



# TOWN OF PORT HEDLAND

Closing Report

30 June 2017



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# 1 KEY MATTERS

## 1.1 Audit opinions

We have completed the audit fieldwork on the financial statements of the Town of Port Hedland (the Town) for the year ended 30 June 2017 and accordingly we provide our findings on the audit.

We have discussed all significant auditing and accounting issues with management and these have been satisfactorily resolved.

The audit procedures are designed to support the audit opinion and they cannot be expected to identify all weaknesses or inefficiencies in the Town's systems and working practices.

We expect to report:

- An unqualified audit opinion will be issued with respect to the financial statements; and
- A qualified opinion in relation to statutory compliance due to the failure by the Town to submit: balanced 30 June 2017 accounts to the auditor by 31 October 2017 as required by section 6.4(3)(a) of the *Local Government Act 1995*.

## 1.2 Presentation of financial statements

The Town is a not-for-profit reporting entity that prepares general purpose financial statements in accordance with Australian Accounting Standards (including Australian Accounting Interpretations) adopted by the Australian Accounting Standards Board (AASB), Australian Accounting Interpretations and other authoritative pronouncements of the Australian Accounting Standards Board, the Act and the Regulations as they relate to financial statements.

## 1.3 Scope of this report

There have been no changes in the audit approach set out in the Audit Planning Memorandum, which was presented to Audit, Risk and Governance Committee (ARGC) on 4 May 2017. The resolution of significant accounting and auditing matters are discussed in this report.

## 1.4 Management letter

Acknowledging that in accordance with our audit approach, we designed a controls testing rotation plan that brings certain transaction cycles into audit scope each year. The Audit Planning Memorandum specifies that in addition to control testing over the revenue cycle, we also tested key management controls over the purchases, payroll and payments cycles. We rotated the control testing over the cash and fixed assets cycles.

During our final audit, nine management letter matters have been reported, four of which are rated as significant, with the remainder rated as moderate. Please refer to annexure A for further details.

RSM will followed up on these matters during next year's audit.

## 1.5 Prior period audit findings

### 1.5.1 RSM management letter points brought forward from the 2015 final audit:

Issues reported	RSM's risk rating	Action taken by management	Comment
1. Fortnightly payroll variance reporting	Moderate	Resolved	Matter is closed. The balance owing from employees was \$0 at 30 June 2017

### 1.5.2 RSM management letter points brought forward from the 2016 interim audit:

Issues reported	Risk rating*	Action taken by management	Comment
1. Non-compliance with internal Purchasing Policy	N/A	In Progress	During our 2017 final audit our sample testing identified a number of exceptions. These have been re-raised in the 2017 interim audit management letter. Refer annexure A.

\* **Risk rating:** RSM was instructed by the Town not to report our risk assessment for the above finding. Instead the Town applied its own risk assessment criteria, which were adopted by Council in April 2016. The Town accepted responsibility of reporting directly to Council on these matters.

### 1.5.3 RSM management letter points brought forward from the 2016 final audit:

Issues reported	Town's risk rating*	Action taken by management	Comment
1. Overhead allocation	Medium	In Progress	Management is currently in the process of preparing an internal operating procedure / policy for the allocation of overheads, which will formalise an overhead allocation methodology.  During our 2017 final audit, we noted some anomalies in the overhead allocations at 30 June 2017. These have been raised in the 2017 final audit management letter. Refer annexure A.
2. Non-compliance with internal Purchasing Policy	Medium	In Progress	During our 2017 final audit our sample testing identified a number of exceptions. These have been re-raised in the 2017 final audit management letter. Refer annexure A.
3. High annual leave accrual at year end	Medium	In Progress	Management is currently in the process of making arrangements for employees to take regular leave to utilise the leave owing to them.  As at 30 June 2017 there was one (1) employee who had more than 300 hours of annual leave accrued to them.

\* **Town's risk rating:** For each of the above findings, the Town performed its own risk assessment in accordance with the Town's risk assessment criteria, which were adopted by Council in April 2016. RSM then reported directly to the Chief Executive Officer on the matters identified.

**1.5.4 Matters reported by UHY Haines Norton (now Moore Stephens) in their Internal Audit Report dated April 2015**

Issues reported	Details of issues	Action taken by management	Comment
1. Depot / Landfill	<p>Stocktake at the Depot is only performed once a year.</p> <p>Routine monitoring or reporting of fuel usage for landfill plant and equipment or town vehicles is not occurring. Controls for the use of a fuel card by a third party to refuel landfill plant and equipment are not considered adequate.</p>	Resolved	Matter is closed. A procedure has now been implemented.

**1.5.5 Matters identified by RSM in the Regulation 5(2)(c) Factual Findings Report dated June 2016**

Issues reported	Risk rating*	Action taken by management	Comment
<p>1. Internal controls</p> <p>No evidence on file that each of the following controls had been performed:</p>			All the matters listed below in Sections 1 and 2 are still in progress by the Town. Therefore, RSM will re-assess during the 2018 interim audit.
<ul style="list-style-type: none"> <li>Each departmental manager performs a regular review of reports detailing all employees listed on payroll master file; all unusual items are investigated. This step could not be performed as there is no policy/procedure in place in order for us to re-perform the step.</li> </ul>	N/A	In Progress	Management is currently in the process of preparing an internal operating procedure / policy.
<ul style="list-style-type: none"> <li>The payroll deduction table data is periodically reviewed by management for accuracy and ongoing pertinence.</li> </ul>	N/A	In Progress	Management is currently in the process of preparing an internal operating procedure / policy.
<ul style="list-style-type: none"> <li>Management reviews a selection of salary sacrifice calculations for accuracy and compliance with statutory requirements; identified errors are promptly corrected.</li> </ul>	N/A	In Progress	Management is currently in the process of preparing an internal operating procedure / policy.
<ul style="list-style-type: none"> <li>Approval in writing is obtained before adding new employees to payroll.</li> </ul>	N/A	In Progress	Management is currently in the process of preparing an internal operating procedure / policy.
<ul style="list-style-type: none"> <li>Automatic or manual checks are performed on serial continuity of invoice documents.</li> </ul>	N/A	In Progress	Management is currently in the process of preparing an internal operating procedure / policy.

Issues reported	Risk rating*	Action taken by management	Comment
<ul style="list-style-type: none"> <li>Procedures exist to ensure receipts are recorded in the correct period.</li> </ul>	N/A	In Progress	Management is currently in the process of preparing an internal operating procedure / policy.
<ul style="list-style-type: none"> <li>Period-end procedures exist to detect and account for unprocessed goods/service receipts.</li> </ul>	N/A	In Progress	Management is currently in the process of preparing an internal operating procedure / policy.
<ul style="list-style-type: none"> <li>Aged report of open orders is reviewed each month and old/unusual items are investigated.</li> </ul>	N/A	In Progress	Management is currently in the process of preparing an internal operating procedure / policy.
<ul style="list-style-type: none"> <li>Suppliers' statements are reconciled to accounts payable monthly and reviewed by management.</li> </ul>	N/A	In Progress	Management is currently in the process of preparing an internal operating procedure / policy.
<ul style="list-style-type: none"> <li>Procedures exist to ensure payments are recorded in the correct period.</li> </ul>	N/A	In Progress	Management is currently in the process of preparing an internal operating procedure / policy.
<ul style="list-style-type: none"> <li>Procedures exist to ensure all bank accounts and signatories are authorised by council.</li> </ul>	N/A	In Progress	Management is currently in the process of preparing an internal operating procedure / policy.
<p>2. There is no evidence on file to show that:</p> <ul style="list-style-type: none"> <li>The fixed asset register has been reconciled to the general ledger since July 2015.</li> <li>Activity recorded in fixed asset register is reviewed by management, including comparison to the capital budget.</li> <li>Management reviews depreciation rates and methodology (at least annually) to ensure that rates and remaining useful lives are reasonable.</li> <li>The fixed asset register to the general ledger reconciliation is prepared and reviewed routinely.</li> </ul>	N/A	In Progress	The Town is currently determining the best approach to manage the risks associated with these issues.

Issues reported	Risk rating*	Action taken by management	Comment
3. During the sampling of 23 receipts we have noted that there was no indication that the reconciliation of the daily deposit total to the receivable posting and cash sales are being reviewed.	N/A	Resolved	Matter is closed. No exceptions were noted during our final audit visit.

\* **Risk rating:** The engagement was to report exceptions to the controls tested, without any consideration of whether any noted exceptions were material or systemic in nature. Therefore, risk rating is not relevant.

#### 1.5.6 RSM management letter points brought forward from the 2017 interim audit:

Issues reported	Risk rating*	Action taken by management	Comment
1. Variances identified during daily cash handling	Moderate	Resolved	Matter is closed. No exceptions were noted during our final audit visit.
2. Non-compliance with Purchasing Policy	Moderate	In Progress	During our 2017 final audit our sample testing identified a number of exceptions. These have been re-raised in the 2017 interim audit management letter. Refer annexure A.
3. Incorrect allocation of GST	Moderate	Resolved	Matter is closed. No exceptions were noted during our final audit visit.

#### 1.6 Independence

The audit methodologies of RSM Australia require that we conduct a regular evaluation of our client relationship. The evaluation includes, among other things, an assessment of independence, which is governed by APES 110 *Code of Ethics for Professional Accountants* and Australian Auditing and Assurance Standards. We confirmed that we are not aware of any matter that causes independence to be impaired in respect of this audit.

## 2 CURRENT YEAR DEVELOPMENTS

The Audit Planning Memorandum identified two current year major developments that required some additional audit emphasis:

#### 2.1 Efficiencies, savings and business system improvements and / or revenues

Council Resolution CM201617/038 included an additional \$2M savings is to be identified in efficiencies, savings and business system improvements and / or revenues across the organisation by 30 June 2017.

RSM reviewed the design and implementation of controls during the audit and other than those matters discussed in annexure A, there were no indicators of detrimental effects on the proper application of key controls.

#### 2.2 Capitalisation of Spoilbank Waterfront Precinct construction costs

In October 2016, the previous State Government confirmed funding of \$112 million for the construction of the Spoilbank Waterfront Precinct. The \$112 million funding allocation from the State Government included three years of operational funding. However, no agreement has been made for ongoing operational funding from the State Government to the Town beyond that initial three-year period. Rather, the State Government has indicated that it will not provide any operational

funding beyond the initial three years. The Town has estimated that \$2 million in operational funding would be required annually by the Spoilbank Waterfront Precinct, which would represent an eight percent increase in rates. The Town has determined that the \$2 million operational funding will be unaffordable in the current economic climate. In July 2017, the Council approved, in principle, the re-staging of the project to deliver a first stage of works to the community that is operationally affordable.

RSM has evaluated that capitalised costs associated with the Spoilbank Waterfront Precinct have been properly identified, classified and brought to account.

### 3 NEW ACCOUNTING STANDARDS NOT YET ADOPTED

As disclosed in the notes to the 2017 financial statements, the Town has assessed the implication of changes in AASBs that have been issued, but are not yet effective and have not been early adopted. The following AASBs are considered to be most relevant to the Town:

Pronouncement	Summary	Effective date	Town impact
AASB 9 <i>Financial Instruments</i>	This Standard supersedes AASB 139 <i>Financial Instruments: Recognition and Measurement</i> , introducing a number of changes to accounting treatments.	1 July 2018	Impact assessment not yet finalised
AASB 15 <i>Revenue from Contracts with Customers</i>	Replaces AASB 118 <i>Revenue</i> which covers contracts for goods and services, and AASB 111 <i>Construction Contracts</i> which covers revenue and costs associated with construction contracts.	1 July 2019	Impact assessment not yet finalised
AASB 16 <i>Leases</i>	Introduces a single lease accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value.	1 July 2019	Impact assessment not yet finalised
AASB 1058 <i>Income of Not-for-Profit Entities</i>	This Standard clarifies and simplifies the income recognition requirements that apply to not-for-profit (NFP) entities, more closely reflecting the economic reality of NFP entity transactions that are not contracts with customers. Timing of income recognition is dependent on whether such a transaction gives rise to a liability, or a performance obligation (a promise to transfer a good or service), or an obligation to acquire an asset.	1 July 2019	Impact assessment not yet finalised

## 4 AREAS OF AUDIT EMPHASIS

During the audit we reviewed the following areas of emphasis mentioned in the Audit Planning Memorandum and other matters identified during the course of the audit for consideration by the Town prior to adopting the 30 June 2017 financial statements:

High risk area	30 June 2017 \$'000	30 June 2016 \$'000	30 June 2015 \$'000
<b>Revenue cycle</b>			
Rates	23,992	25,195	26,374
Fees and Charges	10,359	10,366	14,682
Trade and other receivables (Current and non current)	9,916	10,614	15,309
<b>Payment cycle</b>			
Materials and contracts	13,120	15,043	19,271
Property, Plant and Equipment (additions)	1,976	1,749	9,752
Infrastructure (additions)	8,877	6,750	13,474

### 4.1 Revenue cycle

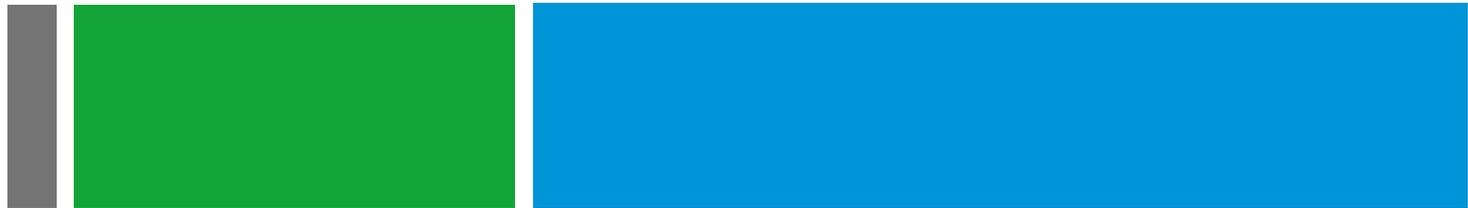
#### 4.1.1 Reasons why considered high risk:

Revenue is measured taking into account multiple elements, for example rates transactions are calculated by the application of a rate in the dollar to the Gross Rental Value (GRV), which is struck by dividing the required rate collection amount by the total amount of valuations on the roll. GRV's vary between the various property types, such as residential, commercial and industrial. The GRV is supplied by Landgate. Depending upon the use of the property, local government has the choice of two types of valuation (GRV) and an Unimproved Valuation (UV). Furthermore, rates revenue represents a significant percentage of the Town's operating income each year and is an important income stream in terms of the Town's financial flexibility. The Town also needs to review and evaluate whether there is any requirement to impair the carrying amount of trade and other receivables in accordance with AASB 136 *Impairment of Assets*.

Fees and charges is a material amount and is measured by the application of an annual charge to rateable land supplied with specified services. For example, classic domestic bin services and swimming pool inspection fee. There are also further complexities with the application of the eligible pensioners rebate scheme.

In addition, further complexity and risk is associated with compliance with AASB 118 *Revenue* and the requirement for the Town to comply with Part 6 Division 6 'Rates and service charges' of the Act.

Based on the above complexities and high risk of management override, revenue recognition for rates / fees and charges was considered to be high risk.



#### 4.1.2 Our approach

We have reviewed the effectiveness of key internal controls operating within the revenue cycle, including the application controls. We have performed a walkthrough on the key management controls over the revenue cycle and test the control on key management controls. We have reviewed, on a sample basis, the reconciliations and calculation of rates / fees and charges and compare against historical results. In order to assess the completeness in recording of revenue in the correct accounting period, we have performed revenue cut off testing and reviewed credit notes. To ensure the existence of the receivable balance and the recoverability of the balance, we have also reviewed receivables balances on sample basis, confirmed these balances and performed subsequent receipt testing. Furthermore, we have performed analytical procedures on rates / fees and charges through detailed comparison with prior year and forecasts. We have also determined that the disclosures in the notes to the financial statements related to the Town's revenue recognition policy are appropriate.

#### 4.1.3 Conclusion:

We conclude that the key management controls are effective to ensure that revenue has been accurately and completely recognised in accordance with AASB 118, the trade receivables balance is accurate and the Town's assessment of the provision for impairment of receivables is in accordance with AASB 136. We also concur with the Town's explanations for the significant falls in revenue from rates.

### 4.2 Payment Cycle

#### 4.2.1 Reasons why RSM considers this area as high risk

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

#### 4.2.2 Our approach

We have reviewed the Policy and assessed the effectiveness of internal controls operating within the payment cycle. In addition, we performed a walkthrough on the key management controls over the purchase and payment cycle, including tendering, and performed test of control on key management controls over purchase and payment cycle. Furthermore, we performed analytical procedures on procurement through detailed comparison with prior year and forecasts. Our testing included an evaluation of whether the Town's purchasing activities have complied with the Act and the Regulations.

#### 4.2.3 Conclusion:

We conclude that key management controls are effective to ensure compliance with the tendering regulations, except for the matters detailed in Annexure A regarding our findings in relation to compliance with the tendering and quotation requirements of the Town's policies and procedures.

## 5 OTHER CRITICAL DISCLOSURES IN THE FINANCIAL STATEMENTS

### 5.1 Related party disclosures

RSM has audited the Town's compliance with the new requirements of AASB 124 *Related Party Disclosures*, which requires disclosures in the financial statements of key management personnel's compensation and certain transactions with related parties.

We conclude that related party transactions and key management remuneration are properly disclosed in the financial statements.



## 6 FRAUD RISK

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

### 6.1 Management override of controls on key estimates and judgments

#### 6.1.1 Key risks:

Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare a fraudulent financial report by overriding controls that otherwise appear to be operating effectively.

#### 6.1.2 Our audit approach:

We have assessed the Town's processes in place to prevent and detect fraud. We documented our understanding of controls in place over the manual journal process as well as reviewing the list of personnel who have access to process manual journal entries in the general ledger. We performed our testing mainly to focus on unusual and non-routine journal entries.

We also incorporated an element of unpredictability in the selection of the nature, timing and extent of audit procedures to be performed due to the fact that individuals within the entity who are familiar with the audit procedures normally performed may be more able to conceal fraudulent financial transactions/reporting.

Management also completed a Fraud Risks Assessment Questionnaire as part of our audit procedures and confirmed that no known instances of fraud has come to their attention.

#### 6.1.3 Our conclusion:

Based on our work, nothing has come to our attention to indicate that the Town does not have proper processes to manage the risk of management override of controls and that material key estimates and judgments are properly assessed and brought to account. Our audit did not detect any instances of fraud.

## 7 OTHER MATTERS

### 7.1 Paxon Group Reports

The Town engaged Paxon Group to conduct three engagements during the financial year. The following three reports were prepared by Paxon Group and submitted to the Town:

1. Review of Procurement Process;
2. Review of Redundancy Payments and Redeployment of Staff; and
3. Review of the Appointment of the Executive Officer in 2015.

We recommend that the Town consider the findings of these reports and any implications for its policies and procedures.

### 7.2 Boat ramp dredging tender

RSM attended a meeting with the Town's Audit Risk and Governance Committee (ARGC) on the 4 May 2017. The ARGC raised a query in relation to Tender 2016-04 "Richardson Street Boat Ramp Dredging". The query specifically related to:

1. The process around the letting of the tender; and
2. The process for determining whether the works had been completed prior to final payment.

These matters were considered during our audit process.



## Conclusion

1. No issues have been noted in relation to the process of letting the tender in terms of compliance with the Act and associated Regulations; nor the Town's delegations and purchasing policies
2. The post dredging survey indicated that:
  - a. The depths of three of the four survey points did not meet the specified depths; and
  - b. The quantity of material estimated to have been removed was less than the indicative amount in the scope of works.
3. The Town was satisfied that the scope of works had been complied with due to:
  - a. An inspection of the works by the Town at completion of the works; and
  - b. Variances between the scope of works and the survey were attributed to natural further sediments being deposited post completion of the works, but prior to the completion of the survey (1 month).

### 7.3 Compliance with laws and regulations

We have reviewed the Town's controls that are in place to manage the risk of systemic failure to comply with relevant laws and regulations. We also reviewed Council minutes of meetings throughout the year to identify any non-compliance with the relevant laws and regulations.

Except for the matter referred to in our audit opinion, nothing further has come to our attention, within the scope of our engagement, which would indicate the controls are ineffective.

### 7.4 Internal audit

The Town does not have an internal audit function. Consequently, we performed our own evaluation and assessment of controls and conclude that controls can be relied on and, except for those matters detailed in this report and Annexure A, nothing further came to our attention, during our sample testing that required reporting to the Town.

### 7.5 Cyber security

Recent ransomware incidents have made global headlines, with a wave of unprecedented attacks infecting companies worldwide. In the utilities sectors, the focus is not only on corporate IT systems but also significant security threats to operational technology (OT). A cyberattack on an OT environment can have serious and wide-ranging consequences beyond just financial losses. We encourage the Town to continue with its efforts to manage cyber security risks, including ongoing education, secure configuration of the network, access controls and malware protection.

## 7.6 Audit adjustments

The following audit adjustments were identified during the course of the audit and were processed by the Town:

Entry	Account No.	Account Description	Debit (\$)	Credit (\$)
1	1259-00	Plant & Equipment	20,422.50	
	1270-00	Accumulated Depreciation - Buildings	4,391,200.40	
	1285-00	Parks and Ovals	2,191,000.00	
	1285-00	Other Infrastructure	9,130,000.00	
	1281-00	Accumulated Depreciation – Plant & Equipment		2,349.99
	1281-00	Accumulated Depreciation – Parks and Ovals		828,475.07
	1281-00	Accumulated Depreciation – Other Infrastructure		3,560,375.34
	1458-00	Buildings		11,341,422.50
		<i>Being For: Reclassification of Infrastructure and Plant and Equipment identified during revaluation from Land and Buildings</i>		
2	1021-01	Current Liabilities – Trade and Other	981,288.00	
	R0302100-042	Grants Commission – General Purpose		606,856.00
	R0302200-042	Grants Commission – Formula Local Road		374,432.00
		<i>Being For: To recognise June 2017 Financial Assistance Grants Receipt as revenue in the 2017 financial year in accordance with AASB 1004 Contributions</i>		

## 7.7 Unadjusted audit differences

There are no unadjusted audit differences remaining at the end of the audit.

## 7.8 Subsequent events

Management has represented that there are no significant subsequent events between the end of the financial year and the date of this report, which may significantly impact the results of the operations and the state of affairs of the Town for the financial year.

## 7.9 Contingent liabilities and commitments

Management has represented to us that, other than those matters disclosed in the financial statements, there is no other:

- Outstanding or pending litigation;
- Contingent liabilities; or
- Commitments.

### 7.10 Management representation letter

A Management Representation Letter is required by RSM before signing the opinion on the financial statements. The Town has been provided with a draft for consideration, dating, signing and returning to us.

### 7.11 Considerations for next year's audit

Except for the need to follow-up on the matters detailed in this report and Annexure A, there are no other significant matters for consideration during next year's audit.

### 7.12 Our appreciation

Finally, we wish to express our appreciation for the co-operation provided by the Town during the course of the audit.

## 8 ADDITIONAL INFORMATION CONTACTS

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**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017**

INDEX OF FINDINGS	RATING		
	Significant	Moderate	Minor
<b>Issues identified during the 2017 audit:</b>			
1. Submission of Annual Financial Report to Auditors	✓		
2. Reconciliation of Fixed Assets	✓		
3. Ratio's	✓		
4. Bank Reconciliations	✓		
5. Non-compliance with Purchasing Policy		✓	
6. Completeness of Tenders Register		✓	
7. Failure to Submit 'Related Party Disclosure' Declaration Forms		✓	
8. Nature of Income and Expenditure (IE) Codes 701 and 702		✓	
9. Incomplete Overhead Allocation		✓	

**KEY TO RATINGS**

The ratings in this management letter are based on the audit team's assessment of risks and concerns with respect to the probability and/or consequence of adverse outcomes if action is not taken. We give consideration to these potential adverse outcomes in the context of both quantitative impact (for example financial loss) and qualitative impact (for example inefficiency, non-compliance, poor service to the public or loss of public confidence).

- Significant** - Those findings where there is potentially a significant risk to the entity should the finding not be addressed by the entity promptly. A significant rating could indicate the need for a modified audit opinion in the current year, or in a subsequent reporting period if not addressed. However even if the issue is not likely to impact the audit opinion, it should be addressed promptly.
- Moderate** - Those findings which are of sufficient concern to warrant action being taken by the entity as soon as practicable.
- Minor** - Those findings that are not of primary concern but still warrant action being taken.

**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017****1 Submission of Annual Financial Report to Auditors****Findings:**

Section S 6.4(3) of the *Local Government Act* states:

*By 30 September following each financial year or such extended time as the Minister allows, a local government is to submit to its auditor —*

- a. the accounts of the local government, balanced up to the last day of the preceding financial year; and*
- b. the annual financial report of the local government for the preceding financial year.*

The Department of Local Government, Sport and Cultural Industries granted the Town an extension to submit the Annual Financial Report to RSM by 31 October 2017.

When assessing the quality of the financial statements submitted by the Town to RSM on 31 October 2017, we have compared them against the Office of the Auditor General's *Minimum requirements to enable the audit of the financial statements to commence*. These requirements are:

1. *Substantially complete*

*The financial statements submitted for audit should include at least:*

- Statement of Financial Position*
- Statement of Comprehensive Income*
- Notes that provide a breakdown of amounts in the above two statements*
- All accounting policy notes.*

*Please note:*

- a. Supporting work papers should be available within two days of receipt of the statements*
- b. The other elements of the financial statements should be available for audit within one week of the abovementioned requirements.*

2. *Sufficient quality*

- a. No errors in comparative data*
- b. Minimal errors in the balances for the current year.*

The draft Annual Financial Report contained several significant deficiencies. Some accounts were not balanced as required by section S 6.4(3)(a), namely:

- The net result per the Statement of Comprehensive Income did not agree to the Statement of Changes in Equity, with a variance of \$144,000; and*
- The Town was unable to support the disclosure of revenue and expenses in the Statement of Comprehensive Income.*

**Rating:**

**Significant**

**TOWN OF PORT HEDLAND**

**Management letter on the final phase of the audit**

**For the year ending 30 June 2017**

***Implication:***

The Town has not complied with the requirements of section S 6.4(3) of the *Local Government Act*.

***Recommendation:***

The Town should review, design and implement procedures to ensure compliance with section 6.4(3) of the *Local Government Act*. All accounts should be balanced up to the last day of the preceding financial year and annual financial report should be submitted to the auditor by 30 September each year.

***Management Comment:***

The Town recognises the quality of the Statements provided to the auditors were not up to standard. The Town has been undergoing a significant amount of process and structure review. Issues raised are currently being investigated and rectified, managed through the engagement of Moore Stephens and the appointment of a new Manager Financial Services.

***Responsible Person:***

Manager Financial Services

***Completion Date:***

Current Annual financial statements have been addressed and rectified

Process going forward 30 June 2018

**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017****2 Reconciliation of Fixed Assets****Findings:**

The first set of draft financial statements submitted to RSM on 31 October 2017 indicated total additions to Property, Plant and Equipment and Infrastructure amounted to \$11,237,000. However, the Assetic fixed asset register indicated additions amounting to \$10,672,705.

Further enquires by RSM indicated inconsistencies between the Synergy general ledger movements and Assetic Fixed Asset Register additions, specifically with regards to transfers from Work In Progress (WIP) upon project completion.

**Rating:****Significant****Implication:**

Failure to reconcile the Synergy general ledger fixed asset additions to the Assetic Fixed Asset Register increases the risk that the Town does not completely and accurately record fixed asset transfers, acquisitions, dispositions and related depreciation. There may also be a failure to properly safeguard fixed assets from loss through theft.

**Recommendation:**

The Assetic Fixed Asset Register should be periodically reconciled to Synergy general ledger to ensure the Town completely and accurately records fixed assets movements and classifications.

**Management Comment:**

The Town acknowledges the fixed asset reconciliation issues raised in this finding report. There was a change to the asset accounting approximately 2 years ago for assets from Synergy to using 2 systems – Synergy for Plant, Land and WIP and Assetic for Infrastructure, Buildings and Furniture and Fittings. As a result of this split of asset accounting it has come to light that the control was lost and reconciliations did not balance due to final entry of capitalisation of WIP for \$4.6m to infrastructure and the audit findings to re-classify \$11m of assets from Building to Infrastructure. The Town has acted to cease using Assetic for the primary source of asset accounting and will revert back to Synergy as a central control. This has been enacted with extreme urgency.

**Responsible Person:**

Manager Financial Services

**Completion Date:**

30 June 2018

**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017****3 Ratios****Findings:**

Local Government Operational Guideline Number 18 – June 2013 (the Guideline), provides benchmark standards for the ratios required to be reported under regulation 50 of the *Local Government (Financial Management) Regulations 1996*.

The following table summarises the Town's ratios in relation to the standard for the year ended 30 June 2017 and based on the Draft Financial Statements at the time of preparation of this draft report, indicates the Asset Sustainability ratio, Debt Service Cover ratio and Operating Surplus ratio are below the acceptable banding:

		Council's Actual Ratios		
	Target Ratio <sup>1</sup>	2017	2016	2015
Current Ratio	≥ 1	1.26	1.44	6.95
Asset Sustainability Ratio	≥ 0.90	0.83	0.37	1.00
Debt Service Cover Ratio	≥ 2	1.84	9.68	4.25
Operating Surplus Ratio	≥ 0.00	(0.21)	0.51	0.12
Own Source Revenue Coverage Ratio	≥ 0.40	0.76	0.71	1.06
Asset Consumption Ratio	≥ 0.50	0.82	0.74	0.73
Asset Renewal Funding Ratio	≥ 0.95	1.04	1.07	0.86
<b>Key</b>				
		Above target as per guidelines		Below target as per guidelines
<sup>1</sup> Local Government Operational Guidelines Number 18 – June 2013 sets out standards for each ratio. The Town of Port Hedland's ratios have been compared against the 'basic' standard for each ratio.				

**Rating:****Significant**

*This has been rated significant primarily due to failure to achieve the operating surplus ratio and the debt service ratio and the falling trend of these ratios*

**Implication:**

Ratios below the benchmark standard could indicate adverse trends in the financial sustainability of the Town in accordance with the Guideline.

**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017*****Recommendation:***

The Town needs to consider the impact of the above ratios on the short term financial sustainability of the Town and any actions required to be incorporated into budgets and the long term financial plan to address this.

***Management Comment:***

The short term financial sustainability of the town reflected in the current ratio is a direct result of reduced grant income and other available income sources to use for operational functions, as well as the increased pressure to reduce rates. The organisation will be undertaking service level reviews following the completion of the Strategic Community Plan to align spending to realistic community needs. This process will also see improvement in the own source revenue coverage ratio.

LTFP is scheduled to have a review with a goal to achieve an operating surplus position over the next 3 years. This will be achieved through reduction/re-alignment of operating expenditure following SCP. Cautious in how this is applied to ensure we are not over-rating rate payers

Decline of the Debt Service Coverage of this ratio over the last 3 years indicates a review of the Town's current debt portfolio is required for long term sustainability. This review will form part of the LTFP process. In order to address this as a matter of urgency, the Town needs to consider ways in increase its own source revenue to fund the debt portfolio. Fortunately the self-supporting loan repayments are a compensating factor and provide some relief. It can be seen that in 2015 the debt service coverage ratio was 4.25, with this ratio including the Airport as a source of revenue. From 2016 following the lease of the Airport and the restriction of the Airport Lease proceeds into reserves the ratio has declined by more than half. The ratio has continued to decline in 2017 from ongoing declining revenue sources. It should also be noted that a large portion of the interest income is restricted to reserves for the PHIA lease proceeds and is unable to be used for funding operations including debt repayment.

A review will be undertaken by the Town of asset data in relation to depreciation, replacement cost and useful life. Preparation of Asset Management Plans are required to underpin asset sustainability and asset renewal moving forward in both the short and long term. These plans will also be impacted by the SCP, assisting in determining future asset requirements. Focus continues to be around asset renewal and ensuring assets are aligned to community needs. Asset Management Plans to be prepared and included in LTFP to ensure this continues

Prior year calculations did not align to the definitions in the Regulations. The DLGC have provided amended ratios which in the most part we agree with (DLGC calculation was missing reimbursements and recoveries for Operating Surplus Revenue and Own Source Revenue Ratios).

***Responsible Person:***

Manager Financial Services

***Completion Date:***

LTFP, AMP, Loan review 30 June 2018

Wealth Management Framework 31 December 2018

**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017****4 Bank Reconciliations****Findings:**

The 30 June 2017 Bank Reconciliations contained journals to a net value of \$930,566 between the Municipal Account and Investments for Cash Backed Restricted Reserves. These journals were not supported by actual cash transfers to / from reserve bank accounts and were subsequently reversed by the Town in September 2017.

*Local Government (Financial Management) Regulation 8(1)(c)* requires a local government to maintain a separate account with a bank or other financial institution for money required to be held in reserve accounts.

**Rating:****Significant****Implication:**

Whilst at 30 June 2017, sufficient funds were held in the reserve accounts, such journals distort the bank reconciliation and have the potential to lead to non-compliance with *Local Government (Financial Management) Regulation 8(1)(c)*.

**Recommendation:**

The Town should review its cash management practices, specifically with regards to reserve transfers and the associated use of journal entries.

**Management Comment:**

Year-end transactions processed for Reserves, relating to the PHIA interest transfers were reversed and re-entered due to incorrect process followed. During reconciliation finalisation it was identified as non cash related and reversed in September 2017 (mistakenly assuming the trial balance for year-end closed).

The Town is committed to addressing and amending the current reserve transfer and cash management practices and developing internal operating procedures and checklists as well as monthly reconciliations to ensure this is correctly handled moving forwards.

**Responsible Person:**

Manager Financial Services

**Completion Date:**

Automation of bank reconciliations and process improvement to be finalised by 30 June 2018

**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017****5 Non-compliance with Purchasing Policy****Findings:**

The Town updated its Purchasing Policy in July 2016. The updated policy:

1. Does not allow for use of the "Request for Payment" form;
2. Requires purchase orders to be raised for purchases in the \$5,000 - \$15,000 threshold (revised in August 2017 to include purchases in the \$15,000 - \$50,000 threshold); and
3. Still requires purchase orders to be raised for certain recurrent expenditure, such as utilities, insurance and medicals (a list is being utilised – "Creditors – without PO's")
4. Does not provide clear guidance on the documentation required when quotations cannot be obtained or there are unavoidable restrictions on the Town's ability to fully meet the tender requirements.

During our sample testing of payments, we noted that the Town's practices had not changed to reflect the updated policy. For instance:

1. The "Request for Payment" form continues to be used;
2. The requisite number of quotations as prescribed by the policy are not always obtained.

**Rating:****Moderate****Implication:**

Non-compliance with the internal Purchasing Policy increases the risk of unauthorised or inappropriate expenditure of Town funds and / or a breach of *Local Government (Functions and General) Regulations 1996* Part 4.

**Recommendation:**

The Town's Purchasing Policy in respect of purchase order requirements should be reviewed to ensure it is in alignment with the Town's tender requirements and minimises the risk of unauthorised purchases. The Purchasing Policy should also clearly codify any exceptions to purchase order requirements, for instance in the case of utilities which, due to their recurring nature, may not require a purchase order to be raised.

Where the requisite number of quotations cannot be obtained, the Purchasing Policy should provide a framework for documenting such instances. The purchasing policy should further provide a framework for recording details of verbal quotations obtained.

The Purchasing Policy should also formalise the application and use of the 'Request for Payment' form if its use is to continue.

The requirement for full compliance with the Purchasing Policy should further be communicated to all Town staff.

**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017*****Management Comment:***

The Town's purchasing policy is currently based on a WALGA model which is considered best practice across the industry, however amendments in relation to the Town's current practice of raising request for payments if a purchase order is not completed before receipt of an invoice, as well as recording verbal quotations will be considered. The Town does not propose to raise a purchase order for every purchase under the tender threshold, as it is not cost effective. Alternative methods such as standing purchase orders and credit card transactions are already in place to avoid the high administrative cost associated in raising a purchase order of a very low value. The Town has recently formed a Procurement team with the view of moving towards a centrally led procurement framework. The Procurement team will take ownership of all procurement documentation, including any policies, for the Town, as well as educate the organisation in best practice procurement processes. The Town is currently in the process of launching an online portal which will see all RFx episodes being issued from the one platform. This will give the Procurement team greater oversight of its purchasing practices, and in turn assist in addressing any discrepancies that might arise from time to time. In relation to quotes not obtained at all times in accordance with the current purchasing policy, the Town changed its policy in August 2017, and added a clause which allows the CEO and Directors to approve such episodes. The Town has developed an internal form that supports this change in policy for audit purposes.

***Responsible Person:***

Manager Financial Services / Manager Governance

***Completion Date:***

Request for payment form current issue to be rectified by 31 December 2017

Policy Review and amended practices 30 June 2018

**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017****6 Completeness of Tenders Register****Findings:**

During our review of the Tenders Register, we noted from our audit sample that the register did not contain the name or amount of the successful tender for tender 2017-05 *Landfill Minor Infrastructure Works and Tip Shop Project*

**Rating:****Moderate****Implication:**

Non-compliance with the requirements of *Local Government (Functions and General) 1996 Regulation 17* and the Town's internal policies.

**Recommendation:**

The Town should review its policies and procedures to ensure that the Tenders Register is updated in accordance with legislative requirements.

**Management Comment:**

The Town recently implemented a Procurement team. As part of the internal processes, the Tender Register will be reviewed monthly.

**Responsible Person:**

Manager Governance

**Completion Date:**

30 November 2017

**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017****7 Failure to Submit 'Related Party Disclosure' Declaration Forms****Findings:**

At the time of drafting the Annual Financial Report for the 2016/2017 financial year, the following former members of staff had not submitted 'Related Party Disclosure' Declaration Forms:

- Christopher Linnell, resigned effective 30 January 2017; and
- Peter Keane, resigned effective 16 May 2017.

**Rating:****Moderate****Implication:**

Non-compliance with the requirements of AASB 124 *Related Party Disclosures*.

**Recommendation:**

The Town should review its human resource policies and procedures to ensure that all employees who leave its service complete the 'Related Party Disclosure' Declaration Form as part of the exit protocol.

**Management Comment:**

The Town did not have a formal process in place in relation to the submission of Related Party Disclosure forms at the time the former staff members noted above resigned. The Town Council will be considering adopting a policy on Related Party Disclosures at its 22 November Ordinary Council meeting. Notwithstanding the above consideration the Town did contact all current and former elected members, ceos and directors in August 2017 and requested that a disclosure be made. All but the two former employees listed above submitted a duly completed form.

**Responsible Person:**

Manager Governance

**Completion Date:**

HR Processes to be finalised following policy adoption at November OCM – 31 December 2017

**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017****8 Nature of Income and Expenditure (IE) Codes 701 and 702****Findings:**

Changes to the Town's chart of accounts in the Synergy system included the creation of general ledger accounts with income and expenditure (IE) codes 701: 'transfers to reserves', and 702: 'transfers from reserves'.

While the IE code descriptions are suggestive of nature and / or purpose of the balance sheet equity accounts, the sum total of the balances in these ledger accounts of \$67,046.95 does not correspond to any movement disclosed in the Statement of Changes in Equity. The sum total has been disclosed as a debit to the Statement of Comprehensive Income in the Annual Financial Report. The IE code descriptions are therefore misleading.

**Rating:****Moderate****Implication:**

Incorrect disclosure of balances in general ledger accounts or incorrect application of such general ledger accounts increases the risk of financial reports not following applicable laws, regulations or accounting standards. There is also an increased risk of failing to prepare and provide accurate information needed by management and others to discharge their responsibilities.

**Recommendation:**

The Town should review IE codes 701 and 702 and clarify the purposes and nature of these codes. The descriptions for these IE codes should also be reviewed.

**Management Comment:**

A chart of accounts re-structure was undertaken and implemented for the commencement of the 2016/17 Financial Year. The inclusion of 701 and 702 reserve transfer accounts in general ledger was done in an attempt to ensure simplification of the chart structure while providing greater visibility of funding for specific areas across the organisation.

A review of the chart is currently underway with Moore Stephens and will be amended for future years to ensure these are separate and easily identifiable equity accounts.

**Responsible Person:**

Manager Financial Services

**Completion Date:**

31 December 2017

**TOWN OF PORT HEDLAND****Management letter on the final phase of the audit****For the year ending 30 June 2017****9 Incomplete Overhead Allocation****Findings:**

Regulation 14 of the *Local Government (Financial Management) Regulations 1996* (FMR) requires local government to disclose by nature or type classification operating revenue and expenses in the Statement of Comprehensive Income. This requires the allocation of operating revenue and expenses by nature to the programmes prescribed by Schedule 1, Part 1 of the FMR.

During the audit testing of the operating expense allocations the following was noted:

1. Plant Overhead Cost Depreciation Allocation (IE Code 89), by which the depreciation charge on plant and equipment is allocated to programmes was found to have an under-allocation of overheads of \$15,313.
2. Plant Overhead Cost Recovery (IE Code 88), which similarly allocates plant operating overheads to programmes, was found to have an under-allocation of overheads of \$119,188.

The failure to fully allocate the expenses does not affect the operating results of the Town and, on this occasion, it was determined that the under-allocations are not material and no adjustment to the disclosures in the Statement of Comprehensive Income has been made.

**Rating:****Moderate****Implication:**

Failure to fully allocate expenses to programmes disclosed in the Statement of Comprehensive Income increases the risk of incorrect reporting and non-compliance with Regulation 14 of the FMR.

**Recommendation:**

The Town should review its procedures for the allocation of operating expenses to programmes and ensure procedures are in place to check that such allocations are correct and made in full on a monthly basis.

**Management Comment:**

An overhead allocation review is done as part of the bi-annual budget review. Further, reconciliation of the overhead allocations forms part of the monthly Financial Services checklist and responsibilities.

Plant overheads are managed through a separate plant module and automatically allocated. The module will be reviewed to ensure account structure set up is correct and monthly reconciliations are performed as part of the monthly Financial Services checklist.

**Responsible Person:**

Manager Financial Services

**Completion Date:**

30 June 2018