed the design and implementation of controls of all other main sources of revenue.</p> <p>We have considered the nature, complexity and materiality of the revenue transactions to assess the risk of fraud in revenue recognition.</p>	<p>Based on work performed, we are satisfied that the Shire's revenue is fairly stated and disclosed in the 2021 financial report.</p>
Rates	\$4.1mil									
Operating grants, subsidies and contributions	\$3.0mil									
Non- Operating grants, subsidies and contributions	\$7.1mil									
Fees and Charges	\$1.9mil									
EMPLOYEE BENEFIT PROVISIONS										
<p>Provisions for annual leave and long service leave involves a degree of management estimation and uncertainty in their calculation in respect of inflation rates, discount factors, timing and probabilities of settlement. There is risk that these liabilities may not be captured completely and recognised in accordance with AASB 119: Employee Benefits.</p> <p>As at 30 June 2021, the Shire reported a total provision of \$785K.</p>	<p>We performed walkthroughs of the systems and tested key financial controls with a view to rely on the internal controls.</p> <p>We performed substantive test of details on the calculation of the provisions to the payroll records utilising our sampling methodology as well as year end analytical review to obtain the required level of audit assurance.</p> <p>We also reviewed the disclosure of the provisions to ensure they are consistent with AASB 119.</p>	<p>Based on work performed, we are satisfied that the Shire's employee benefit provisions are fairly stated and disclosed in the 2021 financial report.</p>								
LEASES										
<p>The Shire recognised right-of- use assets and corresponding lease liabilities pertaining to its operating leases as at 30 June 2021. There is a risk that the assets and liabilities are not properly accounted for if there are new leases entered, old leases expired and changes to existing lease terms during the financial year.</p> <p>As at 30 June 2021, the Shire reported a total right-of-use assets and lease liabilities of \$51K and \$49K respectively.</p>	<p>We reviewed the supporting documents to ensure both assets and liabilities are properly accounted for in accordance with AASB 16.</p> <p>We reviewed the workings for the initial take up of new leases, the removal of expired leases and the recalculation arising from changes to existing lease terms during the year.</p> <p>We also completed depreciation recalculations and testing of lease liability payments based on our sampling approach.</p> <p>We also reviewed the adequacy of the required disclosures in the financial report.</p>	<p>Based on work performed, we are satisfied that the Shire's right of use assets and corresponding lease liabilities are fairly stated and disclosed in the 2021 financial report.</p>								

2. Key Audit Risks and Focus Areas

RISK AREAS	AUDIT PROCEDURES TO ADDRESS RISK	CONCLUSIONS						
EXPENDITURE								
<p>Expenditure forms a large part of a local government's operations. This takes the form of both operating and capital.</p> <p>For the year ended 30 June 2021, the Shire has recognised:</p> <table border="1"> <tr> <td>Employee costs</td> <td>\$4.2mil</td> </tr> <tr> <td>Materials and contracts</td> <td>\$2.1mil</td> </tr> <tr> <td>Depreciation</td> <td>\$6.1mil</td> </tr> </table>	Employee costs	\$4.2mil	Materials and contracts	\$2.1mil	Depreciation	\$6.1mil	<p>For the testing of expenditure, we performed walkthroughs of the systems and tested key financial controls with a view to rely on internal controls.</p> <p>We performed substantive test of details based on our sampling methodology as well as year-end analytical review to obtain the required level of assurance.</p> <p>We paid particular attention to the cost allocation methodology associated with administration allocations, Public Works Overheads and Plant Operating Costs to ensure these are properly allocated as they impacted the split between operational and capital expenditure.</p> <p>Specific attention was also paid to credit cards and changes to creditors' details, particularly in light of recent history in the industry.</p>	<p>Based on work performed, we are satisfied that the Shire's expenditure is fairly stated and disclosed in the 2021 financial report.</p>
Employee costs	\$4.2mil							
Materials and contracts	\$2.1mil							
Depreciation	\$6.1mil							
ACCOUNTING FOR REHABILITATION COSTS								
<p>Accounting for rehabilitation costs involves a degree of management estimation and uncertainty in their calculation in respect of inflation rate, discount factor and work costs. There is risk that the asset and the related liability may not be captured completely and recognised in accordance with AASB 116: Property, plant and equipment and AASB 137: Provisions, Contingent Liabilities and Contingent Assets.</p> <p>As at 30 June 2021, the Shire recognised a rehabilitation cost asset and provision for \$66K and 511K respectively.</p>	<p>We enquired with management regarding the Shire's present obligations to make good and verified the representation to relevant licenses.</p> <p>We reviewed the rehabilitation costs worksheet to ensure cost estimates relating to the asset and liability are calculated using a reasonable approach in accordance with AASB 116 and AASB 137.</p> <p>We also reviewed the accounting entries and assessed the adequacy of the required disclosures in the financial report.</p>	<p>Based on work performed, we are satisfied that the Shire's recognition of the costs to rehabilitate the waste transfer station at the end of its useful life is properly accounted for and disclosed in the 2021 financial report.</p>						
MANAGEMENT OVERRIDE OF CONTROLS								
<p>Management is involved in the day to day operations and monitoring of the business, which gives them the ability to manipulate accounting records and manipulate financial disclosures by overriding controls in place. Due to the unpredictable way in which such override could occur, this leads to potential fraud risk.</p>	<p>The following procedures had been performed:</p> <ul style="list-style-type: none"> Reviewed journal entries and other adjustments for evidence of possible material misstatements due to fraud; Reviewed accounting estimates and application of accounting policies for evidence of bias or aggressive accounting practices; and For significant or unusual transactions, evaluated the business rationale (or the lack thereof) for evidence of fraudulent financial reporting or misappropriation of assets. 	<p>Based on work performed, we have not identified any instances of management override of controls.</p>						
RELATED PARTY DISCLOSURE								
<p>The Shire has disclosed the following related party transactions for the year ended 30 June 2021:</p> <table border="1"> <tr> <td>Elected Members Remuneration</td> <td>\$154K</td> </tr> <tr> <td>KMP Compensation</td> <td>\$680K</td> </tr> <tr> <td>Transactions with related parties</td> <td>\$1.3M</td> </tr> </table>	Elected Members Remuneration	\$154K	KMP Compensation	\$680K	Transactions with related parties	\$1.3M	<p>We reviewed the processes to ensure the required disclosures were adequately addressed and a robust system is in place. We also ensured related party transactions are at arms' length basis.</p> <p>We also remained alert for any undisclosed related party relationships/transactions whilst performing other audit procedures.</p>	<p>Based on work performed, we are satisfied that related party transactions are properly disclosed and at arms' length basis.</p>
Elected Members Remuneration	\$154K							
KMP Compensation	\$680K							
Transactions with related parties	\$1.3M							

2. Key Audit Risks and Focus Areas

RISK AREAS	AUDIT PROCEDURES TO ADDRESS RISK	CONCLUSIONS
IT GENERAL CONTROLS		
<p>The Shire uses Synergy Soft as the key accounting package for its financial reporting purposes.</p> <p>The integrity of financial information relies on the security, integrity and reliability of an organisation's information technology environment.</p>	<p>We assessed the Information Technology General Controls (ITGC) environment to determine the extent to be which financial information can be relied upon.</p> <p>We conducted a high level ITGC review, including the assessment of the key controls relating to:</p> <ul style="list-style-type: none"> • System Security; • Technology Framework; • Service Management, Operations and Change Control; • Security Governance and Reporting; and • Security Training. 	<p>As a result of the review, no further testing was required to enable us to rely upon the financial management information generated by the system.</p>
SIGNIFICANT ADVERSE TRENDS		
<p>Statutory reporting of any material matters that indicate significant adverse trends in the financial position of the Shire relating to the requirements of Local Government (Audit) Regulation 10(3)(a).</p>	<p>We used the statutory ratios disclosed and compared them against our criteria and previously reported ratios. We also assessed how the ratios impact the operations of the Shire.</p>	<p>Based on work performed, we noted a significant adverse trend in the financial position of the Shire as the Operating Surplus ratio has been below the industry benchmark and OAG threshold for the past 3 years.</p>

3. Summary of Audit Differences

We are required by the auditing standards to communicate all unadjusted differences (other than clearly trivial) that we noted during the audit.

There was no unadjusted differences noted during the audit.

4. Internal Controls Relevant to Audit

As part of our planned audit approach, we have evaluated the Shire's system of internal controls primarily to enable us to determine the appropriate nature and extent of our procedures.

This, however, does not constitute a comprehensive review. Accordingly, the Audit Committee may wish to discuss with management any matters they may have raised with respect to particular systems, which may necessitate a more comprehensive review.

It should be appreciated that our audit procedures are designed primarily to enable us to form an opinion on the financial statements and therefore may not bring to light all weaknesses in systems and procedures which may exist. However, we aim to use our knowledge of the Shire's organisation gained during our work to make comments and suggestions which, we hope, will be useful to you.

We are pleased to advise that we did not note any additional significant deficiencies in internal controls during the final audit.

The following matters were noted during the interim audit:

FINDING	RECOMMENDATION	CONCLUSIONS
FIXED ASSETS RECONCILIATION NOT PERFORMED		
Reconciliation of the fixed asset register to corresponding general ledger control accounts for fixed assets has not been performed since December 2020. We also noted that additions, disposals and depreciation have not been updated in the fixed asset register since November 2020.	<p>The Shire should ensure that the fixed asset register be updated every month and perform a reconciliation monthly as part of key reconciliations performed by the Shire.</p> <p>This reconciliation should be reviewed by a senior officer independent of preparation and evidenced accordingly.</p>	Reconciliations are now being performed on a regular basis..
NO EVIDENCE OF REVIEW ON THE INVENTORY (FUEL) RECONCILIATIONS		
Whilst reconciliations between the inventory system and general ledger were performed every month, there is no evidence of them being reviewed by a senior officer independent of preparation.	We recommend that the inventory reconciliations are reviewed and evidenced as such by an independent senior officer.	Reconciliations are now being signed by an independent person.
NO EVIDENCE THAT A VERBAL OR WRITTEN QUOTATION WAS OBTAINED		
Our sample testing of payment transactions noted one instance out of a total of 12 transactions tested where there was no evidence that a verbal or a written quotation was obtained as required by the Shire' purchasing policy.	All authorised officers should be reminded of the need to ensure purchase orders raised complied with the purchasing policy. In addition, where a verbal quotation has been obtained, this should be documented on the purchase order and the required number of written quotations should be attached to the purchase order.	Purchase order needs to adhere to the purchasing policy before they are sent to the suppliers.

We advise we noted on significant deficiency in internal controls:

- a) Fixed asset reconciliation between the register and the corresponding general ledger control accounts has not been performed from December 2020 to April 2021. This is a key control for ensuring the completeness and accuracy of financial data within the general ledger from which financial statements are derived. Without this reconciliation being performed on a regular basis there is an increased risk of fraud and or errors going undetected.

The above matters noted were already included in the formal management letter issued by OAG after the interim audit.

5. Other Key Matters

In accordance with Auditing Standards, we are required to communicate a number of matters with those charged with governance which is covered in the table below.

Matters Considered	Outcome
Ethics and Independence	<p>We have obtained independence declarations from all staff engaged in the audit.</p> <p>We confirmed that to the best of our knowledge, we met the relevant ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants (the Code) that are relevant to our audit of the financial report.</p> <p>We have further considered the safeguards the Moore Australia network has in place and we are not aware of any services being provided that would compromise our independence as external auditor.</p>
Fraud and Compliance with Laws and Regulations	<p>We have enquired with management regarding the existence of fraud and/or non-compliance with laws and regulations. We have also reviewed the general ledger and minutes for evidence of these.</p> <p>Based on confirmation obtained from management and the work performed, we are confident that the risk of fraud in relation to financial reporting and non-compliance with laws and regulations is low and have not identified any reportable matters for your attention.</p>
Appropriateness of Accounting Policies	<p>Based on the work performed, we are satisfied that accounting policies used for the preparation of financial report are acceptable financial reporting framework and in accordance with the requirements of the Act, the Regulations and, to the extent that they are not inconsistent with the Act, Australian Accounting Standards.</p>
Appropriateness of the Use of Going Concern Basis of Accounting	<p>Based on the audit evidence obtained up to the date of our auditor's report, we are not aware of material uncertainty exists related to events or conditions that may cast significant doubt on the Shire's ability to continue as a going concern.</p>
Liaison with Management	<p>We had no disagreements with management about significant audit, accounting or disclosures matters.</p> <p>There were no difficulties encountered in dealing with management related to the performance of the audit.</p>

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