

## Report 10 of 2018

### Examination of the District Council of Coober Pedy





# **Report of the Auditor-General**

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### Examination of the District Council of Coober Pedy

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First Session, Fifty-Fourth Parliament

By authority: S. Rodrigues, Government Printer, South Australia

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# **Auditor-General's Department**

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Dear President and Speaker

### **Report of the Auditor-General: Report 10 of 2018 'Examination of the District Council of Coober Pedy'**

As required by the *Public Finance and Audit Act 1987* (PFAA), I present to each of you Report 10 of 2018 titled 'Examination of the District Council of Coober Pedy'. As required by the PFAA a copy of the report was also delivered to the Treasurer and the District Council of Coober Pedy.

#### **Content of the Report**

On 1 May 2017, the then Treasurer, the Hon Tom Koutsantonis MP, requested that the Auditor-General examine the District Council of Coober Pedy's accounts under section 32(1)(a) of the PFAA. Section 32(1b) requires the Auditor-General to conduct an examination if requested to do so.

This report communicates my findings on the examination of District Council of Coober Pedy's accounts.

#### **Acknowledgements**

The audit team for this report was Andrew Corrigan, Satish Chandra Akula and the Local Government audit team. They were assisted in the review by Simon Marsh and the legal firm, Lipman Karas.

I would like to record my appreciation for the cooperation and assistance provided by the District Council of Coober Pedy.

Yours sincerely

A handwritten signature in black ink, appearing to read "Richardson", with a long horizontal flourish extending to the right.

Andrew Richardson  
**Auditor-General**

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# 1 Executive summary

## 1.1 Introduction

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On 1 May 2017 the Treasurer of South Australia requested that I examine the District Council of Coober Pedy's (the Council's) accounts. The Treasurer's request arose from his concerns about certain communications between the Office of Local Government (the OLG) and the Council. These concerns related to the Council's:

- financial position, financial performance and financial management practices
- compliance with and discharge of its responsibilities under the *Local Government Act 1999* (LG Act) and the Local Government (Financial Management) Regulations 2011 (LG Regulations).

The former Minister for Local Government<sup>1</sup> (the Minister), on the advice of the OLG, had been communicating with the Council since September 2015 about these concerns. I considered this correspondence to properly understand the matters of concern.

The Council provides local government services to the residents of Coober Pedy, an opal mining town in the South Australian outback. Coober Pedy is a remote town located a long way from the nearest service towns and cities, with a declining population.

Given its remote location, the Council provides essential services that are not generally provided by local councils, such as electricity and water supply. These functions are significant components of the Council's operations and exposes it to significant operational and financial risks. These services are complex to manage, both financially and operationally, and costly to operate as they require significant investment in infrastructure assets and technology to provide these services to the town's community. In my opinion it is essential that the Council reviews and properly understands the management and financial performance of these and its other operations and manages the associated risks effectively. The Council needs appropriately qualified and experienced personnel to sustain an effective accounting and financial management function and to manage its risks.

Since 2012 the Council has experienced large variances between actual and budget operating results, with large deficits reported in 2012, 2014, 2015 and 2016. The variances resulted mainly from the Council spending beyond its approved budget and not earning the income it expected to. The deficits were mainly funded by borrowings which, since 2011, increased by \$6.1 million to \$7.1 million as at 30 June 2016.

The examination objective was to critically examine the Council's accounts to evaluate the Council's financial position, financial performance and financial management practices and determine if it complied with relevant legislative requirements. The legislative requirements relevant to the examination covered key elements of the strategic and financial management framework provided in Chapter 8 of the LG Act.

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<sup>1</sup> From 22 March 2018 known as Minister for Transport, Infrastructure and Local Government.

## 1.2 Conclusion

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### 1.2.1 Overall conclusion

Based on the examination of the Council's accounts for the years from 2011-12 to 2016-17 (relevant period), I concluded the following:

- The Council's financial position, and particularly its current level of indebtedness, is unsustainable. The Council cannot meet its operational cash flows and has no realistic prospect of repaying its indebtedness from its own resources.
- The Council's financial performance was inadequate. It reported losses in 2011-12, 2013-14, 2014-15 and 2015-16 that were not budgeted for. There is no evidence the Council considered the impact of these losses until it was in financial crisis. The Council has, from time to time, developed planned responses which were, in my opinion, reasonable but it has not demonstrated an ability to implement the required actions.
- The Council's accounting systems and records are significantly deficient and unable to support effective financial management of the Council's operations.

I further concluded the Council failed to comply with key aspects of the strategic and financial management requirements of the LG Act during the period 1 July 2014 to 30 June 2017.

In my opinion, Council will only successfully respond to its current financial position if it is able to recruit and retain a chief executive and finance manager who are appropriately qualified and experienced.

### 1.2.2 Deficiencies in key strategic and financial management practices

I found that during the relevant period the Council did not comply with key components of the strategic and financial management framework requirements of the LG Act.

I concluded that during the relevant period:

- the Council failed to comply with section 124 of the LG Act which requires it to maintain accounting records that explain its revenues, expenses, assets and liabilities and enable the timely and accurate preparation of financial reports
- the Council failed to comply with section 13 of the *State Records Act 1997* which requires it to maintain its official records, which includes its accounting records, in good order and condition
- the Council failed to comply with section 127 of the LG Act in that:
  - its financial statements for the years ended 30 June 2015, 30 June 2016 and 30 June 2017 were not prepared by the second Friday of September in each year
  - it did not adopt its financial statements for the years ended 30 June 2015 and 30 June 2016 and provide a copy to the Minister by 30 November in each year

- the financial statements for the years ended 30 June 2014 and 30 June 2015 were certified without authorisation by the Council
- the Council failed to comply with section 131 of the LG Act in that it did not provide its annual report, including its audited financial statements for the years ended 30 June 2015, 30 June 2016 and 30 June 2017, to Parliament by 31 December in each year
- the CEOs failed to fulfil the functions of that office prescribed by section 99 of the LG Act, in that they failed to ensure the Council was:
  - provided timely, sufficient and accurate information to the Council to support recommendations to incur debt from 2012-13 to 2015-16
  - provided regular and proper reports to enable the Council to understand and monitor its financial performance and respond strategically to its emerging financial risks since 1 July 2014
- Council failed to comply with sections 44 and 134 of the LG Act in that Council staff did not obtain the approval of the elected members before incurring debt in August 2012, August 2013, August 2014 and June 2015
- the Council failed to comply with section 122 of the LG Act in that it did not:
  - comprehensively review its strategic management plans by November 2016, within two years of the general council election
  - review its long-term financial plan (LTFP) annually, and update it when required, after it was adopted in March 2013
  - prior to incurring debt, and as provided in its LTFP, review its LTFP and receive and consider a report from the CEO on the sustainability of its long-term financial position and performance and its ability to repay debt
- the Council failed to uphold the principles prescribed in section 8 of the LG Act because it did not ensure the sustainability of its long-term financial performance and position. The Council did not:
  - properly assess the impact on its long-term financial sustainability, and its ability to repay, before approving and incurring significant debt in August and September 2015
  - analyse and consider the financial impact of subsidising the costs of user-pays services
  - prepare regular management reports to understand, analyse and monitor its financial performance since 1 July 2014. This meant the Council could not identify the significant losses being incurred, and take timely remedial action
- the Council failed to comply with section 123(13) of the LG Act and Regulation 9 of the LG Regulations in that it did not prepare adequate, and regular reports, to monitor its financial position and performance and identify any emerging need to reconsider its annual business plan and budget for 2014-15, 2015-16 and 2016-17

- the Council failed to comply with section 123(13) of the LG Act, and Regulation 10 of the LG Regulations, in that it did not prepare a report comparing its audited financial results with budget estimates for 2014-15, 2015-16 and 2016-17
- Council failed to comply with section 44 of the LG Act, in that Council staff were permitted to incur expenditure beyond the approved budget without proper authority in 2014-15 and 2015-16
- the Council failed to comply with section 126 of the LG Act in that its audit committee did not meet regularly, or at all, and failed to perform its statutory functions since 1 November 2014
- the Council, since 1 July 2014, failed to comply with section 125 of the LG Act which required it to implement and maintain appropriate policies and procedures of internal control to ensure the accuracy and reliability of its accounting records.

### 1.2.3 The Council's financial position is not sustainable

I have concluded that the Council's financial position is not sustainable because, during the relevant period, it:

- did not demonstrate the capacity to meet its financial obligations as they fell due
- experienced problems recovering debt owed to it in a timely manner or at all
- had not implemented and maintained prudent financial management practices, which contributed to its significant operating deficits
- failed to maintain accounting records to explain its grants, received under the Remote Areas Energy Supplies (RAES) scheme, and enable it to prepare the financial information, in the form and within the timeframes, required by the RAES agreement. As a consequence, the Council's 2018-19 grant payment will be reduced by \$1.1 million which reflects adjustments for the 2014-15, 2015-16 and 2016-17 financial years. This adjustment is likely to have a significant impact on the Council's finances as it does not appear to have put aside funds arising from the underspend of grant money. The Council most likely applied this money to meet other operational requirements
- failed to set user charges at a level required to recover the cost of providing services. Prior to 2016-17, the Council's decision to reduce the user charges rates for water supply was not supported by appropriate analysis of the financial impact of it subsidising these costs.

I further concluded the Council does not have the capacity to generate additional cash to repay its debt obligations as they fall due. In my view, the Council's borrowings are at unsustainable levels and have a significant impact on the Council's financial sustainability.

### 1.2.4 Deficiencies in governance and financial arrangements

As mentioned above, the Council provides essential services that are not generally provided by local councils, such as electricity and water supply. These functions are significant



components of the Council's operations and expose the Council to significant operational and financial risks. Accordingly, it is critical that the Council has appropriately qualified and experienced personnel to:

- manage and oversee these operations, along with the other operations common to local councils, and manage its risks effectively
- develop and implement accounting systems and records, along with other records of non-financial data, to capture and promptly report on its financial and operational performance
- analyse financial information related to its functions to identify emerging financial issues and risks, then to identify and implement appropriate risk mitigation strategies.

The frequent turnover of key senior personnel appears to have contributed to a breakdown in the Council's leadership and management.

The detrimental effect a change at the senior management level has on the operations of a remote entity like the Council cannot be underestimated. This level of turnover was significant given the Council's small management team, flat organisation structure and limited capacity to:

- cover vacancies in the CEO and Finance Manager positions
- support each new acting and permanent CEO and Finance Manager while they developed an understanding of the Council's operations.

The Council administration was without stable and effective leadership from 1 January 2015 to August 2016, when a permanent CEO was appointed. This gap in the Council's leadership team was significant at a time when it faced challenges in:

- managing the Council's daily operations and affairs
- complying with legislation
- identifying and responding to emerging challenges.

During the period considered by this examination it was evident the Council's audit committee did not perform the functions required by the LG Act. This meant the Council administration, and particularly its accounting systems and practices and the associated system of internal controls, were not subject to the oversight and review of the audit committee. I accept that the audit committee members and other elected members were dependent upon the CEO to ensure meetings were scheduled and agendas and papers were prepared. I further accept that the turnover of CEO and Finance Managers, during the period from 1 January 2015 to August 2016, contributed to the lapse in the audit committee.

The Council appears to have had some difficulty in attracting and retaining qualified staff. It relied on external consultants to assist in various functions over the years. In my view, this is not a sustainable practice given the complexity and risks associated with Council's operations.

The Council was protected from the impact of the financial risks associated with the electricity supply function by its agreement with the SA Government to subsidise the electricity supply costs. This protection depended on the Council effectively implementing the quarterly and annual budgeting and reporting framework required by the agreement. The Council failed to comply with the requirements of the RAES agreement.

Effectively mitigating the financial risks associated with the water supply function required the Council to understand the revenues and expenses associated with the function and, specifically, to understand the water production costs. I found no evidence that the Council considered the unit cost of production for its water supply function until 2016-17. Council's analysis shows that, prior to 2016-17, the user charges set by Council did not recover the cost of water production.

The absence of regular, and proper, financial analysis and reporting meant the Council did not understand its financial situation until it was forced to incur significant and unplanned borrowings to respond to the emerging financial crisis. The Council incurred significant borrowings without assessing its capacity to repay the outstanding debt and the impact on its long-term financial sustainability.

In my view, the Council's practice of approving loans based on inadequate information or when facing a financial crisis condoned the Council's poor approach to financial management practices and masked the Council's emerging financial difficulties, which had serious implications for the Council's financial sustainability.

In my view, the Council acted appropriately when, in August 2015, it initiated an examination under section 130A of the LG Act in response to a request from Council staff to approve further unplanned borrowings. The outcome of the examination, however, did not effectively respond to the Council's request and concerns.

It was not until May 2016 that the Council assessed its financial situation and identified financial strategies for a way forward. The Council has confirmed its commitment to mitigating its financial risks but, in my view, has demonstrated limited capacity to implement the planned strategies and respond to its challenges.

It is not evident that the Council had, or now has, the capacity to achieve an effective accounting and financial management function to manage essential and complex services, unlike those provided by any other council established under the LG Act in South Australia.

On the basis of all the available evidence provided to the examination, in my opinion, it is unreasonable to expect the Council to meet its current financial obligations and continue to provide essential services with its existing governance and financial arrangements. This is because:

- it is in a remote location with a declining population and rate base
- it has limited human resource capability
- its financial position is not sustainable.

## 1.3 What I found

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### 1.3.1 Understanding the Council's financial position and performance (section 8)

The Council had borrowings outstanding of \$6.7 million as at 30 June 2018, mainly incurred to fund past operating deficits.

Repaying this significant level of debt will require Council to demonstrate prudent financial management and the capacity to generate additional revenue to accumulate cash. The Council, however, has limited capacity to generate additional revenue.

The Council has difficulty converting its revenue raised into cash, because of problems recovering debt owed by ratepayers and utility users. This inability to recover debt on time (if at all) had a significant impact on the Council's cash flows and contributed to its inability to pay its own obligations on time.

The Council had difficulty paying its creditors on time and within acceptable commercial terms. This supports my assessment that the Council's cash balances were insufficient to meet its monthly expenses and any unexpected event, or large expense, would have made it difficult for the Council to continue operating without borrowing more money.

I found the Council had not set user charges at a level to recover the cost of providing the service. As a result, it subsidised the cost of services such as water supply and child care. Further, I found no evidence of regular financial reporting to the Council on these operations. The Council's decision to reduce these charges was not supported by detailed and documented financial analysis of the impact on the Council's financial sustainability.

The Council's 2016-17 annual business plan records a total subsidy cost of \$1.6 million for water supply since 2014-15. My analysis of the Council's financial records supported a conclusion that child care services contributed to losses totalling \$1.3 million since 2010-11.

### 1.3.2 Accounts and accounting records (section 9)

Council staff were unable to provide information required for me to properly examine and understand the Council's accounts and explain the underlying transactions. They appear to have found it difficult to locate all the documents and information I requested due to the Council's poor record-keeping practices.

The Council's accounting system supports standard local government budgeting, management and financial reporting functions, but not accounting for its electricity and water supply functions. The chart of accounts implemented by the Council did not support effective reporting on all Council functions and did not meet all reporting obligations. I found that the Council did not use its accounting system to prepare financial reports but used other software to prepare reports from data extracted from the accounting system.

My findings highlight that the Council relied heavily on the corporate knowledge of individuals and on external consultants to perform various finance functions over the years.

### 1.3.3 Financial reporting (section 10)

The Council failed to prepare its financial statements for the years ended 30 June 2015 and 30 June 2016 by the second Friday of September in each year.

The Council failed to adopt its financial statements for the years ended 30 June 2015 and 30 June 2016 and provide a copy to the Minister by 30 November in each year.

The financial statements for the years ended 30 June 2014 and 30 June 2015 were certified without the Council's authorisation.

The Council failed to provide its annual reports, including its audited financial statements, for the years ended 30 June 2015, 30 June 2016 and 30 June 2017 to Parliament by 31 December in each year.

The Council certified its financial statements for the year ended 30 June 2017 on 17 September 2018.

### 1.3.4 Borrowings (section 11)

At 30 June 2018 the Council had loans outstanding of \$6.7 million, mainly incurred to fund past operating deficits. This level of indebtedness imposes a significant debt servicing load on a small council with a prior record of reporting operating deficits and difficulty generating the cash required to repay the loan principal.

Council staff do not appear to have provided elected members with regular and/or proper reports to understand and monitor the Council's financial performance and respond strategically to its emerging financial risks.

The Council incurred significant and unplanned debt to respond to its specific financial difficulties. Some loans were procured without Council approval. When debts were approved or incurred, the Council's records did not adequately:

- explain the need for the loans
- explain how the loans would be repaid
- assess the impact of the planned borrowings on the Council's long-term financial sustainability.

The Council's practice of approving loans based on inadequate information, or when facing a specific financial crisis, condoned the Council's poor approach to financial management and masked the Council's emerging financial difficulties, which had serious implications for the Council's financial sustainability.

The Council has confirmed its commitment to mitigating its financial risks but it has demonstrated limited capacity to implement the planned strategies and respond to its challenges.

### 1.3.5 Electricity grants (section 12)

Council staff were unable to provide accounting records to explain the grants the Council received under the RAES scheme.

The Council did not provide quarterly reports and audited financial statements for years 2013-14 to 2015-16 in the form, and within the timeframes, prescribed by the RAES agreement.

The Council did not provide audited financial statements for years 2011-12 to 2015-16 in the form prescribed by the RAES agreement.

The SA Government calculated the reconciliation payment, as provided for in the RAES agreement, for 2014-15, 2015-16 and 2016-17 and has determined that the 2018-19 grant payments will be reduced by \$1.1 million. This adjustment recognises that the value of grants paid to the Council by the SA Government under the RAES scheme for these years exceeds the Council's net cost of providing the electricity function.

Information provided by the officers responsible for calculating the reconciliation payment highlight that they have revised the calculations as the Council has provided more and better information. This supports my view that the Council's failure to provide reliable information to the SA Government, in the form and within the timeframes prescribed by the RAES agreement, has caused uncertainty about the integrity of the reconciliation process, the amount of the adjustment and the impact of the adjustment on the Council's finances.

The Council failed to prepare regular, timely and reliable reports to effectively manage the impact of variations between the budgeted and actual net cost of the electricity function. These reports would enable the Council to engage with the SA Government to validate, and if necessary challenge, an assessment that future grant payments should be adjusted due to past outcomes.

In summary, the Council failed to comply with the reporting regime, established by the RAES agreement, that was designed to protect the Council from excessive over/under payments and avoid significant impacts on its cash flows.

### 1.3.6 Strategic management (section 13)

Over the six years to 30 June 2016, the Council spent beyond its approved budget, incurred significant debt and reported significant operating deficits.

From late 2014 the Council experienced significant turnover in the CEO and Finance Manager positions. The CEO plays a key role in ensuring that the Council's daily operations and affairs are managed and legislative requirements are complied with.

This level of turnover was particularly significant because the Council has limited management staff, and therefore limited capacity to:

- cover vacancies in these two key positions

- support the new acting and permanent appointees while they developed an understanding of the Council's operations.

The frequent turnover in these key positions also appears to have contributed to the breakdown in monitoring and reporting the Council's financial position and performance, and complying with LG Act requirements.

The Council did not:

- comprehensively review its strategic management plans by November 2016, within two years of the general council election
- review its LTFP annually and update it when required
- prepare adequate and regular reports to enable the effective review of its financial performance after 1 July 2014
- maintain adequate records to explain the significant variances between its budgeted and actual results.

I found no evidence to suggest that the Council operated with an appropriate long-term focus as required by the LG Act. The Council's strategic management plans were not properly integrated into its annual budgets and operational plans.

The lack of monitoring, reporting and evaluating of its financial performance is further evidence of the Council's failure to properly discharge its legislative responsibilities to the Coober Pedy community and ensure its long-term financial sustainability.

### 1.3.7 Audit committee (section 14)

The Council's audit committee:

- did not meet in 2014-15
- met only once in 2015-16, on 10 September 2015
- met only twice in 2016-17, on 10 November 2016 and 6 April 2017.

The audit committee did not perform its legislative functions by failing to:

- provide advice to the Council on its finances and the section 130A investigation process as requested
- oversee the section 130A investigation process and implementation of the recommendations to address the findings
- provide advice on the Council's financial statements for the years ended 30 June 2015 and 30 June 2016
- provide information relevant to the Council's strategic and annual planning processes, including reviewing the SMPs and annual business plans
- regularly review the adequacy of the Council's financial management systems and practices

- provide independent assurance to the Council on the effectiveness of its internal controls.

Further, the audit committee did not provide sufficient oversight and advice to the Council for a number of key events that required the audit committee's attention. The audit committee's lack of oversight was a serious deficiency in the Council's overall control environment.

### 1.3.8 Information technology controls impacting financial data (section 15)

My high level review of IT controls over the confidentiality, integrity and availability of the Council's financial data identified:

- a lack of user access controls to the Council's systems and data
- known high risk general IT control deficiencies existed
- limited vendor support contracted to assist the Council.

### 1.3.9 Policies, practices and procedures of internal controls (section 16)

The Council was unable to provide documented policies and procedures of internal controls to support all key account balances and finance functions.

The Council was unable to provide any evidence that reconciliations of its subsidiary ledgers to the general ledger, a significant control procedure, were performed as at 30 June 2014, 2015, 2016 and 2017.

### 1.3.10 Other observations (section 17)

In September 2015 the Council approved the appointment of a person to the position of interim CEO. The terms and conditions of this appointment were not formally documented. Council staff then paid the interim CEO's remuneration to an entity associated with him without the authority of a Council decision or any signed contractual arrangements.

## 1.4 The Council's response to my findings

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The Council responded to my findings and conclusions as provided in sections 1.2 and 1.3.<sup>2</sup>

The Council advised it supports my general findings and advised of action being taken to address some of the reported findings. A copy of the Council's response to my Report is provided in full (but with some names redacted) in appendix 3.

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<sup>2</sup> I also received a formal response to my findings and conclusions from a former CEO. This response was considered before finalising my Report. No responses were received from other relevant non-government parties.

In responding to my Report, the Council also noted that, in 2015-16, some councillors had raised concerns with the State Government about the Council's financial administration over a period of years. The Council advised these councillors were seeking government intervention to resolve the Council's perceived financial problems.

The Council also advised the current Acting Mayor, Cr Paul Athanasiadis had raised concerns at council meetings dating back to 2012. The Council's response included details of the current Acting Mayor questions recorded at council meetings in 2015 and 2016. These concerns related to the financial mismanagement associated with borrowings taken out without the Council's approval and compliance with legislative requirements.

The Council reported that it had advised the Minister that it supports the appointment of an administrator. The Council seeks a rapid response to put the council on the path to financial stability.



## 2 Introduction

### 2.1 Request for examination

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On 1 May 2017 the Treasurer requested that I examine the Council's accounts under section 32(1)(a) of the *Public Finance and Audit Act 1987* (PFAA). A copy of the Treasurer's request is provided in appendix 1.

The Treasurer's request was in the context of the following matters raised by the OLG:

- The OLG had been communicating with the Council about its financial position, financial performance and financial management practices.
- There were apparent large adverse variances between the Council's actual and budgeted financial results for the 2014-15 and 2015-16 financial years.
- A number of legislative financial reporting requirements had not been met, including the failure to provide audited financial statements for 2015-16 to the Minister within the statutory timeframe.
- It was expected that the audited financial statements for 2015-16 would reveal significant levels of debt and a significant operating deficit.

The Minister, on the advice of the OLG, has been communicating with the Council since September 2015 about these concerns. The Minister requested quarterly reports from the Council on its progress to address them.

In responding to the Treasurer's request for the examination, it was necessary for me to consider the correspondence between the Minister and the Council to properly understand the concerns about the Council's:

- financial position, financial performance and financial management practices
- compliance with and discharge of its responsibilities under the LG Act.

The key correspondence I considered is provided in appendix 2.

### 2.2 Structure of this report

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This Report outlines the examination approach, certain information and documentation I obtained and reviewed, and the examination findings and conclusions as follows:

- Section 3 details the examination objectives and approach
- Section 4 outlines the legislative requirements relevant to the examination
- Section 5 provides a timeline of key events
- Section 6 provides an overview of the Council's operations and finances
- Sections 7 to 17 detail the examination findings and conclusions.

## 3 Examination mandate, objective and approach

### 3.1 My mandate

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Section 32 of the PFAA sets out the requirements on the Auditor-General of an examination requested by the Treasurer. The following subsections of section 32 of the PFAA are relevant to this examination:

*(1)(a) The Auditor-General may examine the accounts of a publicly funded body and the efficiency and economy of its activities.*

*(1b) The Auditor-General must conduct an examination under subsection (1) if requested to do so by the Treasurer...*

*(2) After making an examination under subsection (1), the Auditor-General must prepare a report setting out the results of the examination.*

*(3) The Auditor-General must deliver copies of the report to*

- (a) any publicly funded body concerned in the examination,*
- (b) If the examination was requested by the Treasurer - the Treasurer*
- (d) the President of the Legislative Council and the Speaker of the House of Assembly.*

The Council is a publicly funded body under section 4 of the PFAA, which defines such a body to include a council constituted under the LG Act.

### 3.2 My objective

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The examination objective recognises the requirements of section 32 of the PFAA with specific regard to the particulars of the Treasurer's request.

I examined the Council's accounts to evaluate its financial position, financial performance and financial management practices and assess its compliance with the following legislative requirements:

- The Council's accounting records were correct and adequate and explained its revenues, expenses, assets and liabilities to enable the preparation of financial statements that present fairly financial and other information as required by section 124 of the LG Act.
- The Council had submitted audited financial statements to the Minister by 30 November each year as required by section 127 of the LG Act.

- The Council had prepared, adopted and reviewed its strategic management plans in line with section 122 of the LG Act.
- The Council had prepared, adopted and reviewed its annual business plan and budget in line with section 123 of the LG Act.
- An audit committee was established and carried out its functions under section 126 of the LG Act.
- The Council implemented and maintained adequate policies and procedures of internal controls to support the accuracy and reliability of its accounting records as required by section 125 of the LG Act.

An overview of the specific legislative framework for this examination is provided in section 4.

### 3.3 What I examined and how

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Planning for the examination included discussions with key Council personnel and a preliminary review of various documents to understand:

- the Minister's concerns
- the nature and extent of the Council's financial issues and challenges and its response to them
- the Council's governance, organisational activities and accounting records and systems
- relevant matters previously raised by independent consultants engaged by the Council and the Council's external auditor.

To understand the Council's financial performance, I reviewed its approved budgets and audited financial statements for the six years from 2010-11 to 2015-16 to determine when it experienced financial difficulties and identify areas requiring specific and detailed examination. My primary focus was the Council's accounts for 2014-15 and 2015-16. I also sought to understand significant fluctuations in some account balances before 2014-15. I requested relevant accounting records to gain a substantive understanding of specific accounting transactions and procedures.

In conducting the examination, I was mindful of the Council's resource limitations. I agreed communication protocols at the outset, provided reasonable timeframes to respond to information requests, agreed the timing of site visits, and communicated my requirements well ahead of my officers' visits.

I understand the Council staff went to considerable effort to respond to my information requests and inquiries which was exacerbated by the Council's previous poor record keeping, application system constraints and high turnover in key senior personnel. Council staff were unable to provide all the documents I requested, and could not explain events that occurred before they were employed.

I made several requests for information/documentation that the Council failed to fully comply with. I then issued a summons under section 34 of the PFAA compelling the Council to produce the outstanding information.

My objective was to meet the Treasurer's request to examine the Council's accounts. This could only be achieved by taking all reasonable steps to complete the examination, including obtaining and considering all relevant and necessary supporting information. I only issued the summons after I was unsuccessful in obtaining the required information in a timely manner from informal requests. In some instances, the summons sought formal confirmation that documentation to respond to a particular information request could not be provided.

I interviewed the then Mayor about some gaps in documentation and events relating to the audit committee and council meeting proceedings. It was evident the then Mayor sought to assist the examination by responding to my inquiries.

In many areas my capacity to conduct the examination, as requested by the Treasurer, was constrained because the Council staff were unable to provide the accounting records required to enable an examination of the accounts at the standard required to satisfy my obligations under the PFAA.

Where possible I sought documents from external parties to address gaps in the Council's accounting records and responses to my inquiries.

I relied primary on information obtained directly by the examination while, where relevant, using the insights gained from considering the work done by other parties, and the Council's own evaluation, to corroborate and test the findings arising from the examination procedures. The reviews performed by other parties provide contemporary insights into the Council's position at a point in time and before key Council staff left the organisation.

Further details of the examination approach are provided in each section of this Report.

Consistent with natural justice principles, I provided a confidential draft of this Report to the Council's elected members, the acting CEO, other staff nominated by the Council, the Council's legal representatives and other relevant external parties to give them the opportunity to provide comments for me to consider in finalising the Report.

On the basis of all the information available to me, I made a number of examination findings and conclusions.

### **3.4 What I did not examine**

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The examination did not involve re-performing the audit of the Council's audited financial statements. The Council is independently audited by private sector auditors each year. I reviewed the reports prepared by these auditors.

The examination did not include a review of the Council's accounts for 2016-17. The Council certified these accounts on 17 September 2018, after my examination work had been completed. I noted that the Council's external auditor did not express an opinion on the Council's financial statements for the year ended 30 June 2017. The Independent Audit Report noted they were unable to obtain sufficient appropriate audit evidence, for the following account balances, to provide the basis for an audit opinion:

- Valuation, existence and completeness of property, plant and equipment
- Accuracy and completeness of depreciation
- Existence and valuation of inventory and inventory expensed during the year
- Recoverability of the electricity debtors
- Completeness and accuracy of the tax liability.

For the same period, the Council's external auditor also determined that the Council had significant deficiencies in its internal controls. These deficiencies related to controls which ensure that financial transactions relating to the receipt, expenditure and investment of money, acquisition and disposal of property and incurring of liabilities for 2016-17 were in accordance with legislative provisions. These deficiencies were described as being due to an absence of policies, procedures and robust internal controls.

The examination of the accounts did not include a review of the Council's decision to enter into a \$198 million power purchase agreement and the financial impact of this. This agreement did not take effect until 1 July 2017 and as such did not cause the deterioration in the Council's financial position and performance as at 30 June 2016. For this reason, I determined that it was outside the scope of the examination requested by the Treasurer. The Ombudsman of South Australia published a report dated 3 July 2018 on an investigation into the Council's decision to enter into the agreement. The findings of that report have not been considered by me in undertaking this examination.

## 4 Overview of the strategic and financial management framework

### 4.1 Introduction

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Councils in South Australia are established and governed by the LG Act. The LG Act has requirements for administration and financial accountability that establishes a governance and management framework. This framework integrates the roles and functions of a council, as a body corporate, Councillors, as members of a council's governing body, and the CEO, as the person responsible for executive management of the council. The LG Act also provides a framework for long-term, medium-term and annual planning by councils and requires councils to consider development, services, asset and financial elements in each level of planning.

The arrangements for planning are supported by a framework for recording key data related to a council's operations, including its finances, and reporting financial data to Councillors and other stakeholders. Reporting and monitoring arrangements include both an element of evaluating past performance and a requirement to test the continued relevance of plans and update them to reflect outcomes.

Importantly these elements of the framework are consistent with the legislated roles, authority and functions for councillors, both individually and as members of the governing body and its committees, and CEOs and other council officers.

The governance and management framework established by the LG Act is directed towards ensuring the sustainability of councils and focuses on achieving their development objectives and their provision of services to the community. The framework obliges councillors, CEOs and other council employees to provide assurance that their decisions and actions support the achievement of a council's objectives, across its different functions and planning time horizons.

### 4.2 Governance arrangements

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CPA Australia's 'Excellence in Governance for Local Government' manual states that:

*Good financial governance requires both council and the administration to play their roles. The administration's competence and performance is grounded in the experience, qualifications and capability of the key players and their teams.*

It also highlights the risk of not having sound financial management:

*... sound financial management is critical to overall success because financial failure itself is enough to bring a council down, irrespective of any other good qualities it may possess.*

The LG Act establishes the powers and functions of a council and a CEO, which are summarised below.

## The Council

Section 35 of the LG Act states a council is a body corporate with perpetual succession. A council acts as a third level of government, independent of the State and Commonwealth governments.

A council consists of members appointed or elected to the council under the LG Act or the *Local Government (Elections) Act 1999*. Periodic elections are held every four years to determine the membership of each council. The council, however, continues to exist and carry out its legislative functions regardless of changes to its membership.

A council's principal roles and functions are outlined in sections 6 and 7 of the LG Act. A council's principal role includes to:

- act as a representative, informed and responsible decision maker in the interests of its community
- exercise, perform and discharge the powers, functions and duties of local government under the LG Act and other Acts.

In performing its roles and functions, section 8 of the LG Act requires a council to:

- seek to ensure that resources are used fairly, effectively and efficiently
- achieve and maintain standards of good public administration
- ensure the sustainability of the council's long-term financial position and performance.

The LG Act requires a council to perform its functions with a long-term focus, beyond the four-year membership term. This means the governing body, when fulfilling their role of reviewing the council's objectives and policies and monitoring its service delivery, is to focus not only on its annual and medium term operations but also its long-term strategic objectives and priorities, policy and outcomes.

The LG Act confers general and specific powers and capacities to a council to perform its roles and functions. Generally, a council has the power to do anything necessary to perform or discharge its functions or duties or to achieve its objectives (section 36 of the LG Act). A council, however, must not do anything inconsistent with a State or Commonwealth law.

## Council members

Sections 58 and 59 of the LG Act provide for the specific roles of mayors and councillors as members of the council's governing body.

As a member of the council's governing body, a council member's role includes to:

- keep the council's objectives and policies under review to ensure that they are appropriate and effective
- keep the council's resource allocation, expenditure and activities, and the efficiency and effectiveness of its service delivery, under review

- ensure, as far as is practicable, that the principles set out in section 8 of the LG Act are observed.

An individual council member does not have the power to make decisions of council. Section 85 of the LG Act requires that no business can be transacted at a council meeting unless there is a quorum present.

A council member is entitled, by making a request to the CEO, to have access to any council document relevant to performing or discharging of their functions or duties. These documents include accounting records, contracts and any documents prepared under Chapter 8 of the LG Act, which deals with administrative and financial accountability.

### The chief executive officer

The CEO is a statutory position where a person is appointed, and the appointment may be terminated, by the council in line with sections 97 and 98 the LG Act. The LG Act requires the council to appoint a person to act as CEO until a vacancy is filled, appoint a selection panel to assess applications and make recommendations to the council on the appointment.

The LG Act confers specific powers or functions on the CEO, which include appointing and managing council employees (section 103). The CEO plays an important role in achieving the council's strategic objectives and priorities. The LG Act specifies the CEO's role and functions (section 99) which includes to:

- provide financial advice and information to the council to make decisions and to discharge its roles and functions. This includes information for the council to adopt strategic management and annual business plans, assess its performance against these plans, and adopt the annual financial statements
- implement council policy and decisions in a timely and efficient manner
- manage the council's daily operations and affairs
- properly manage and maintain the council's assets and resources
- maintain proper accounting records
- implement and maintain appropriate policies, practices and procedures of internal controls.

Whilst not tasked with any specific legislation obligations, the chief finance officer is a key council employee who supports and assists the CEO by:

- providing advice and information on financial matters
- maintaining effective financial management practices, systems and controls
- preparing financial reports to help the council undertake a proper and robust review of its financial performance against budget
- preparing the annual financial statements and maintaining proper accounting records.



## Council committees, including audit committees

Section 41 of the LG Act provides for a council to establish committees to:

- help the council perform its functions
- inquire into and report to the council on matters within the council's responsibilities
- provide advice
- exercise, perform or discharge delegated powers, functions or duties.

Section 126 of the LG Act requires the council to have an audit committee. The audit committee's role is to oversee and provide independent advice to the Council on financial accountability and internal control matters. Its functions are outlined in the LG Act and in its terms of reference. Further information on the Council's audit committee is provided in section 14.

### 4.3 Statutory requirements – strategic and financial management

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A council is accountable to its community for its financial performance and long-term financial sustainability. Chapter 8 of the LG Act provides a robust strategic and financial management framework to enable a council to discharge its financial accountability to its community and other stakeholders. The framework's key features are:

- a process focused on setting a council's strategic direction and planning for the long term (strategic management plans) which are aligned with the council's short-term plans (annual business plan and budget)
- a recognition that there are various groups/positions within a council that have specific roles and responsibilities to assist in discharging its financial accountability
- it is an integrated process of planning, reporting, monitoring and review which follows a logical sequence as each stage depends on the other. The dependency is evident in the specific timeframes prescribed in the LG Act.

The key components of the strategic and financial management framework are discussed in more detail below.

#### Planning

Section 122 of the LG Act requires a council to develop and adopt plans for the management of its area, to be called collectively the strategic management plans. In developing them, a council is required to develop and adopt an LTFP and an infrastructure and asset management plan, both plans covering a period of at least 10 years.

Developing the strategic management plans requires a council to set its long-term strategic objectives and priorities and assess its capacity to continue to deliver the range and level of services to its community. A council's capacity to meet its long-term strategic objectives is

demonstrated through its LTFP and infrastructure and asset management plan. These plans identify the required financial (including planned borrowings) and infrastructure resources required to meet a council's strategic objectives and protect its long-term financial sustainability.

Section 123 of the LG Act requires a council to have an annual business plan and budget for each financial year. It outlines the activities and allocates the financial resources to achieve the objectives set out in the strategic management plans, for the financial year. When preparing its annual plans, a council is required to take into account its LTFP and any issues with the management and development of its assets.

Section 123(8) requires the annual business plan and budget be adopted by a council after 31 May for the following financial year and, except in a case involving extraordinary administrative difficulty, before 31 August for the financial year.

Commentary on the Council's compliance with the legislative requirements for strategic management planning is provided in section 13.

## Records, systems and controls

A council discharges its financial accountability by preparing and considering financial information during the year and at year end. This information reflects how the council has performed financially and its financial position, and demonstrates compliance with its adopted plans.

Section 124 of the LG Act requires a council to maintain accounting records that:

- correctly and adequately record and explain the council's revenues, expenses, assets and liabilities
- enable it to prepare financial statements and other information on time and at times required during the year and at year end
- enable the financial statements to be conveniently and properly audited.

Section 125 of the LG Act requires a council to ensure that appropriate policies, practices and procedures of internal controls are implemented and maintained to secure the accuracy and reliability of council records. Effective internal controls over accounting records will enable the council to prepare financial reports that are reliable and present fairly information on the council's financial position and performance.

The outcome of my examination of the Council's compliance with the legislative requirements for accounts and accounting records, internal controls and financial systems is provided in sections 9, 15 and 16.

## Report, monitor and review

The LG Act requires timely and regular financial reporting to enable a council to:

- evaluate its performance in achieving its strategic objectives

- understand its financial performance, position and future viability
- identify emerging issues and take timely and appropriate responsive action.

To enable a council to do the above, the LG Act requires it to prepare and consider specific reports within specific timeframes. These reports and timeframes are detailed below.

#### *Review of annual plans*

Section 123(13) of the LG Act requires a council to reconsider its annual business plan or budget during the financial year and make any changes required. Regulation 9 of the LG Regulations requires the following reports to be prepared to enable a council to reconsider its annual plans:

- at least twice, between 30 September and 31 May, a report showing a revised forecast of its operating and capital investment activities, compared with the estimates in the budget for the relevant financial year
- between 30 November and 15 March, a report showing a revised forecast of each item in the budgeted financial statements, compared with the estimates set out in the budget, for the relevant financial year. This report must also include revised forecasts for the council's financial sustainability ratios compared with the estimates in the budget.

Further, Regulation 10 requires a council to prepare and consider a report comparing the audited financial results with the budget estimates by 31 December in each year. This report may provide financial information which should prompt the council to reconsider its current budget. Significant variances between the estimated and audited financial results may show that the budget assumptions in prior years were inappropriate and highlight the need for the council to review the budget assumptions to confirm they remain valid.

Commentary on the Council's compliance with the legislative requirements to review its annual plans is provided in section 13.

#### *Review of long-term plans*

Section 122(4) of the LG Act provides that a council may review its strategic management plans at any time but must:

- review its LTFP after adopting the council's annual business plan each financial year
- comprehensively review its strategic management plans within two years of a general council election.

Section 122(4a) of the LG Act requires a council, when reviewing its LTFP, to take into account a report from the CEO on the sustainability of the council's long-term financial position and performance, considering the provisions of the council's annual business plan and strategic management plans.

Commentary on the Council's compliance with the legislative requirements to review its LTFP is provided in section 13.

### *Review of financial results*

The LG Act provides for a council to prepare timely and reliable information summarising its financial position and performance to enable the elected body, and other stakeholders, to make better and informed decisions. I consider it is critical that financial results are provided on time to ensure they are relevant for subsequent financial decision making.

Section 127 of the LG Act requires a council to:

- prepare, for each financial year, financial statements and other documentation before the second Friday in September
- have its financial statements audited
- submit its audited financial statements to prescribed persons by 30 November in each year.

Section 131 of the LG Act requires a council to:

- include its audited financial statements in its annual report
- adopt its annual report on or before 30 November in each year
- submit its annual report to the presiding members of both Houses of Parliament by 31 December in each year.

Commentary on the Council's compliance with the legislative requirements to prepare financial reports is provided in section 10.

## 5 Timeline of events

This table sets out a timeline of events relevant to the examination and is intended to assist the readers of this Report. It is not a complete list of all events but provides context to events discussed in the following sections.

Date	Event
18 November 2014	The Council's first meeting after the local government's general election.
16 December 2014	The Council re-establishes the audit committee.
January 2015	The then CEO resigns. The then Finance Manager becomes acting CEO.
22 April 2015	The Council appoints a permanent CEO commencing 22 June 2015.
21 July 2015	The Council appoints Bentleys as external auditor for a five-year term.
11 August 2015	The Council resolves to initiate a section 130A investigation into the efficiency and economy with which it manages its financial resources. The Council resolves to borrow \$1 million.
27 August 2015	The then Mayor resigns. The then Deputy Mayor is appointed as the acting Mayor.
4 September 2015	The Council terminates the then CEO's appointment.
8 September 2015	The Minister writes to the acting Mayor about recent Council events and the potential need for Ministerial action in the future if there is further evidence of instability or potential breaches of the LG Act.
9 September 2015	The Council appoints an interim CEO.
10 September 2015	The audit committee meets for the first time since it was re-established. The then acting Mayor is appointed as Chair.
11 September 2015	The then Finance Manager resigns.
22 September 2015	The Council resolves to borrow \$2 million.
1 October 2015	The Council resolves to engage DFK Gray Perry to undertake the section 130A investigation.
17 November 2015	The Council receives DFK Gray Perry's final report, dated 26 October 2015, on the outcome of the section 130A investigation.
7 December 2015	The acting Mayor writes to the Treasurer about the Council's governance and decision making and issues with the administration.
15 December 2015	A new Mayor is elected following Council election.
15 February 2016	The Council's financial statements for the year ended 30 June 2015 are certified.

Date	Event
15 March 2016	The Council terminates the then interim CEO's appointment.
15 March 2016	The Council appoints a new interim CEO for one month.
12 April 2016	The Council's external auditor, Bentleys, advises the Minister of legislative breaches.
19 April 2016	The Council appoints an acting CEO commencing 26 April 2016.
11 July 2016	The Council appoints a permanent CEO (pursuant to a five-year contract) commencing on 22 August 2016.
22 July 2016	The then acting CEO meets with the OLG to discuss concerns with the Council's financial position and performance.
20 September 2016	The Council appoints two independent members to its audit committee. The Council appoints an external consultant as the audit committee's Executive Officer.
December 2016	The Council's Finance Manager commences employment.
16 March 2017	The Minister advises the Mayor he was considering exercising his powers under Chapter 13 Part 3 of the LG Act.
1 May 2017	The Treasurer requests the Auditor-General to examine the Council's accounts.
26 June 2017	The Council authorises the 2015-16 financial statements to be certified.
16 February 2018	The then Mayor resigns.
20 April 2018	The Council's then Finance Manager resigns.
17 August 2018	The Council's then CEO resigns.

## 6 Council overview

### 6.1 Coober Pedy

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The Council was constituted in 1987 and is responsible for providing local government services to the residents of Coober Pedy. Coober Pedy is an opal mining town located in the South Australian outback between Adelaide and Alice Springs. The town area is about 78 km with a population of around 1800.<sup>3</sup> The town's population has decreased by 28% since 2001.<sup>4</sup>

Coober Pedy is a remote town located a long way from the nearest service towns and cities. This presents many challenges and cost pressures to the Council, including that it:

- has limited people available to provide services to its community. The Council relies on engaging consultants and contractors from outside of town. This is a significant cost to the Council not only in travel and accommodation costs, but also in paying high rates to attract service providers
- has limited financial resources with a relatively low rate base. As a consequence, the Council relies on grant funding from the Commonwealth and SA Governments to supplement its income
- is highly sensitive to price increases, such as freight costs.

Given its remote location, the Council provides the following essential services to the town:

- electricity supply
- water supply
- child care services.

The electricity and water supply services are complex to manage, both financially and operationally, and costly to operate as they require significant investment in infrastructure assets and technology.

### 6.2 Organisational instability: high turnover in key positions

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The Council's governing body consists of a Mayor and eight elected members (council members). The November 2014 local government elections resulted in five new members being elected to the Council, including the Mayor.

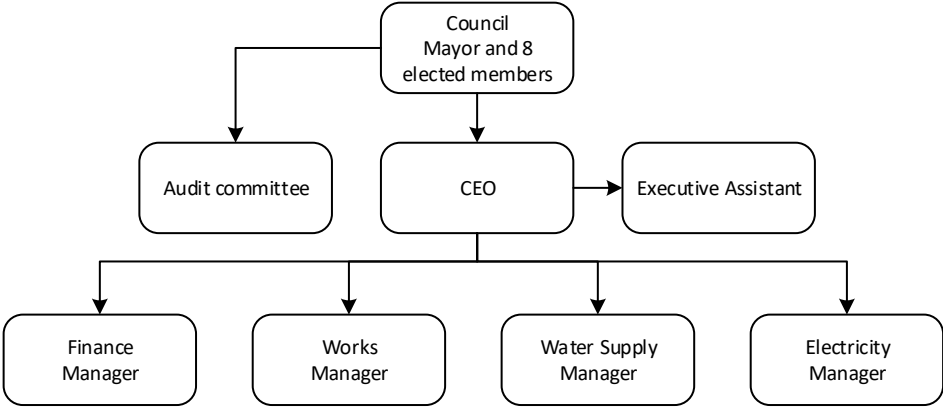
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<sup>3</sup> Australian Bureau of Statistics 2016, Census QuickStats: Coober Pedy, viewed 21 March 2018, <<http://www.censusdata.abs.gov.au>>.

<sup>4</sup> Australian Bureau of Statistics 2001, Census QuickStats: Coober Pedy, viewed 21 March 2018, <http://www.censusdata.abs.gov.au>>.

Figure 6.1 shows the Council’s flat organisation structure, including senior staff, as reported in its 2015-16 annual budget.

**Figure 6.1: Organisation chart**



Source: The Council’s 2015-16 annual budget.

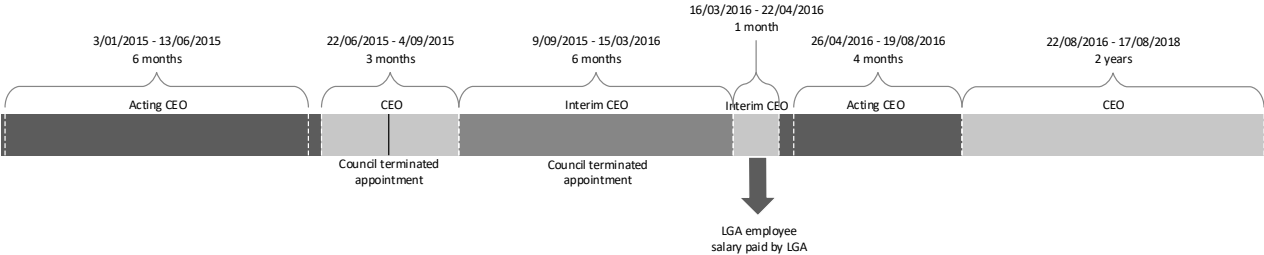
The CEO is responsible for the daily management of the Council’s operations and affairs. As set out in section 4.2, the CEO’s role is specified in the LG Act. In consultation with the Council, the CEO determines the organisational structure of the Administration and appoints and manages staff. The Council also relies on external assistance by engaging contractors to assist in both financial management and in operations to supplement its limited human resources.

The CEO plays a critical role in the administration of the Council to ensure:

- it achieves its strategic objectives
- it provides services and discharges its financial accountability to the community
- its policy and decisions are implemented in a timely and efficient manner
- it complies with LG Act requirements.

Since late 2014 there has been high turnover in the CEO position, with six CEOs (including acting and interim CEOs) over three years, as shown in figure 6.2.

**Figure 6.2: Turnover in CEO role**



The Council appointed a CEO in July 2016 who resigned on 17 August 2018, during the examination.



Further, there were four Finance Managers in the same period. When the Finance Manager acted as CEO between 1 January and 20 June 2015, the Council did not appoint a qualified person to replace him. As a result, the finance function was inadequately resourced over this time. A permanent Finance Manager was appointed in December 2016, over 12 months after the previous Finance Manager resigned. This new Finance Manager resigned in April 2018. The Water Supply Manager has been acting CEO since May 2018.

I appreciate the impact this high turnover in CEO's has had on the Council's administration. It is particularly significant because of the Council's small management team and flat organisation structure which meant the Council had limited capacity to:

- cover vacancies in the key positions of CEO and Finance Manager
- support the new acting and permanent appointees while they developed an understanding of the Council's operations.

The turnover in the CEO and Finance Managers is also likely to have contributed to the effective absence of an audit committee during this period. Elected members were reliant upon Council staff, led by the CEO, to schedule meetings and prepare agendas and reports for the audit committee. This meant the Council administration, and particularly its accounting systems and practices and the associated system of internal controls, were not subject to the oversight and review of the audit committee.

By November 2015 three Council members had resigned, including the then Mayor. A supplementary election was held in December 2015 to elect three new Council members and a new Mayor. The then Deputy Mayor was elected as Mayor on 7 December 2015 and resigned on 16 February 2018. Further information on the role of the Council members, CEO and the senior finance officer in the Council's strategic and financial management is set out in section 4.2.

As required by section 126(1) of the LG Act, the Council established an audit committee to provide advice on relevant matters and assist in performing its functions. The audit committee stopped meeting regularly in November 2014 and was re-established in September 2015 and again in November 2016. Further information on the Council's audit committee is provided in section 14.

The frequent turnover of key senior personnel also appears to have contributed to a breakdown in the leadership and management of the Council's operations and affairs and compliance with legislative obligations. This meant existing challenges were not addressed and emerging challenges were not identified or responded to. Further commentary on the Council's response to those challenges is provided in section 7.

## 6.3 The Council's financial performance

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I reviewed the Council's financial performance from 2010-11 to 2015-16 to determine the periods it experienced financial difficulties and identify areas that needed specific and

detailed examination of the Council’s accounting records. My review was based on information from the Council’s:

- approved budgets for the years from 2010-11 to 2015-16
- audited financial statements for these financial years.

I identified the areas outlined in section 6.3.1 and 6.3.2 for further review and sought to obtain from the Council the detailed information I needed to understand the Council’s financial issues.

The audited financial statements provided limited information as I found:

- they were prepared for general purpose and did not provide the level of detail required to understand the specific financial issues being faced by the Council
- there were inconsistent and incorrect accounting practices applied in preparing them. This limited my ability to understand the Council’s financial performance from one year to the next. Further commentary on this matter is provided in section 10.3.5
- the Council’s external auditor issued qualified opinions for the 2014-15 and 2015-16 financial statements.

Council staff were unable to provide me with the accounting system records and source documents I needed to perform a meaningful analysis of the Council’s financial position or performance. In light of this I sought to obtain information from other parties who have a relationship with the Council, including other SA Government agencies.

Further commentary on the Council’s accounting records is provided in section 9.

### 6.3.1 Financial performance

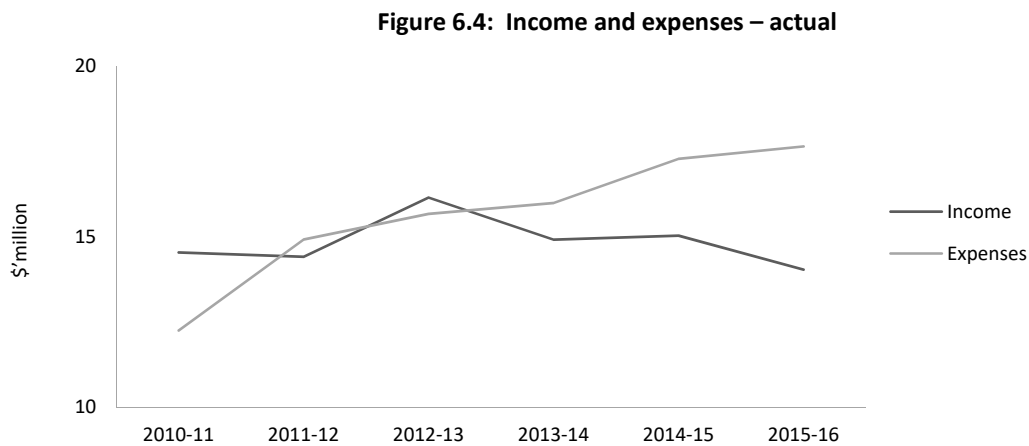
Over the six years I reviewed, the Council experienced large variances between actual and budgeted operating results, with large deficits reported in 2012, 2014, 2015 and 2016. The large variances were mainly a result of the Council spending beyond its approved budget and not earning the income it expected. Figure 6.3 shows the variances between the budgeted and actual income, expenses and operating result for the six years I reviewed.

**Figure 6.3: Income, expenses and operating result – budget v actual**

	Income			Expenses			Operating Result		
	Budget \$'000	Actual \$'000	Variance \$'000	Budget \$'000	Actual \$'000	Variance \$'000	Budget \$'000	Actual \$'000	Variance \$'000
2011	13 690	14 537	(847)	13 185	12 248	937	505	2 289	1 784
2012	14 620	14 410	210	14 154	14 917	(763)	466	(507)	(973)
2013	15 708	16 148	(440)	15 512	15 667	(155)	196	481	285
2014	16 208	14 913	1 295	16 064	15 988	76	144	(1 075)	(1 219)
2015	16 400	15 030	1 370	16 186	17 283	(1 097)	214	(2 253)	(2 467)
2016	16 804	14 033	2 771	16 422	17 646	(1 224)	382	(3 613)	(3 995)

Source: The Council’s audited financial statements and published annual budgets.

Figure 6.4 shows the difference between actual income and expenses.



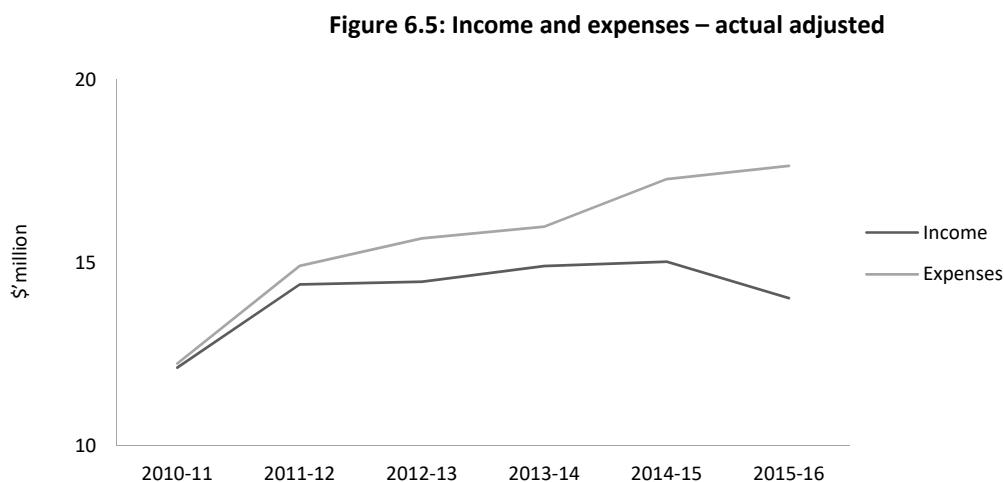
Source: The Council’s audited financial statements.

The data shows that for 2010-11 and 2012-13 actual income exceeded actual expenses. My review of the audited financial statements identified two significant one-off income items in those years:

- a one-off electricity subsidy reconciliation payment from the SA Government of \$2.4 million received in 2010-11 to settle a subsidy underpayment for the prior nine years. The Council repaid \$1.8 million of its loans in 2010-11 with this money
- a capital grant of \$1.7 million received in 2012-13 from the SA and Commonwealth Governments for the specific purpose of replacing bore pipeline.

In both instances, the grants were recognised as operating revenues and included in the grants, subsidies and contributions balance. For the purposes of this analysis, I excluded these one-off income items to understand the Council’s financial performance from its operations in 2010-11 and 2012-13.

Figure 6.5 shows that, after making these two adjustments, the Council had been operating in deficit since 2011. The Council’s income growth has not kept up with its increase in operating expenses, generating operating deficits.



Source: The Council’s audited financial statements.

I reviewed the Council’s meeting minutes from 1 July 2014 to determine whether it had reviewed its strategic management plans and annual budgets. I found that the Council did not prepare regular reports to enable the Council to:

- perform a robust and proper review of its financial performance against its approved budget
- identify and respond, on a timely basis, to the emerging financial trends and underlying causes of its financial issues.

Further commentary on this matter is provided in section 13.3.3.

### 6.3.1.1 Income

A review of the Council’s 2015-16 audited financial statements indicated that its main income sources were from:

- rates and other charges (14% of total income)
- user charges for electricity and water supply (37% of total income)
- grants/subsidies received from the SA Government for electricity supply including diesel fuel excise tax credits (33% of total income).

Figure 6.6 shows the Council’s actual income against budget for the six years I reviewed. It also shows actual income adjusted for the two one-off transactions discussed in section 6.3.1.

**Figure 6.6: Income – actual/actual adjusted v budget**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Actual	14 537	14 410	16 148	14 913	15 030	14 033
Actual – adjusted	12 137	14 410	14 448	14 913	15 030	14 033
Budget	13 690	14 620	15 708	16 208	16 400	16 804
Variance*	(1 553)	(210)	(1 260)	(1 295)	(1 370)	(2 771)

\* The variance is between the actual – adjusted income and budget.

Source: The Council’s audited financial statements and approved budgets.

This analysis shows that over the six years, the Council did not earn the income it expected. After making the two adjustments, the data shows there has been little growth in income over the six-year period, except in 2011-12 when there was an increase of \$2.3 million. This increase was mainly due to an increase in user charges for electricity and water sales of \$1.4 million as shown in figure 6.8.

In 2015-16 income decreased by about \$1 million to \$14 million, below the income levels earned prior to 2011-12.

I examined the Council's main income sources to understand the causes for the significant fluctuations in actual income in 2011-12 and 2015-16.

## Rates

Figure 6.7 compares actual rate income to budget over the six years.

**Figure 6.7: Rate income – actual v budget**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Actual	1 477	1 639	1 667	1 778	1 898	1 931
Budget	1 239	1 360	1 429	1 473	1 885	1 923
Variance	238	279	238	305	13	8

Over the six years, the Council's actual rate income was more than budgeted. My analysis was focused on general rate revenue which represents 67% of the total rates revenue. This supports a conclusion that the Council's unexpected losses were not due to a failure to raise and collect its budgeted rates revenue.

Further commentary on rates is provided in section 8.4.2.2.

## User charges

Figure 6.8 shows that over the six years, actual user charges income was significantly below budget.

**Figure 6.8: User charges – actual v budget**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Electricity sales	2 974	3 758	4 655	5 000	4 049	3 960
Water sales	899	1 522	1 584	1 466	1 369	1 282
Other user charges	548	609	891	914	679	538
Total actual user charges	4 421	5 889	7 130	7 380	6 097	5 780
Budget	6 260	6 970	6 848	7 852	7 740	7 950
Variance	(1 839)	(1 081)	282	(472)	(1 643)	(2 170)

Source: The Council's audited financial statements and approved budgets.

I sought to understand the assumptions and calculations supporting the budget and examined actual electricity and water sales in detail. Further commentary on user charges is provided in sections 7.4.2.3 and 12.

## Grants, subsidies and contributions

Figure 6.9 shows significant variances between actual grants, subsidies and contributions income compared to budget over the six years.

**Figure 6.9: Grants, subsidies and contributions – actual v budget**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Actual	8 011	6 379	7 058	5 260	5 864	5 901
Budget	5 162	5 196	5 394	6 087	5 627	5 653
Variance	2 849	1 183	1 664	(827)	237	248

Source: The Council's audited financial statements and approved budgets.

Over the six years the Council earned more income from grants, subsidies and contributions than planned, except in 2013-14. The fuel excise<sup>5</sup> and energy subsidy makes up 80% of total grants, subsidies and contributions. I examined the Council's electricity arrangements to understand the reasons for these variances. The examination was limited because Council staff were unable to provide detailed working papers to support the annual budget. Further commentary on the Council's electricity arrangements is provided in section 12.

### 6.3.1.2 Expenses

A review of the Council's 2015-16 audited financial statements indicated that its main expenses were:

- employee costs (30% of total expenses)
- materials, contracts and other expenses which were 60% of total expenses, of which 50% is related to the purchase of power from the energy supplier.

Figure 6.10 shows the Council's actual expenses against budget for the six years I reviewed.

**Figure 6.10: Expenses – actual v budget**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Actual	12 248	14 917	15 667	15 988	17 283	17 646
Budget	13 185	14 154	15 512	16 064	16 186	16 422
Variance	(937)	763	155	(76)	1 097	1 224

Source: The Council's audited financial statements and approved budgets.

Over the six years the Council has spent more than it planned except in 2010-11 and 2013-14. Expenses increased by 43%, with large increases in 2011-12 and 2014-15. The 43% increase was mainly due to increases in employee costs and materials and contracts.

I examined the Council's main expenses to understand the causes for the significant fluctuations in 2011-12 and 2014-15.

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<sup>5</sup> The council received tax credits for electricity generating activities in line with its electricity purchase agreement. These tax credits are for diesel purchased by the contractor to generate electricity. These credits were passed onto the Council.

## Employee costs

Figure 6.11 compares actual employee costs to budget over the six years.

**Figure 6.11: Employee costs – actual v budget**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Actual	3 542	4 372	4 114	4 795	5 358	5 305
Budget	3 313	3 403	3 334	4 373	3 931	5 131
Variance	229	969	780	422	1 427	174

Source: The Council's audited financial statements and approved budgets.

In the six years I reviewed the Council has consistently spent more in employee costs than planned, with significant variances from 2011-12 to 2014-15. Over the six years employee costs increased by 50%. There were significant increases in employee costs in 2011-12, 2013-14 and 2014-15.

I sought to understand the reasons for the significant variances in budget and increases in employee costs. The Council's inability to provide the documentation I needed limited my ability to perform a proper and comprehensive analysis of the Council's employee costs. Further commentary on employee costs is provided in section 8.4.2.4.

## Materials, contracts and other expenses

Figure 6.12 shows that over the six years actual materials, contracts and other expenses increased by \$3.3 million (45%) but remained below budget except in 2015-16.

**Figure 6.12: Materials, contracts and other expenses – actual v budget**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Actual	7 312	9 157	9 980	9 589	10 337	10 604
Budget	8 539	9 411	10 799	10 711	11 178	10 007
Variance	(1 227)	(254)	(819)	(1 122)	(841)	597

Over 50% of these expenses is the cost of purchasing power from the energy supplier.

Figure 6.13 shows this breakdown.

**Figure 6.13: Breakdown of materials, contracts and other expenses - actual**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Power purchase <sup>1</sup>	-	-	6 990	5 462	5 451	5 951
Other materials, contracts and expenses	7 312	9 157	2 990	4 127	4 886	4 653
Total materials, contracts and other expenses	7 312	9 157	9 980	9 589	10 337	10 604

<sup>1</sup> Power purchase costs were included in other materials, contracts and expenses in 2010-11 and 2011-12.

Source: The Council's audited financial statements and approved budgets.

I sought to examine the Council's expenses to understand the variances between budget and actual and analysed the expenses against revenues. Council staff were unable to provide the documentation I needed to perform a proper and comprehensive analysis of its expenses. Further commentary on these matters is provided in sections 9 and 10.3.5.

### 6.3.2 Financial position

The most significant items of the Council's assets and liabilities for the six years to 2016 are shown in figure 6.14.

**Figure 6.14: Assets and liabilities – significant items**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
<b>Assets</b>						
Cash and cash equivalents	1 248	966	1 721	1 265	44	375
Trade and other receivables	1 206	1 094	1 837	2 047	2 164	1 888
Infrastructure, property, plant and equipment	27 403	27 906	28 969	28 947	29 905	28 540
<b>Liabilities</b>						
Trade and other payables	1 607	2 349	1 495	1 995	3 059	1 991
Borrowings	1 159	1 067	4 232	4 451	4 696	7 147
<b>Net assets</b>	<b>27 585</b>	<b>27 088</b>	<b>27 604</b>	<b>26 578</b>	<b>25 450</b>	<b>21 837</b>

Source: The Council's audited financial statements.

### Cash and cash equivalents

Figure 6.15 provides an analysis of the cash flows over the six years.

**Figure 6.15: Analysis of cash flows**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Cash at 1 July	793	1 248	966	1 721	1 265	44
Net cash from operating activities	2 892	1 632	(19)	587	(419)	(1 818)
Net cash from investing activities	(677)	(1 822)	(2 391)	(1 334)	(1 081)	(113)
Net cash from financing activities	(1 760)	(92)	3 165	291	279	2 262
Cash at 30 June	1 248	966	1 721	1 265	44	375

Source: The Council's audited financial statements.

Over the six years spending on investing activities (capital expenditure) exceeded the cash available from operating activities by \$4.7 million.

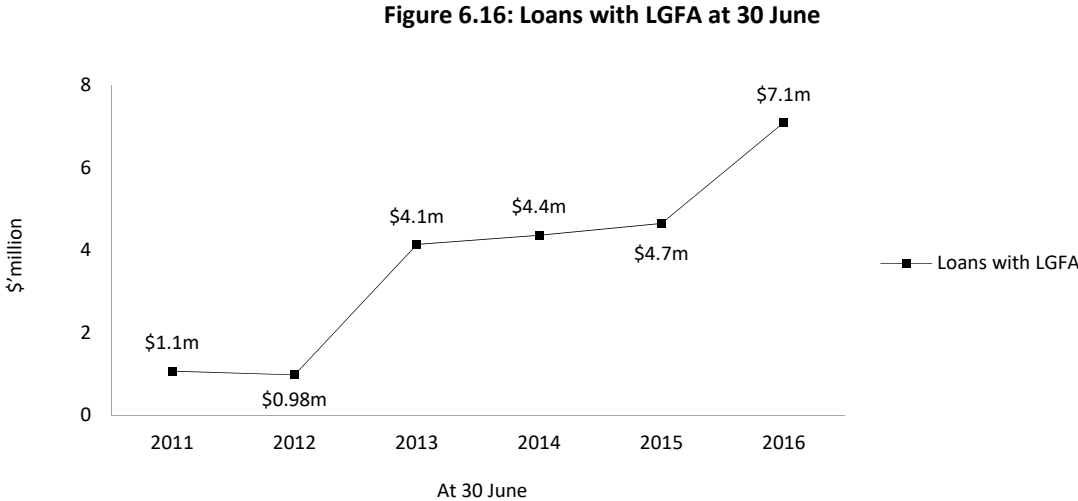
My review of the audited financial statements found that, prior to 2014-15, the cash balance at 30 June included an amount which was, in my opinion, characterised incorrectly. This amount accounted for more than 50% of the total cash and cash equivalents balance in each financial year. Further commentary on this matter is provided in section 10.3.5.



I examined the Council’s cash balances to determine whether it had sufficient cash to pay its expenses. Further commentary on this matter is provided in section 8.4.1.2.

### Borrowings

Over the six years borrowings increased by \$6.1 million to \$7.1 million at 30 June 2016. This was due to an increase in loans with the Local Government Financing Authority (LGFA) as shown in figure 6.16.



I sought to understand why the Council incurred significant borrowings and to assess whether the Council can repay its outstanding debt. Further commentary on borrowings is provided in sections 8.4.3.3 and 11.

### Infrastructure, property, plant and equipment

Since 2011 the written down value of infrastructure, property, plant and equipment has increased by \$1.1 million. Figure 6.17 shows the movement over the six years to 2016.

**Figure 6.17: Movement in infrastructure, property, plant and equipment**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
1 July	19 449	27 403	27 906	28 969	28 947	29 905
Additions	715	1 822	2 393	1 389	2 318	112
Disposals	(34)	10	-	(19)	-	-
Depreciation	(1 211)	(1 329)	(1 328)	(1 392)	(1 360)	(1 478)
Revaluation	8 484	-	-	-	-	-
30 June	27 403	27 906	28 969	28 947	29 905	28 540
Net change in written down value	7 954	503	1 065	(22)	1 271	(1 366)

The Council spent \$8 million on capital works between 2012 and 2015, mainly for water supply and infrastructure assets. Depreciation has remained about the same despite an

asset revaluation increase of \$8.5 million in 2011 and \$8 million in additions over the six years. Underproviding for depreciation expense can result in:

- overstating a favourable operating result
- misrepresenting the required level of asset replacement works
- mismatched economic benefit realised from assets relative to depreciation expense.

I sought to examine the infrastructure, property, plant and equipment additions and the appropriateness of depreciation costs. The examination was limited as Council staff were unable to provide the documentation I needed.

The Council's external auditor issued qualified opinions for 2014-15 and 2015-16. The 2015-16 financial statements were qualified as there was insufficient evidence to support the:

- valuation, existence and completeness of property, plant and equipment
- accuracy and completeness of depreciation.

# 7 The Council's response to its financial challenges

## 7.1 Introduction

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This section provides a summary of action taken by the Council to respond to its financial challenges, at the time events unfolded, and based on the information available at the time.

The Council was first alerted to its poor financial position at its meeting on 11 August 2015, when the then Finance Manager advised the elected members that the Council did not have sufficient cash to pay amounts due to creditors and needed to increase its borrowings. At 30 June 2015, the Council's cash balance was \$44 000 with current liabilities of \$3.7 million. The Council subsequently borrowed \$3 million between 11 August and 22 September 2015 to pay its outstanding bills. By 30 June 2016 the Council reported total borrowings of \$7.1 million.

In response to the concerns raised by the elected members, the Council initiated a section 130A investigation into its finances on 11 August 2015. On 31 August 2015 the Council required its audit committee to review its financial position and oversee the section 130A investigation process.

On 4 September 2015 the Council terminated the then CEO's appointment and the then Finance Manager resigned on 11 September 2015. The Council continued to experience significant instability in its key leadership roles until August 2016. A permanent CEO commenced in August 2016 and a Finance Manager in December 2016. Both these appointees, however, have since left the Council. Further commentary on the Council's organisational instability is provided in section 6.2.

## 7.2 Examination approach

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I held discussions with key Council personnel and examined documentation to understand:

- the Minister's concerns
- the nature and extent of the Council's financial issues and challenges
- the Council's response to its challenges
- when the Council identified its financial difficulties and whether it took timely action to respond.

I considered the following key documentation:

- correspondence between the Minister and the Council
- Council meeting minutes and agenda papers
- audit committee meeting minutes and agenda papers
- the Council's key planning documents (strategic management plans, approved annual business plans and budgets)

- the Council's certified and audited financial statements
- DFK Gray Perry's report on the section 130A investigation outcome.

### 7.3 Assessment of Council's response

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This element of the examination highlighted the following:

- The Council did not receive regular and timely management reports to enable it to understand its poor financial position and performance. This is further discussed in section 13.3.
- When the Council became aware, it responded appropriately by initiating a section 130A investigation.
- The section 130A investigation, however, did not identify the cause of the Council's financial crisis or provide advice on the action needed. In my view, the section 130A investigation outcome did not fulfil its intended purpose, as determined by the Council on 11 August 2015.
- The section 130A investigation undertaken by DFK Gray Perry identified a significant breakdown in financial controls.
- The audit committee did not respond to the Council's request to review its financial position and oversee the section 130A investigation. This is further discussed in sections 14.3.3 and 14.3.4.
- The reality of the Council's financial crisis was confirmed by the then acting CEO in May 2016 and again by the then CEO in August 2017.
- In mid-2016 the Council identified strategies to mitigate its immediate financial risks. These strategies were included in the Council's 2016-17 and 2017-18 annual business plans.
- The Council has sought to progressively implement the identified financial strategies. However, the Council has not documented the timeframe for implementing these strategies and prepared project plans for all key projects. The then CEO advised that some key projects were stalled. This is further discussed in section 7.8.
- The Council has demonstrated limited capacity to implement these strategies and respond to its challenges.

### 7.4 Section 130A investigation

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The Council was first alerted to its poor financial position at its meeting on 11 August 2015. The then Finance Manager's report to the Council recorded that:

- an April 2014 flood event damaged most of the roads and the quarry
- the Council spent approximately \$1 million of its own money to rectify the damage
- the process to apply for the grant money was not as simple as expected

- making these payments meant that the Council had been short of cash for a period of time
- the Council should borrow money to ensure current accounts were paid on time.

The Finance Manager recommended:

*That Council take out a loan with the Local Government Financing Authority (LGFA) for \$1,000,000 for the period of 1 year for the purpose of providing Working Capital for Disaster Recovery in April 2014 and that the money from the Disaster Recovery Fund be applied to this loan when it is received.*

The Council approved the additional borrowings of \$1 million and also initiated a section 130A investigation into the efficiency and economy with which it managed its financial resources to achieve its objectives.

On 31 August 2015, in response to concerns raised by the elected members as to the financial position, the Council determined that its audit committee:

*... meet immediately and discuss the Council's financial position ...*

*... receive a second and third quote for an efficiency and economic audit or audit decided on by the audit committee and approved by the elected body.*

In my view the Council took appropriate action to address its concerns by initiating a section 130A investigation and seeking the audit committee's involvement.

However, I found that the audit committee subsequently failed to respond to the Council's decision. Further commentary on this is provided in sections 14.3.3 and 14.3.4.

At this time there was significant organisational instability, as the then CEO's employment was terminated and the then Finance Manager resigned.

The interim CEO commenced on 9 September 2015 and sought to procure an independent organisation to perform the section 130A investigation. On 1 October 2015 the Council resolved to set aside its procurement policy and directly appoint a firm of chartered accountants, DFK Gray Perry, to undertake the section 130A investigation. The Council minutes and agenda papers did not record details of the scope of the investigation.

## 7.5 DFK Gray Perry review

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On 17 November 2015, the Council received DFK Gray Perry's final report on the section 130A investigation findings, dated 26 October 2015. It states that the Council appointed DFK Gray Perry to:

- investigate the integrity, reliability and performance of the Council's financial systems and services

- report its findings to the Council
- prepare and implement any recommendations to mitigate any present and future defects
- publish and recommend all necessary internal controls, systems, policies and procedures to provide for the future financial sustainability of the Council's financial systems and services.

DFK Gray Perry found significant weaknesses in the Council's financial systems and internal controls. The report stated that:

- key reconciliations had not been performed for more than a year
- there were deficiencies in the financial system
- the audit committee was ineffective
- internal controls were ineffective to ensure that Council's assets were safeguarded, management policies were adhered to and Council records were accurate and reliable.

The report recommended measures to address the identified weaknesses and detailed the status of action taken. Some recommendations acknowledged that remediation work was in progress. The recommendations included the development of various policies and procedures to ensure tasks are performed correctly and efficiently. The report also recommended further investigation of the Council's fixed assets and long-term liabilities.

Many of these internal control deficiencies were raised again by the Council's external auditor as part of the audit for the year ended 30 June 2015. Further details are provided in section 16.

The DFK Gray Perry review reported significant control deficiencies but did not address the cause of the Council's financial position and performance or recommend action to better allocate and manage its resources. In my view, the section 130A investigation outcome did not fulfil the Council's purpose when it initiated the investigation on 11 August 2015.

## 7.6 Acting Chief Executive Officer

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A new acting CEO commenced at the Council on 26 April 2016. The agenda papers for the 17 May 2016 Council meeting include a report titled 'Financial sustainability' by the acting CEO. It stated that the Council had conducted a review of its current financial position and detailed a series of recommendations presented to the elected body at a CEO briefing on 16 May 2016.

My review of Council minutes and papers found that this was the first time the Council had received information which outlined the cause of the Council's financial performance.

The acting CEO identified financial strategies to mitigate the Council's immediate risks. The acting CEO provided information on these risks and strategies to the Minister in correspondence dated 31 August 2016. The risks related to:

- financial sustainability

- corporate capability
- statutory reporting and compliance obligations
- dysfunctional leadership.

On 17 May 2016 the Council resolved to request that the acting CEO prepare project plans and start developing the following suite of strategic management plans to demonstrate how the Council could repay its debt and operate in a financially sustainable way:

- annual business plan and budget for 2016-17
- long-term financial plan 2017-2027
- asset management plan 2017-2027
- strategic plan 2017-2021.

Further details on these plans are provided in section 13.

The Council's 2016-17 annual business plan recorded the financial strategies. The Council started to implement these strategies before the next CEO commenced on 22 August 2016.

## 7.7 Financial strategies

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### 7.7.1 Annual business plans

Since May 2016 Council staff have sought to implement the financial strategies recorded in the Council's 2016-17 annual business plan. They were carried forward to the 2017-18 annual business plan.

The 2017-18 annual business plan reported that:

*The impression of financial sustainability portrayed in this plan rests heavily on the successful implementation of the financial strategy ... If this plan were to be redrafted without the financial strategy being implemented it would reveal that Council is in a financially unsustainable position.*

The financial strategies were to:

- implement project planning
- conduct reliable and robust service reviews to determine the future range and level of services the Council could afford to provide
- delay capital expenditure on non-essential renewal expenditure.

The plan also stated that its achievement depended on the service reviews identifying significant savings and raising additional revenue.

My review of documentation and discussions with Council staff found that the Council had sought to progressively implement the identified financial strategies. I found, however, that

the Council has not documented the timeframe for implementing these strategies. I also found that:

- project plans had not been developed for all projects
- service reviews were being undertaken but reviews of key services had not been completed
- some key projects have stalled.

The following sections provide further commentary on the Council's financial strategies.

### 7.7.2 Project planning

The Council's financial strategy proposed the development of project plans to ensure projects are delivered and to improve its financial reporting. The Council's 2017-18 annual business plan reported that project plans were developed in 2016-17 and were to be implemented in 2017-18.

The Council's Finance Function Action Plan (FFAP) provides a list of projects/tasks the finance staff are to perform. The various versions of the FFAP from May 2016 to October 2017 reported that project plans were to be developed for the following projects as provided in the Council's 2016-17 business plan:

- internal control framework and procedures
- preparing the Council's strategic management plans
- internal and external reporting upgrade
- IT hardware and software review
- service reviews.

My review of the updated versions of the FFAP since May 2016 found that the FFAP provides an extensive list of tasks with responsibility mainly allocated to two finance staff and a part-time consultant. Since May 2016, however, the finance function was not fully resourced which impacted the project progress.

I found that project plans had not been prepared for all key projects as reported in the Council's 2017-18 annual business plan.

### 7.7.3 Service reviews

The Council's FFAP as at 31 July 2016 reported that a project plan to implement service reviews was to be prepared by August 2016. I asked Council staff for this project plan to understand the priority and extent of the services being reviewed, estimated savings and the expected cost and time to undertake the reviews.

Council staff advised that the Council did not have a project plan but provided copies of various reports on the specific service reviews that had been completed and provided to Council.



I found that the Council is progressively reviewing its services, including key services such as child care. The reports provided to Council on service reviews noted that some were complex and require a detailed financial analysis to formulate options for the Council to consider and make an informed decision. They also noted that some reviews may require expert advice, which would impact the time and cost to complete the service review.

I note that without a service review project plan, there is uncertainty as to the priority and extent of services to be reviewed, the resources needed to undertake the review, completion time and estimated savings to be achieved.

In my view, the Council needs the outcome of the service reviews to determine the service ranges and levels that it can afford to provide while protecting its medium to long-term financial sustainability. This information is also required to prepare the Council's strategic management plans.

#### 7.7.4 Delay in capital expenditure

The Council's 2016-17 and 2017-18 annual business plans proposed deferring capital expenditure on non-essential renewal expenditure and new construction expenditure for three years, from 2016-17.

The 2016-17 annual business plan recorded that the Council had planned to review its LTFP and asset management plan by the end of 2016 to identify the essential capital items to be replaced in the next three years. This review was not undertaken in 2016 as intended. The 2017-18 annual business plan provided that the asset management plan and a 10-year asset renewal program would be completed in 2017-18.

The 2017-18 annual business plan allocated \$400 000 to essential capital expenditure, stating that this was around \$1 million less than what should be spent on capital renewal when compared to the Council's annual depreciation.

I acknowledge that reducing capital spending is a strategy available to the Council to address its financial position. However, I note that adopting this strategy will result in future higher asset renewal/replacement, repairs and maintenance costs.

In my view, not reviewing the Council's LTFP and asset management plan, increases the risk that the Council will have a significant backlog of maintenance and asset replacement that will impose greater financial stress in the future. The Council has failed to demonstrate:

- whether the \$400 000 allocation is sufficient as it has not identified the essential capital items
- the medium and long-term effect of delaying capital expenditure
- the future funding strategy to ensure the capital asset renewal program is up to date by 2019-2021.

## 7.8 The then Chief Executive Officer's update

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The Council provides quarterly reports to the Minister on its progress addressing the Minister's concerns (as set out in section 2.1). In a quarterly report dated 15 August 2017, the then CEO advised the Minister that the Council incurred significant liabilities in 2014-15 and 2015-16 to fund operating deficits. The deficits were a result of providing services at a level the Council could not afford, poor management practices and ineffective internal controls leading to inefficiency in service delivery, overstaffing, and wasting money.

The then CEO also advised that the Council's operating result improved in 2016-17 directly due to implementing the financial strategies and improving expenditure controls, and many council services had been reviewed, with efficiencies identified and improved work practices leading to cost savings and additional revenue.

The then CEO also advised the Minister that the Council believed the forecast improvements for 2017-18 were achievable due to the following financial strategies:

- the Council planned to implement a reliable and robust budgeting and reporting system. This was to be operational for most of 2017-18
- improved level of resourcing toward delivering the finance function which had been under-resourced in prior years
- significant expected savings or additional revenue to be obtained from three current ongoing service reviews into child care, water and rubbish services
- implementing modern IT hardware and software systems
- a proactive approach by the audit committee
- establishing a staff structure that is financially sustainable over time
- developing a robust integrated suite of asset management plans.

The then CEO advised the Minister that the Council expected to prepare its 2016-17 financial statements within the statutory reporting timeframes. The Minister wrote to the Council on 25 January 2018 and advised that the Council's external auditor had reported to him that the Council had breached these timeframes. The Minister also requested that the Council provide a quarterly progress report and advice on the status of the Council's financial statements.

At the time of performing this examination the then CEO and the now acting CEO had not responded to the Minister and had not provided a quarterly progress report since 15 August 2017.

The then CEO advised me, in a letter dated 17 January 2018, that the following projects had stalled:

- IT hardware and software upgrade
- chart of accounts and financial reporting system upgrade
- internal financial control framework, policies and procedures upgrade.

These key projects are required to enable the Council to produce reliable and timely financial reports on its financial position and performance and comply with its statutory reporting requirements.

## 7.9 Conclusion

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The Council did not receive proper and regular reports on its actual financial performance against its budget over the period I reviewed. As a consequence, it did not understand the depth of its financial difficulties until it was asked to incur significant borrowings to fund cash shortages.

In my view, the Council took appropriate action to address its concerns by initiating a section 130A investigation. Council management took responsibility for implementing the investigation. In my view, the outcome of the investigation did not effectively respond to the Council's initial request.

The investigation process and outcome was relevant to the audit committee's functions. The audit committee should have had proper oversight over the investigation.

The then acting CEO assessed the Council's financial situation and identified financial strategies in May 2016. I did not find anything to suggest that the Council's understanding of its financial risks and strategies to address those risks were not valid. The Council has confirmed its commitment to mitigate its financial risks but, in my view, has demonstrated limited capacity to implement the planned strategies and respond to the Council's challenges.

In my view, the Council's inability to attract and retain qualified personnel compromised its capacity to effectively respond to its financial difficulties and implement the planned financial strategies. As reported in the Council's 2017-18 annual business plan, the Council will remain in a financially unsustainable position if the financial strategies are not implemented successfully and if the service reviews do not identify significant savings and additional revenue.

In my view, unless a robust review of its services is completed, supported by reliable costings, and key decisions are made about future service provision, the Council will not be able to finalise its strategic management plans. Without current strategic management plans, it is difficult for the Council to demonstrate with any confidence that it is financially sustainable.

## 8 Understanding the Council's financial position and performance

### What I found

The Council had borrowings outstanding of \$6.7 million as at 30 June 2018, mainly incurred to fund past operating deficits.

Repaying this significant level of debt will require the Council to demonstrate prudent financial management and the capacity to generate additional revenue to accumulate cash. The Council, however, has limited capacity to generate additional revenue.

The Council has difficulty converting its revenue raised into cash, because of problems recovering debt owed by ratepayers and utility users. This inability to recover debt on time (if at all) had a significant impact on the Council's cash flows and contributed to its inability to pay its own obligations on time.

The Council had difficulty paying its creditors on time and within acceptable commercial terms. This supports my assessment that the Council's cash balances were insufficient to meet its monthly expenses and any unexpected event or large expense would have made it difficult for the Council to continue operating without borrowing more money.

The Council had not set user charges at a level to recover the cost of providing the service. As a result, it subsidised the cost of services such as water supply and child care. Further, I found no evidence of regular financial reporting to the Council on these operations. The Council's decision to reduce these charges was not supported by detailed and documented financial analysis of the impact on the Council's financial sustainability.

### What I concluded

The Council did not demonstrate the capacity to meet its financial obligations as they fell due.

The Council experienced problems recovering debt owed to it in a timely manner or at all.

The Council does not have the capacity to generate additional cash to repay its debt obligations as they fall due. In my view, the Council's borrowings are at unsustainable levels and have a significant impact on the Council's financial sustainability.

The Council did not achieve and maintain prudent financial management practices, which contributed to its significant operating deficits.

The Council failed to comply with its LTFP by not setting user charges at a level required to recover the cost of providing services.

Council's decision in 2012-13 to reduce user charge rates for water supply was not supported by appropriate analysis of the production costs, anticipated sales volumes or the impact of variations in demand on the unit cost of production.

The Council failed to analyse and consider the financial impact of subsidising the costs of user-pays services to ensure the sustainability of its long-term financial performance and position.

The Council failed to prepare regular management reports documenting relevant, timely and reliable data to help it understand, analyse and monitor the financial performance of its operations. This meant the Council did not identify the significant losses being incurred in providing services or take timely remedial action.

In my view, the Council's financial position is not sustainable.

## 8.1 Introduction

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A fundamental purpose of this examination was to understand the Council's financial position and performance. This recognises the concerns expressed by the Minister that prompted the Treasurer to initiate the examination.

I understand from my review of correspondence between the Minister and the Council, and the Treasurer's request, the Minister was concerned that:

- the Council had reported a series of losses in its financial statements and the reported losses were inconsistent with the Council's annual business plans
- the Council's borrowings had increased significantly.

Responding to the Minister's concerns the examination sought to understand the Council's financial position and assess whether that position is sustainable. I also sought to understand the cause of the significant unbudgeted financial losses reported by the Council.

## 8.2 Examination approach

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The initial phase of this examination was based on analysis of the Council's audited financial statements and comparison with the approved LTFP and annual business plans. The primary source of information was the Council's audited financial statements, notwithstanding that, for 2014-15 and 2015-16, the independent auditor's reports were qualified.

The objective of my initial analysis was to identify areas for specific and detailed examination of the Council's accounting records. It confirmed that the Council's financial position declined over the period I reviewed and identified areas of revenues and expenses for specific review.

I then developed detailed examination plans and identified relevant accounting system records and supporting source documents. I sought to obtain the information I needed from the Council to conduct the examination.

In many instances the Council was unable to provide me with the accounting system records and source documents I needed to perform a meaningful analysis of its financial position and performance. I therefore sought to obtain relevant information from other parties who have relationships with the Council, including other SA Government agencies.

The Council’s inability to provide me with the documents and other information I needed imposed a significant limitation upon my ability to perform this part of the examination. This reality is, of itself, an indictment of the Council’s performance of its statutory function and obligations.

### 8.3 The financial overview

#### Highlights of the Council’s financial position and performance

**Figure 8.1: Financial position and performance**

	2010-11 Actual \$'000	2011-12 Actual \$'000	2012-13 Actual \$'000	2013-14 Actual \$'000	2014-15 Actual \$'000	2015-16 Actual \$'000
Financial performance						
Income	14 537	14 410	16 148	14 913	15 030	14 033
Expenses	12 248	14 917	15 667	15 988	17 283	17 646
Operating surplus (deficit)	2 289	(507)	481	(1 075)	(2 253)	(3 613)
Financial position						
Current assets	3 205	2 849	4 634	4 697	3 889	2 774
Non-current assets	27 403	27 906	28 969	28 947	29 905	28 540
Total assets	30 608	30 755	33 603	33 644	33 794	31 314
Current liabilities	2 242	2 662	5 144	6 345	3 708	2 362
Non-current liabilities	781	1 005	855	721	4 636	7 115
Total liabilities	3 023	3 667	5 999	7 066	8 344	9 477
Total equity	27 585	27 088	27 604	26 578	25 450	21 837

Source: The Council’s audited financial statements.

Section 6 identified the following revenue, expense, asset and liability accounts for specific examination to assess whether the Council is in a sustainable financial position:

- financial position
  - borrowings
  - cash
  - debtors
  - creditors

- financial performance
  - rates revenue
  - user charges: water supply
  - employee costs.

## 8.4 Findings

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### 8.4.1 The Council's financial position

#### 8.4.1.1 Borrowings are unsustainable

I sought to understand why the Council incurred significant increases in borrowings of \$6.1 million since 2011. Section 11 details the examination of the Council's borrowings. I found that it had loans outstanding of \$6.7 million as at 30 June 2018, mainly incurred to fund past operating deficits.

I also assessed whether the Council's level of debt was sustainable by analysing its net financial liabilities<sup>6</sup> ratio. This measures the extent to which financial liabilities can be repaid from operating revenues. The target range for the local government sector is a ratio between 0% and 100%,<sup>7</sup> with a low percentage preferred. An analysis of the Council's net financial liabilities and ratio is shown in figure 8.2.

**Figure 8.2: Net financial liabilities**

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Net financial liabilities (\$'000)	569	1 607	2 440	3 754	6 136	7 214
Operating income (\$'000)	14 537	14 410	16 148	14 913	15 030	14 033
Net financial liabilities ratio	4%	11%	15%	25%	41%	51%
Adjusted net financial liabilities ratio	16%	45%	60%	101%	163%	206%

Source: The Council's audited financial statements. Adjusted net financial liabilities ratio calculated on 25% of operating income.

The data shows that the Council's net financial liabilities ratio has increased, which reflects its increasing borrowings while operating income remained steady over the six years, except in 2012-13.

The net financial liabilities ratio was highest at 51% at 30 June 2016. This indicated the Council had capacity to repay its debt, but it should also have signalled that it needed to manage its financial position carefully and increase its surplus cash to achieve a lower and more suitable ratio for the Council.

The Council, however, has limited capacity to generate additional revenue to accumulate cash. Most of its operating revenue is dependent on a cost recovery model (75% from

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<sup>6</sup> Net financial liabilities = total liabilities less receivables and cash and cash equivalents.

<sup>7</sup> Local Government Association of South Australia, Financial Sustainability Information Paper No. 9: Financial Indicators - Revised May 2015.

electricity and water supply). When this is taken into account, the Council’s adjusted net financial liabilities ratio was 206% for 2015-16. This is well outside the target range.

In my opinion it was appropriate for the Council to adopt a lower acceptable range in line with the ratios achieved in 2010-11 and 2011-12. This would better reflect its limited capacity to generate additional revenue to pay its debt in the areas of:

- rate revenue – the rate base is too small, and declining, to generate surplus cash
- water and electricity supply – operate on a cost recovery model and the electricity charges are regulated. Further detail is provided in section 8.4.2.3
- other user charges – the revenue raised is minimal and I found some services were operating at a loss. Further detail is provided in section 8.4.3.

**Conclusion**

As concluded in sections 8.4.1.2, 8.4.2.2 and 11, the Council has not demonstrated the capacity to generate additional cash to repay its financial obligations as they fell due.

In my view, the Council’s borrowings are at unsustainable levels and have a significant impact on the Council’s financial sustainability.

**8.4.1.2 Cash reserves were insufficient**

I assessed whether the Council had sufficient cash to meet its expenditure needs by analysing its cash expenditure ratio. This is a measure of cash at the end of the financial year compared with the Council’s monthly cash expenditure for the year. A high percentage indicates that there is sufficient cash to pay expenses. An analysis of the Council’s cash, expenditure and cash expenditure ratio is shown in figure 8.3.

**Figure 8.3: Analysis of cash sufficiency**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Cash at bank*	353	192	1 027	533	44	375
Cash expenditure**	13 826	14 218	17 504	14 663	15 137	16 855
Average monthly cash expenditure	1 152	1 185	1 459	1 222	1 261	1 405
Cash expenditure ratio	0.31	0.16	0.70	0.44	0.03	0.27

\* This amount excludes the amount characterised incorrectly as discussed in section 10.3.5.

\*\* Total of operating and financing cash outflows.

Source: Prepared based on financial information reported in the Council’s audited financial statements.

The data shows that the Council had insufficient cash to meet its monthly expenses. For example, at 30 June 2016 the Council’s cash balance was \$375 000, which would meet only 27% of the month’s expenses of \$1.4 million. In my view, the Council should have cash reserves to meet at least one month’s expenditure.

In my opinion, the Council’s cash balances were too low and any unexpected event or large expense would have made it difficult for the Council to continue operating without borrowing more money.



I acknowledge my analysis is a broad measure and was limited due to the Council’s inability to provide more detailed information. However, the outcome is consistent with my analysis of other areas, such as the Council’s inability to pay its creditors on time. It is also consistent with the Council’s advice to the Minister that it incurred significant liabilities in 2014-15 and 2015-16 to fund operating deficits. The Council reported that these deficits were a result of services provided at a level greater than Council could afford, poor management practices and generally wasting money.

Further, the then acting CEO’s briefings to the Council and the OLG in July 2016 reported that the Council was very close to being insolvent, as it did not have cash available to meet current liabilities (such as fortnightly pays and creditors).

**Conclusion**

The Council’s cash reserves were inadequate to meet its immediate operating needs. As a result, the Council relied on borrowings to meet its financial commitments.

**8.4.1.3 Creditors not paid on time**

I reviewed the Council’s audited financial statements for 2010-11 to 2015-16 and noted large payable balances at year end. I analysed the payables against the underlying expenditure (ie the materials, contracts and other expenses balance reported in the Statement of Financial Performance) to determine the creditors outstanding ratio. This measures the percentage of expenditure outstanding at year end. A higher percentage indicates that the Council has taken longer to pay its creditors. An acceptable timeframe to pay creditors would be within 30 days. An analysis of the Council’s payables, relevant expenditure and creditors outstanding ratio is shown in figure 8.4.

**Figure 8.4: Payables and creditors outstanding ratio**

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Current payables (\$'000)	1 415	2 074	1 236	1 969	2 956	1 733
Material, contracts and other expenses (\$'000)	7 312	9 157	9 980	9 589	10 337	10 604
Creditors outstanding ratio	19%	23%	12%	21%	29%	16%
Total months of expenditure outstanding	2.3	2.7	1.5	2.5	3.4	2

Source: Prepared based on balances reported in the Council’s audited financial statements.

The data shows that the Council’s payables at 30 June in every year equated to more than one month of expenditure.

My review of the limited accounting records available revealed that the Council had difficulty paying its creditors on time and within acceptable commercial terms. The following are some examples:

- The invoices for electricity supply accumulated to \$4.5 million and \$2.5 million in 2012 and 2015, respectively. These amounts represented five months of electricity supply. The Council incurred \$75 000 in penalty charges imposed by the electricity supplier for late payment.

- In 2014-15 the Council received \$1.2 million in grant funding for airport runway widening works. Invoices totalling \$494 000 for works completed in March 2015 were unpaid as at 30 June 2015.
- The Council consistently failed to lodge BAS returns with the ATO and accumulated tax liabilities of about \$816 000 as at 30 June 2015.

## Conclusion

The Council generally failed to meet its obligations to creditors as and when they fell due.

### 8.4.1.4 Debtor collection difficulties

I reviewed the Council's audited financial statements for 2010-11 to 2015-16 and noted large receivable balances at year end. I analysed:

- the aged receivables at 30 June 2017 to determine how long debts had been outstanding
- the receivables against the underlying revenues to determine the outstanding debtors ratio. This measures the percentage of revenue earned outstanding at year end. A higher percentage indicates that the Council has taken longer to recover money it is owed (ie longer to convert revenue raised into cash).

#### *Aged receivables analysis*

Rates and user charges (for water and electricity supply) represent 51% of the Council's total revenue. An analysis of the Council's receivables for user charges as at 30 June 2017 is shown in figure 8.5.

**Figure 8.5: Receivables – electricity and water**

30 June 2017	<30 days \$	<60 days \$	<90 days \$	90+ days \$	Total \$
Electricity	137 960	61 456	80 737	632 207	912 361
Water	50 944	18 519	22 940	63 899	156 301
<b>Total</b>	<b>188 904</b>	<b>79 975</b>	<b>103 677</b>	<b>696 106</b>	<b>1 068 662</b>
Percentage of total receivables	18%	7%	10%	65%	100%

Source: Data supplied by the Council (unaudited).

Note: The actual receivables are higher by at least 10% due to credit balances from customers who are unknown or who pay their accounts in advance.

The data reveals that 65% of receivables were outstanding for over 90 days and 85% of receivables were for electricity user charges.

#### *Outstanding debtors ratio*

An analysis of the outstanding debtors ratio for rates and user charges (for water and electricity supply) is shown in figure 8.6.

**Figure 8.6: Outstanding debtors ratio**

	30.06.2011	30.06.2012	30.06.2013	30.06.2014	30.06.2015	30.06.2016
	%	%	%	%	%	%
Outstanding debtors:						
Rates	12	9	9	11	15	12
Water	12	9	14	17	28	21
Electricity	13	11	18	21	17	22
Total	13	10	15	18	18	19

Source: Prepared based on balances reported in the Council's audited financial statements.

The data shows that, across the six years, an average of 16% of rate and utility revenue remains uncollected at 30 June. For 2015-16, the outstanding debt ratio for electricity (22%) was higher relative to general rates (12%).

My analysis shows that the Council continues to experience difficulty in recovering debt owed by ratepayers and utility users. This inability to recover debt on time (if at all) has a significant impact on the Council's cash flows and contributed to its inability to pay its own obligations on time.

My review of the Council's records found that in 2014-15 the Council wrote off \$260 000 in bad debts from debtors who were deceased, could not be located or passed the applicable limitation period to recover the debt.

## Conclusion

The Council failed to collect debt owed to it in a timely manner or at all.

### 8.4.2 The Council's financial performance

#### 8.4.2.1 Financial risks associated with the Council's different functions

My initial review of the Council's financial operations highlighted that it provides water and electricity supply functions that are not generally provided by other local councils in South Australia and these functions are a significant part of the Council's operations. I sought to understand whether the Council's unique mix of functions affected its operational and financial risk profile.

A council's rate revenue is derived from statutory charges that are determined and raised in line with the LG Act and are highly predictable and controlled by each council. This source of revenue provides a sound base for funding the traditional activities of councils, which can be effectively budgeted for and controlled by councils.

The water and electricity charges that formed a significant part of the Council's revenue were based on regulated charge rates, which were set annually. The revenue received by the Council from these user charges was significantly affected by changes in demand from

consumers. Revenue to the Council from water charges varied significantly across the period covered by the examination and it is evident that changes in the volume of water sold were a significant factor.

The Council's costs for supplying water and electricity were also more complex than those applying to typical council operations. Water supply operations involved significant investment by the Council in plant and equipment to pump and treat water and both the water and electricity supply functions required significant investment in distribution networks. In addition to this investment in assets, which are relatively fixed costs, both functions imposed significant variable costs.

The electricity supply function was exposed to significant variations in generation costs which were exposed to changes in the price of the diesel fuel used by the generator. Council records support a conclusion that the price of diesel changed significantly over the period considered by the examination and that the changes were not predictable or controllable. Similarly, it is reasonable to assume that the cost of electricity to pump and treat water would vary as the volume of water supplied changed.

The combination of cost variations for key inputs, due to changes in supply market prices and the quantities purchased, and a component of fixed costs, support my conclusion that the water and electricity supply functions performed by the Council exposed it to the risk of changes in the unit cost of production and resultant financial risk.

In reviewing the Council's management of the electricity supply function I found that it recorded and reported both budgeted and actual revenues and costs associated with the function when meeting the annual budgeting and reporting requirements of the RAES scheme. However, this was not always in the form or within the timeframes required.

It is important to reflect on the significance of the electricity supply function and the risks arising from possible variations in revenues and costs. As discussed in more detail in section 12, the electricity supply function was subsidised by the SA Government so that the Council was protected from losses. The RAES scheme also appears to have subsidised a substantial amount of the CEO and Finance Manager salaries.

As noted in section 8.4.2.3 my review of the Council's water supply function highlighted that the revenue from water usage charges has varied over time and that a significant component of the variation is attributable to changes in volumes sold. I found no evidence that, until 2016-17, the Council implemented appropriate analysis on reporting of the revenues and costs associated with the water supply function in the period covered by the examination.

I note that the Council's annual business plan for 2016-17, for the first time in the period covered by the examination, included information related to the cost of production for the water supply function and the net cost of the function. As discussed below the Council reported it had subsidised the water supply function by \$493 000 in 2014-15 and \$618 000 in 2015-16, and would charge most users at rates below the cost of production.

## Conclusion

The Council's electricity and water supply functions were significant components of its operations and exposed it to significant operational and financial risks.

The Council was protected from the impact of both short and long-term financial risks associated with the electricity supply function by the agreement with the SA Government to subsidise the electricity supply scheme. This protection required the Council to effectively implement the quarterly and annual budgeting and reporting framework required by the agreement. The evidence considered by the examination supports my conclusion that the Council:

- did not prepare all quarterly reports required by the agreement
- in some instances, prepared quarterly reports but not within agreed timeframes
- prepared annual budgets and statements of actual revenues and expenses but not always in the form, or within the timeframes, required.

Effectively mitigating the financial risks associated with the Council's water supply function required the Council to understand the revenues and expenses associated with the function and, specifically, to understand the unit cost of production and the impact of variations in volume on unit costs. I found no evidence that the Council considered the unit cost of production for its water supply function until 2016-17.

It is not evident that the Council developed and implemented the accounting systems and records required to capture and report upon the revenues and expenses associated with its electricity and water supply functions. More importantly it is not evident that the Council had the capacity to analyse financial information related to these functions to enable it to adequately mitigate the financial risks it faced.

The CEO's and Finance Manager's salary costs were subsidised explicitly by the RAES scheme in that the electricity budget approved by the Minister met a substantial amount of these costs.

This means the Council is substantially dependent on the electricity function to fund its operating overheads.

### 8.4.2.2 General rates revenue is a limited revenue stream

I reviewed the Council's audited financial statements for 2010-11 to 2015-16 to analyse the trend in rates revenue. I focused on general rates, which represent 67% of total rates revenue in 2015-16.

An analysis of the Council's general rates revenue for the six years I reviewed is shown in figure 8.7.

**Figure 8.7: General rates revenue**

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
General rates revenue – budget (\$'000)	1 097	1 209	1 278	1 297	1 405	1 443
Percentage increase in general rate revenue – budget		10%	6%	1%	8%	3%
General rates revenue – actual (\$'000)	1 044	1 161	1 163	1 251	1 311	1 296
Percentage increase in general rate revenue – actual		11%	0.2%	8%	5%	(1%)
Total income – actual (\$'000)	14 537	14 410	16 148	14 913	15 030	14 033
General rates as a percentage of total income – actual	7%	8%	7%	8%	9%	9%

Source: The Council's audited financial statements and annual business plans.

The data shows that general rates revenue accounts for only 9% of the Council's total income in 2015-16. There has been a steady increase in general rates revenue over the six years, except in 2015-16. The budgeted increase was 32% over the six years compared to the actual increase in general rates revenue of 24%.

The Council's general rates were increased by inflation as required by the Council's LTFP, which reports that a 1% increase in rates only generates an additional \$13 000. As the general rates revenue is a small component of total income there is little to no capacity to generate additional revenue without significantly increasing rate charges.

## Conclusion

The Council raised its general rates in line with its LTFP. The general rates were not increased to match the growth in expenses and to raise additional cash for debt servicing.

The Council has limited capacity to raise general rates to generate sufficient cash to continue to provide the current range and level of services and repay its debt.

### 8.4.2.3 Understanding water user charges revenue

I reviewed the following information to understand the trend in the Council's water user charges revenue for the years from 2010-11 to 2015-16:

- the audited financial statements
- the Council approved LTFP
- the Council approved annual business plans.

The Council's LTFP provides that utility service charges would be increased to recover costs and generate a small surplus. I asked the Council to provide information to understand the costs incurred in providing this service and compliance with its LTFP. Council staff were unable to provide the requested information. My analysis and commentary is limited by this lack of information.

The Council generated 9% of its total revenue from water user charges. An analysis of its water user charges revenue for the years from 2010-11 to 2015-16 is shown in figure 8.8.

**Figure 8.8: Water user charges**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Domestic sales	460	703	717	628	566	509
Commercial sales	421	611	866	604	540	405
Water access charges	257	279	288	296	304	315
Total water user charges revenue	1 138	1 593	1 871	1 528	1 410	1 229
Percentage increase (decrease)		40%	17%	(18%)	(8%)	(13%)

Source: The Council's general ledger. Data reconciled to the Council's audited financial statements.

It is evident that the Council's revenue from water user charges for the three years to 30 June 2014 increased significantly when compared to 2010-11.

These increases can be explained only in part by increased user charge rates. Using 2012-13 as an example:

- user charge rates for water sales increased by approximately 20% when compared to the rates applied in 2010-11
- revenue from domestic sales increased by 56% and commercial sales by 106% when compared to equivalent sales for 2010-11.

Revenue to the Council from water user charges declined in each year after 2012-13. Domestic sales in 2015-16, for example, were 29% lower and commercial sales were 53% lower than comparable sales for 2012-13. The reduction in revenue between these years is greater than the change in user charge rates between the years, as user charge rates reduced by between 9% and 13%.

The comparison of changes in sales revenue and user rates supports a conclusion that changes in sales revenue were not principally due to changes in user charge rates but were significantly impacted by changes in sales volumes. Council documents record that its water sales revenue was affected by sales to regional mining projects and that these sales grew between 2010-11 and 2012-13 and declined after this.

## Understanding the cost of the water supply function

I reviewed the cost of the Council's water supply function disclosed in its audited financial statements to understand if there was any significant movement. As discussed above, I could not obtain sufficient documentation to validate this data.

The Council's audited financial statements from 2010-11 to 2015-16 report that the cost of the water supply function increased by between 1% and 7% each year, with an overall increase of 19% from 2010-11 to 2015-16.

**Figure 8.9: Cost of the water supply function**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Cost of water supply	1 268	1 302	1 370	1 398	1 497	1 514

Source: The Council's audited financial statements.

Comparison of the movement in costs and revenues support a conclusion that the cost of supplying water in the period from 2010-11 to 2013-14 did not change on a basis which was consistent with the change in revenue.

This indicates that the cost of water supply included a significant component of fixed costs. This is consistent with my understanding of the Council's water supply operations, which involved a significant capital investment in:

- bores to extract water
- pipeline to transport water from the bores to the township of Coober Pedy
- treatment facilities
- a distribution network.

The analysis supports a conclusion that there was a significant component of fixed costs in the Council's cost of water supply. This further supports a conclusion that there will be a significant variability in the unit cost of producing water as the volume of water sold changed.

### Information provided to elected members about the water supply function

In examining the Council's financial performance, I considered the information provided to the elected members. The objective of this element of the examination was to assess whether the elected members were provided with the information they needed to determine the user charges for water supplied by the Council in line with the Council's LTFP.

I noted that monthly reports were prepared by Council management which recorded operational data and the activities of the water supply department. These reports did not contain any financial information or analysis.

It is evident the Council received information related to the financial operations of the water supply department as part of annual:

- audited financial statements which included a note disclosing the financial result for each year by function, including the water supply function
- business planning documents, which included a detailed budget by department, including the water supply department, to support recommended rates and user charges.

The annual business plans generally did not include significant discussion of the prior year's estimated outcomes or the proposed budget for each department. This changed in 2016 when the 2016-17 annual business plan included an analysis of the unit cost of producing water and the overall result for the water supply function for the previous three years.

The 2016-17 annual business plan noted that the cost of producing water under the proposed budget and charges for that year, and for the previous two years, was higher than the water charges for most water users which meant the Council was subsidising the supply of water to most users as shown in figure 8.10.



**Figure 8.10: Water supply – unit costs and prices per kilolitre (kl)**

	2014-15 Actual \$	2015-16 Estimate \$	2016-17 Budget \$
Cost per kl	6.05	6.16	6.27
Water charges price per kl:			
0-50 kl per annum	4.13	3.92	4.65
51-300 kl per annum	5.26	5.00	5.50
301+ kl per annum	6.48	6.16	6.78

The 2016-17 annual business plan also noted that the water supply function had reported losses in the preceding two financial years as shown in figure 8.11.

**Figure 8.11: Water function – operating result**

	2014-15 Actual \$'000	2015-16 Estimate \$'000	2016-17 Budget \$'000
Operating income	1 440	1 350	1 485
Total operating expense	1 933	1 968	2 005
Surplus (Deficit)	(493)	(618)	(520)

It is evident that the losses disclosed in the 2016-17 annual business plan for the water supply function in the preceding three years were not consistent with the:

- operating result disclosed in note 9 of the annual financial statements for the function
- budgeted operating results for 2014-15 and 2015-16.

Council staff's inability to provide me with relevant documentation and explanations prevented me from understanding the reasons for the differences between the information reported in the 2016-17 annual business plan and the:

- audited financial statements
- previous years' budgeted results by department.

The absence of documentation also prevents me from validating the data and analysis included in the 2016-17 annual business plan.

### The Council cuts its water usage charges

The Council's 2014-15 and 2015-16 annual business plans proposed that water user charges, set by the Council, would be decreased by 11% and 5%, respectively. Figure 8.12 shows the Council approved water usage charges for 2010-11 to 2015-16 and the domestic and commercial water sales revenue.

**Figure 8.12: Water usage charges and sales revenue**

	Tier 1 usage 0-50 kl \$/kl	Tier 2 usage 51-300 kl \$/kl	Tier 3 usage 301+ kl \$/kl	Domestic sales revenue \$'000	Commercial sales revenue \$'000
2010-11	3.80	4.70	5.70	460	421
2011-12	4.27	5.22	6.27	703	611
2012-13	4.57	5.70	6.80	718	866
2013-14	4.70	5.81	7.00	629	604
2014-15	4.13	5.26	6.48	566	540
2015-16	3.92	5.00	6.16	509	405

Source: The water usage tariffs reported in the Council's approved annual business plan. The sales revenue amounts reported in the Council's general ledger.

When the Council adopted its 2014-15 and 2015-16 annual business plans and decided to cut the water charges, there was no documented and detailed analysis to:

- support the rationale for cutting water charges
- understand the water usages of specific users and the unit cost of supplying water to them
- understand the impact on the Council's finances
- ensure costs of providing the service were being recovered.

The 2014-15 annual business plan included a summary of budgeted revenue and expenses associated with the water supply function which disclosed a budgeted operating surplus of \$201 324 and a deficit, after allowing for capital spending, of \$444 000. The 2015-16 annual business plan anticipated an operating surplus of \$264 524 and a surplus after capital spending of \$172 524.

## Conclusion

The Council could not provide me with the information I needed to validate data reported in its audited financial statements and the annual business plans for the water supply function. This is a significant limitation and the following conclusions should be considered in light of my reliance on data I could not validate.

It is evident that the Council's revenue from water sales varied significantly over the years from 2010-11 to 2015-16 and that the variation is, in large part, due to changes in the volume of water sold.

Expenses reported by the Council related to the water supply function increased each year but did not vary on a basis that was consistent with the change in sales revenue.

The variability of sales revenue and the steady increase in expenses supports a conclusion that the:

- unit cost of the water supply changed from year to year

- surplus or deficit related to the water supply function would change from year to year, principally due to changes in water sales volumes.

It is not evident that the Council considered the unit cost of production for water sales until 2016-17. When it considered the unit cost of sales it did not consider the potential impact of variations in sales volumes on the unit cost or discuss the possibility of variations in future sales.

The analysis in the 2016-17 annual business plan, which showed Council had incurred significant losses on the water supply function for the previous two years and was budgeting a loss for 2016-17, appears reasonable.

Council’s decision in 2012-13 to reduce user charge rates for water supply was not supported by appropriate analysis of the production costs, anticipated sales volumes or the impact of variations in demand on the unit cost of production.

#### 8.4.2.4 The variations in employee costs could not be explained

The Council’s employee costs account for 30% of its total expenditure. My analysis of employee costs is provided in figure 8.13.

**Figure 8.13: Employee costs**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000
Employee costs (budget)	3 313	3 403	3 334	4 373	3 931	5 131
Employee costs (actual)	3 542	4 372	4 114	4 795	5 358	5 305
Percentage increase (decrease) in actuals		23%	(6%)	17%	12%	(1%)
Total expenditure (actual)	12 248	14 917	15 667	15 988	17 283	17 646

Source: The Council’s audited financial statements and annual business plans.

The data shows that actual employee costs varied significantly from one year to the next. Over the six years the Council’s employee costs increased by 51% from \$3.5 million to \$5.3 million. I sought to understand why employee costs increased significantly over the six years I reviewed.

The Council was unable to provide me with documentation to explain the cause of the significant variations in actuals and budgets. It could not provide documentation (such as employment contracts, reliable leave reports and payroll system reconciliations) to understand and support a sample of employee payments I selected to test. This limited my ability to perform a proper and comprehensive analysis of the Council’s employee costs.

As discussed in section 13, the Council failed to review its LTFP and update it where necessary. The significant variations between budget and actual employee costs should have prompted the Council to review its employee cost projections.

## Conclusion

The Council was unable to provide the documents required for me to perform a proper and comprehensive analysis of its employee costs. As provided in section 9.3.1, I concluded that the Council has not maintained adequate accounting records that explain, in this instance, its employee costs.

### 8.4.3 Child care services incurred significant losses

I sought to understand the Council’s operations to identify the reasons why it incurred operating deficits.

As mentioned in section 13, the Council was unable to provide me with management reports detailing the budgeted and actual performance of its various operations, which limited my ability to undertake a comprehensive analysis.

Council staff advised me that the child care services provided by the Council had been operating at a loss. In the absence of management reports I sought to recreate the financial information by:

- obtaining the income and expenditure account numbers for the child care service in the budgets by department report
- matching these numbers to the Council’s trial balances and general ledger for 2010-11 to 2015-16 to obtain the actual income and expenditure.

I acknowledge the limitations of this financial information as it was not audited for accuracy or completeness.

My analysis of the child care services’ finances is provided in figure 8.14.

**Figure 8.14: Child care services**

	2010-11 \$'000	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	2015-16 \$'000	Total \$'000
<b>Budget</b>							
Revenue	403	401	418	441	441	492	2 599
Expenditure	391	384	397	438	443	465	2 520
Net result	12	17	21	3	(2)	27	79
<b>Actuals</b>							
Revenue	252	316	311	327	274	295	1 778
Expenditure	410	443	484	514	633	562	3 049
Net result	(158)	(127)	(173)	(187)	(359)	(267)	(1 271)

Source: The Council’s budgets by department reports and data obtained from the general ledger.

The data shows the Council's annual budgets consistently projected breakeven or small surpluses for child care services. The actual result, however, was a loss each year, with a net loss of \$1.3 million over the six years.

The Council's 2016-17 annual business plan reported that, like water supply, child care fees over the past few years had not been increased to fully recover the costs of providing the service. The Council had been subsidising the child care services, which it could no longer afford to do.

The Council advised the Minister in a letter dated 15 August 2017, that it had incurred significant liabilities in 2014-15 and 2015-16 to fund operating deficits. A reason for the deficit was the Council providing services at a level it could not afford.

My findings and the Council's advice support my assessment that the losses incurred in providing child care services contributed to the Council's operating deficits.

## Conclusion

The Council failed to prepare management reports to perform a proper analysis of the financial performance of its operations. The Council therefore was not in a position to identify the significant losses being incurred in providing child care services and take timely remedial action.

I concluded that the Council's child care operations contributed to its operating deficits.

As mentioned in section 7, the Council committed to planned financial strategies including a service review of its child care operations, but has demonstrated limited capacity to implement the planned strategies and respond to its immediate financial risks.

## 9 Accounts and accounting records

### What I found

Council staff were unable to provide information required for me to properly examine the Council's accounts and explain the underlying transactions. They appear to have found it difficult to locate all the documents and information I requested due to the Council's poor record keeping practices.

The Council's accounting system supports standard local government budgeting, management and financial reporting functions, but not accounting for its electricity and water supply functions. The chart of accounts implemented by the Council did not support effective reporting on all Council functions and did not meet all reporting obligations. The Council did not use its accounting system to prepare financial reports, but instead used other software to prepare reports from data extracted from the accounting system.

My findings highlight that the Council relied heavily on the corporate knowledge of individuals and on external consultants to perform various finance functions over the years.

### What I concluded

The extent and nature of the gaps between the documents and information I requested and that which was able to be provided by the Council support my assessment that the Council has not maintained adequate accounting records that explain its revenues, expenses, assets and liabilities, or which enable the timely and accurate preparation of financial reports.

I concluded that the Council has not implemented and maintained its accounting system and chart of accounts in a manner to:

- ensure its transactions are correctly and adequately recorded
- prepare financial information to explain its revenues, expenses, assets and liabilities
- prepare various financial reports within the timeframes required by the LG Act.

The Council appears unable to recruit and retain qualified staff to deliver an effective accounting function. It has relied heavily on external consultants to assist in various functions, including preparing its planning documents.

In my view, having appropriately skilled and experienced staff with expertise in accounting and finance is critical to an effective accounting function, including maintaining accounting records.

My findings support my assessment that, in the absence of being able to recruit and retain appropriately skilled and experienced staff, the Council is unable to deliver an effective accounting function.

I concluded that the Council failed to comply with section 124 of the LG Act and section 13 of the *State Records Act 1997*.

## 9.1 Introduction

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### 9.1.1 Purpose

This section considers whether the Council's accounting records effectively support its performance of basic accountability functions including preparing:

- statutory financial reports
- financial reports for use by managers and elected members
- specific purpose financial reports.

I also considered whether the Council's accounting records captured sufficient details of its income, expenses, assets and liabilities to enable it to understand and effectively manage its financial activities. The obligation to keep appropriate accounting records is explicitly required by section 124 of the LG Act.

The examination of the Council's accounting records included specific procedures to evaluate the adequacy of its accounting system and supporting practices. I also considered the outcomes of other examination procedures which indirectly provided insights into the way the accounting system was implemented and operated by the Council.

I considered reviews of the Council's accounting systems prepared by the Council, its external auditor and consultants engaged by the Council to evaluate its accounting systems.

I sought to gain an understanding of both the adequacy of the design of the accounting system and the way it was implemented and operated by the Council. This acknowledges that effective accounting functions are the outcome of both well designed and implemented systems and the input of appropriately skilled and experienced staff with expertise in accounting and finance.

### 9.1.2 Relevant law

Section 124(1) of the LG Act requires a council to:

- maintain accounting records which correctly and adequately record and explain the council's revenues, expenses, assets and liabilities
- maintain accounting records to enable:
  - the preparation and provision of statements that present fairly financial and other information

- the financial statements of the council to be conveniently and properly audited.

Section 4 of the LG Act defines accounting records as all records and documents relevant to any receipt or payment of money, including the working papers and other documents necessary to explain the methods and calculations by which statements and accounts are made up.

I note that the LG Act does not prescribe the form of the accounting records councils are required to keep. Section 124(2) of the LG Act provides councils with the discretion to determine the form of their accounting records. The requirements of the LG Act are expressed in terms of the accounting records' qualitative characteristics and their capacity to enable the recording and understanding of each council's revenues, expenses, assets and liabilities.

The LG Act also requires the council's accounting records to enable the preparation of financial reports on time and at the times required during the year and at year end. The LG Act prescribes specific timeframes to provide financial information to stakeholders, shown in figure 10.1.

Section 13 of the *State Records Act 1997* also requires councils to ensure that the official records in their custody are maintained in good order and condition. In my opinion the accounting records of a council are official records for the purposes of the *State Records Act 1997*.

## 9.2 Examination approach

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My initial review of correspondence between the Council and the Minister and of the Council's minutes and agendas confirmed that there were longstanding concerns about the adequacy of the Council's accounting records and systems. These matters were considered in formulating an examination approach which would enable me to independently form an opinion with respect to the adequacy of the Council's accounting records and systems.

The examination included procedures to understand and evaluate the adequacy of the Council's accounting records and systems with the objectives of:

- evaluating the functionality and capability of the accounting systems and records
- understanding and critically reviewing how the accounting systems and records were implemented and operated
- understanding the extent and organisation of the Council's accounting records.

I also sought to evaluate the significance of the outcomes of other examination procedures which were not principally designed to evaluate the adequacy of accounting records but provide some insight into the capacity of the accounting systems. This included evaluating the Council's responses to my various requests for the accounting records I needed to understand specific accounting transactions and procedures.



I also considered the outcome of work performed, during the period of interest to the examination, by independent experts who evaluated the Council's accounting records and systems. In doing so I sought to evaluate the relevance and credibility of the work performed and the conclusions reached. The reviews, by DFK Gray Perry and Vectra Corporation, have the advantage of being prepared by experts engaged by the Council for purposes that are relevant to this examination. They also provide contemporary insights into the Council's position at a point in time and, in some instances, before key Council staff left the organisation.

I considered reports prepared by the Council's external auditors because they provide an independent expert evaluation of the Council's accounting records and systems at relevant points in time.

Finally, I also considered assessments prepared by Council management of its accounting records and systems. This included the critical self-assessment implicit in the proposed action plans the Council described to the Minister from time to time in response to his requests for information and advice regarding proposed actions.

I sought to place primary reliance on information I obtained directly, while using the insights I gained from considering the work of other parties and the Council's own evaluation, to corroborate and test my findings.

## 9.3 Findings

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### 9.3.1 Inadequate accounting records maintained to properly examine the accounts

#### Finding

I asked Council staff for information to enable a review of the Council's accounts and underlying transactions. They found it difficult to locate the relevant documents and information I requested. They also advised me that the set-up of the electronic filing system and the lack of version control compromised the integrity of some of the documents. In some instances, Council staff were unable to provide any relevant documents and attempted to re-create the accounting records by obtaining documents from external parties. The more significant examples of requested information the Council was unable to provide included:

- invoices, purchase orders and contracts with service providers to explain the Council's expenditure
- employment contracts and other relevant payroll documents to explain significant payroll transactions, such as performance bonus payments, termination payments and back pays
- documents relevant to capital works projects including contracts and project management reports

- documents evidencing key reconciliations for several years, including 30 June 2017, relating to water and electricity revenue and debtors
- documents to reconcile reported inventory and fixed asset balances to subsidiary ledgers
- explanations of how the Council's payroll system leave liability reports were reconciled to its audited financial statement disclosures
- documentary evidence or explanations to support journals.

The report provided by the Council's external auditor for 2014-15 noted that the external auditor found the Council's record keeping was ad-hoc and important supporting documentation was not readily available. The Council's external auditor highlighted an increased risk that the Council may not have adequate documentation to support its decision-making processes and entries to the accounting system.

This is consistent with my findings and supports my view that, over the period I examined, the Council's accounting records were not maintained in an organised manner and nor were they readily available.

The Council's letters to the Minister dated 31 August 2016 and 3 February 2017 acknowledge there were insufficient working papers to understand how the budget was prepared and to enable the Council to prepare a report on its financial results. The Council's letter to the Minister dated 15 August 2017 further acknowledged that the lack of reliable information required to prepare financial reports was one reason the Council was unable to comply with its 2016-17 statutory reporting obligations.

## Conclusion

The extent and nature of the gaps between the documents and information I requested and that which was able to be provided by the Council support my assessment that the Council has not maintained adequate accounting records:

- that explains the Council's revenues, expenses, assets and liabilities
- which enable the timely and accurate preparation of financial reports.

This assessment is consistent with the external auditor's report and the Council's report to the Minister.

I concluded the Council failed to comply with section 124 of the LG Act and section 13 of the *State Records Act 1997*.

### 9.3.2 The accounting systems not adequately maintained

#### Finding

I sought to understand the Council's accounting system by interviewing Council staff and the Council's external accounting consultant. I then sought to critically evaluate the adequacy of

the accounting system's design to support the Council's finance function and reporting obligations.

The Council staff interviewed were not responsible for implementing and operating the accounting system during the critical periods considered by the examination. As such, I was not able to obtain an adequate understanding of the Council's accounting system for the purposes of the examination.

A well designed and implemented accounting system should enable a council to keep an audit trail of its financial transactions and generate financial information for reporting purposes.

My analysis was based on my experience in evaluating accounting systems operated by public sector agencies which, in principle, are substantially the same as those operated by councils.

#### *Suitability of the accounting system*

The Council used the SynergySoft accounting system in the period I examined. This software is provided and supported by itvision, a software vendor servicing over 140 councils across Australia.<sup>8</sup> The SynergySoft accounting system has budgeting, management and financial reporting capability. In my view, the SynergySoft accounting system should be fit for the Council's purposes.

The Council required, however, additional system functionality to account for its electricity and water supply. The software does not specifically support these operations, but if the accounting system and chart of account structure was appropriately implemented and maintained it should, in my opinion, have enabled the Council to capture and report relevant revenues and expenses associated with these operations. The Council would still be required to analyse this information to understand its unit cost of production and would still be required to maintain appropriate records of non-financial information.

As further detailed below, I found the Council's implementation and operation of its accounting system did not enable the Council to keep an adequate and accurate record of its financial transactions and generate reliable financial reports.

As discussed below, the Council acknowledges the deficiencies in its accounting system.

#### *The chart of accounts structure*

I understand that a well designed and maintained chart of accounts enables financial transactions to be summarised in a manner consistent with the account balances required for reporting purposes.

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<sup>8</sup> <<http://www.itvision.com.au/what-we-do/our-industries/local-government/>> (accessed 19/04/2018).

My review of the Council's chart of accounts structure found that it appeared to have the capacity to:

- record and summarise transactions by various categories (such as nature, function, cost centres and projects)
- support the preparation of budget reports, financial statements and other financial reports.

However, I found the chart of accounts implemented by the Council did not support effective reporting on all Council functions and did not meet all reporting obligations.

As discussed below, the Council acknowledged the deficiencies in its chart of accounts.

#### *Preparing financial reports*

I found that the Council did not generate its financial reports (such as budgets, financial statements and specific purpose financial reports) directly from the SynergySoft accounting system. The account balances were extracted from the accounting system and inputted into Excel spreadsheets. Adjustments to the financial information were then made in preparing the reports. For example, to prepare the financial report a trial balance was extracted from the SynergySoft accounting system. Adjustments would be made to assign each general ledger account balance to an account line reported in the financial statements.

I obtained the account balances in the general ledger for several financial years to recreate and reconcile the account balances reported in the audited financial statements. I found it difficult to do this because there were inconsistencies in how the financial transactions were summarised and classified in the financial report across the financial years. I also could not establish whether the data in the general ledger was complete and accurate.

These inconsistencies meant I could not reconstruct a comparison of account balances from year to year to analyse the Council's performance over time. Further commentary on misclassifications and comparability of financial statements is provided in section 10.3.5.

My finding is consistent with DFK Gray Perry's review in October 2015 which reported that the Council's accounting system's financial reporting module was not used to produce fully integrated financial statements.

While this method of preparing reports is not uncommon, it increases the:

- time and effort required to keep track of financial transactions and maintain the accounting system (ie processing adjustments made in the Excel spreadsheets)
- risk of errors in financial reports, including inconsistent practices between years
- risk of loss in the audit trail of financial transaction data
- reliance on the corporate knowledge of individuals, which increases the risk of inconsistent and/or incorrect practices and the time it takes to prepare financial reports when there is staff turnover

- loss of reliance on controls embedded in the accounting system to ensure data and reporting integrity.

The findings in this section and elsewhere evidence that these risks eventuated. For example, I found that:

- the Council failed to meet reporting obligations under the RAES agreement (refer section 12)
- the Council failed to prepare financial statements on time and I identified instances of incorrect and inconsistent accounting practices (refer section 10)
- the Council's annual budgets were not presented in a way that enabled proper comparison to actual financial results. Further, the Council failed to report on its financial results (refer section 13).

#### *Accounting practices and treatment*

I reviewed the Council's audited financial statements for 2010-11 to 2015-16 to identify account balances for specific and detailed examination. I asked Council staff to explain:

- how financial transactions were reflected in the general ledger based on the chart of accounts structure
- the accounting treatment of some financial transactions that appeared not to have been correctly recognised and reported in the audited financial statements.

Council staff were unable to explain the past financial information and generate reliable financial reports from the general ledger in response to my inquiries. This supports my assessment that Council staff did not have a good understanding of the chart of accounts structure and how it was used in the past.

The Council staff who responded to the examination were not employees at the time the accounting system and chart of accounts were implemented. My findings (such as lack of policy and procedures, the absence of proper management reporting and the poor maintenance of accounting records) highlight that the Council relied heavily on the corporate knowledge of specific individuals and was at risk of loss of corporate knowledge if key staff left the Council.

In my opinion, it is reasonable to conclude that:

- the Council lost critical corporate knowledge when key employees left the Council
- it required significant time and effort for new staff to obtain an understanding of the Council's financial management and accounting practices and then to implement remedial action.

This is consistent with the Council's external auditor's findings in its 30 June 2016 report that:

- the original trial balance at 30 June 2016 contained various errors

- Council staff had to perform extensive reconciliation work over the general ledger and subsidiary systems to report a fair view of the Council's financial position and performance.

Further commentary on accounting treatments and practices is provided in section 10.3.5.

#### *The IT controls and infrastructure*

I reviewed IT controls over the Council's accounting system that could impact the integrity and availability of the financial data. I also considered the outcome of reviews performed by DFK Gray Perry and the Vectra Corporation.

In October 2015 DFK Gray Perry reported that the accounting system was underperforming due to inadequate infrastructure. In November 2015 the Vectra Corporation reported a number of high risk IT control deficiencies, including server hardware and software deficiencies. In October 2016 the Vectra Corporation reported that many of these deficiencies remained.

I concluded that the identified weaknesses in controls meant reliance could not be placed on the integrity of the financial data. The IT control deficiencies reduce the assurance as to whether the Council's accounting records were correct and adequate. Further commentary on the Council's IT controls is provided in section 15.

#### *Council's awareness and response to challenges*

The Council became aware of the significant deficiencies in its financial systems and internal controls and practices when it received the DFK Gray Perry report in October 2015. The Council's progress reports to the Minister since October 2015 noted that

- there was no integrity in the Council's financial systems
- its general ledger did not balance prior to 2014-15
- errors were identified in the audited financial statements, including inaccuracies in the allocation of revenue and expenses.

The Council advised the Minister on 15 August 2017 of its plans to upgrade the accounting system, including developing a completely new chart of accounts, as in the Council's view the existing accounting system was completely dysfunctional and unable to meet the Council's reporting requirements.

The Council's then CEO advised me in a letter dated 17 January 2018 that the project to upgrade the chart of accounts and financial reporting systems had stalled.

## Conclusion

My findings support my assessment that the Council has not implemented and maintained its accounting system and chart of accounts in a manner to:

- ensure its transactions are correctly and adequately recorded

- prepare financial information to explain its revenues, expenses, assets and liabilities
- prepare various financial reports within the timeframes required by the LG Act and special purpose reporting obligations.

I concluded that the Council failed to comply with section 124 of the LG Act.

### 9.3.3 Inexperienced finance staff and reliance on external contractors

As mentioned above, the examination required Council staff to explain and provide information and documents for me to understand and evaluate the Council's accounting records and systems. I found that the Council staff relied on the SynergySoft service provider and an external contractor to respond to most of my inquiries and information requests.

The information I considered supports my conclusion that the Council appears to have some difficulty retaining qualified personnel given its remote location. This and the high turnover of senior finance staff in recent years resulted in the loss of corporate knowledge and required inexperienced staff to perform key finance functions. The Council's former external auditor also advised me that an organisation in a remote area, like Coober Pedy, would struggle to attract and retain staff with adequate expertise and experience.

In performing other parts of the examination, I found that the Council relied on external consultants to assist in various finance functions over the years. This included preparing the LTFP, annual budgets, financial statements and financial information papers presented to the Council and its audit committee. In my view, this is not a sustainable practice. The significant reliance on external consultants to perform these functions increases the risk that:

- corporate knowledge obtained during the process is not transferred to Council staff
- the information quality is diminished due to limitations in the external consultant's detailed knowledge of the Council's operations
- Council staff are not in a position to explain and provide financial information at a later date
- Council staff do not take responsibility for the regular monitoring and reporting of financial information.

In October 2015 DFK Gray Perry reported that staff appeared to lack the required knowledge and/or training to perform key finance functions such as reconciliations. DFK Gray Perry recommended the Council engage SynergySoft to train staff to ensure the system was being used correctly and that staff received training in operating procedures and policies.

As discussed in section 16, I found that the Council did not have documented policies and procedures and had not performed key reconciliations.

The Council advised the Minister, in letters dated 31 August 2016, 3 February 2017 and 15 August 2017, of the high and continued staff turnover throughout 2015-16 and 2016-17.

It advised the Minister that the turnover meant inexperienced staff were forced to perform finance work. Further, the Council advised the Minister of its planned actions which included rigorous staff training, a system utilisation review and additional staff resources for the finance team.

## Conclusion

My findings support an assessment that the Council was unable to recruit and retain staff with sufficient experience and skills to perform the finance functions which meant Council staff did not:

- have a sound understanding of the operations of the accounting system
- maintain accounting records to correctly and adequately record and explain the Council's accounts, budgets and financial statements.

In my view, recruiting and retaining appropriately skilled and experienced staff with expertise in accounting and finance is a critical component of an effective accounting function, including maintaining accounting records.

My findings support an assessment that the Council appears unable to recruit and retain appropriately skilled and experienced staff to deliver an effective accounting function.

This assessment is consistent with the Council's reporting to the Minister.

I concluded that the Council's inability to recruit and retain sufficient appropriately qualified, experienced and skilled accounting and finance staff contributed to its failure to comply with section 124 of the LG Act.



## 10 Financial reporting

### What I found

The Council failed to prepare its financial statements for the years ended 30 June 2015, 30 June 2016 and 30 June 2017 by the second Friday of September in each year.

The Council failed to submit its audited financial statements to the Minister for the financial year ended 30 June 2014.

The Council failed to adopt its financial statements for the years ended 30 June 2015 and 30 June 2016 and provide a copy to the Minister by 30 November in each year.

The financial statements for the years ended 30 June 2014 and 30 June 2015 were certified without the Council's authority.

The Council failed to provide its annual report, including its audited financial statements, for the years ended 30 June 2015, 30 June 2016 and 30 June 2017 to Parliament by 31 December in each year.

The Council certified its financial statements for the year ending 30 June 2017 on 17 September 2018.

### What I concluded

The Council failed to provide timely information on its financial position and performance for three financial years. In my view, this is a serious deficiency in the Council discharging its financial accountability to the Coober Pedy community, the Minister and the Parliament.

I concluded that the Council failed to comply with sections 127 and 131 of the LG Act in 2014-15, 2015-16 and 2016-17.

## 10.1 Introduction

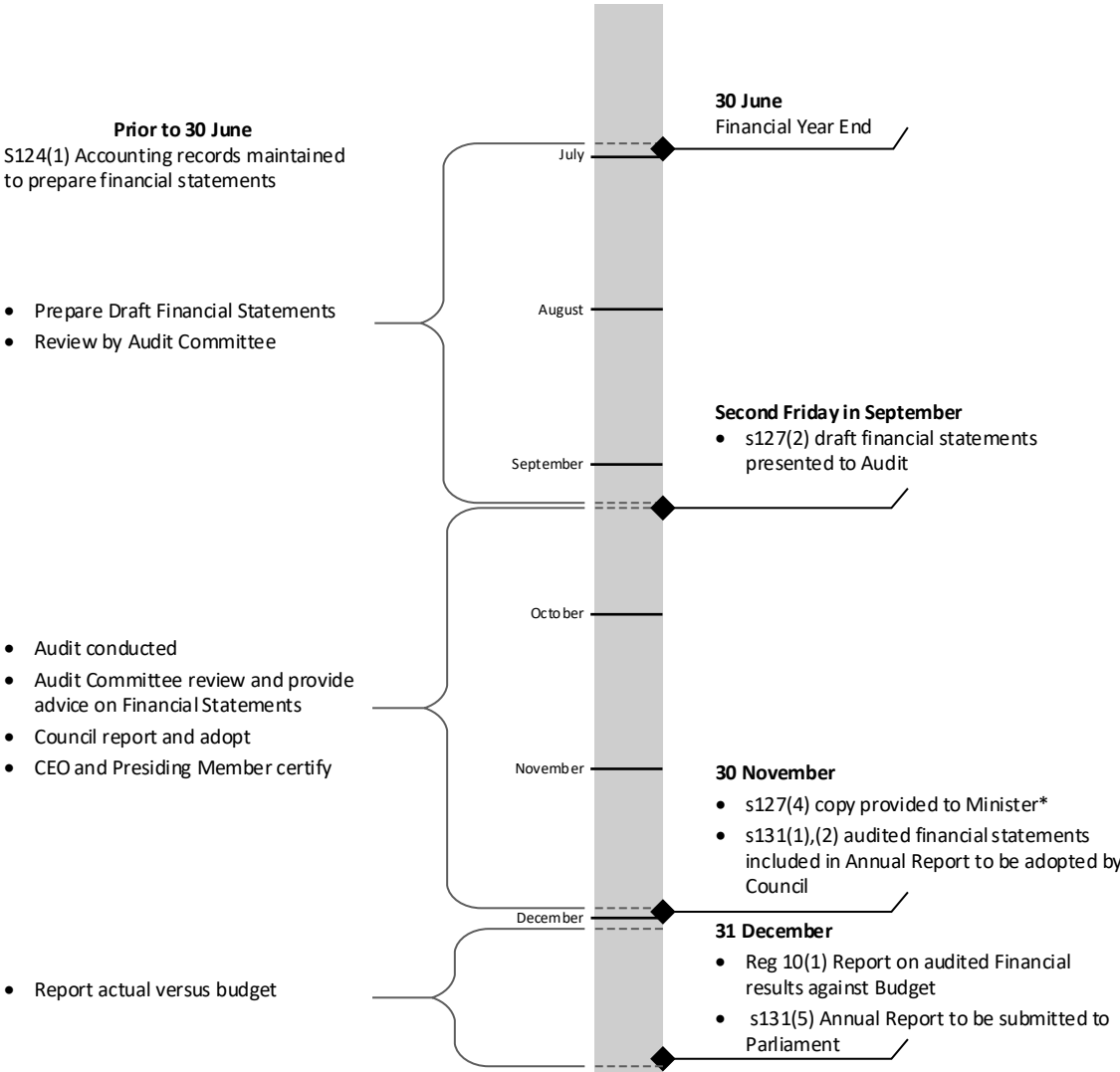
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### 10.1.1 Relevant law

The LG Act provides the legislative framework for a council to prepare timely and reliable information on its financial position and performance for the elected body, and other stakeholders, to make better and informed decisions. The provision of timely information is particularly important because it ensures decision-making is based on up to date and relevant information.

The following summary of provisions of the LG Act and LG Regulations describes what the Council was required to do to prepare and certify its financial statements. Figure 10.1 provides a timeline of the financial reporting requirements.

**Figure 10.1: Financial reporting requirements**



\* Only until 28 November 2017

Section 124(1) of the LG Act requires a council to keep its accounting records in a manner that enables:

- the preparation of statements that present fairly financial and other information
- the financial statements to be conveniently and properly audited.

Section 127(1) of the LG Act requires a council to prepare for each financial year:

- (a) financial statements and notes in accordance with standards prescribed by the regulations; and*
- (f) other statements or documentation on the financial affairs of the council required by the regulations.*

Section 127(2) of the LG Act requires a council to prepare the financial statements and other documentation before the second Friday in September.<sup>9</sup> The financial statements are then to be audited by the council's external auditor.

Regulation 14 of the LG Regulations requires the council's financial statements to include a statement signed by the CEO and the council's principal member certifying that:

- (c) the financial statements comply with relevant legislation and Australian Accounting Standards*
- (d) the financial statements present a true and fair view of the financial position, results of the operations and cash flows of the council for the financial year*
- (e) internal controls implemented by the council provide a reasonable assurance that its financial records are complete, accurate and reliable and were effective throughout the financial year*
- (f) the financial statements accurately reflect the accounting and other records of the council*
- (g) the CEO and the principal member have been authorised by the council to certify the annual financial statements in their final form.*

Section 127(4) of the LG Act requires a council to submit a copy of its audited financial statements to the persons prescribed by the regulations on or before the day prescribed by the regulations.

Prior to 28 November 2017, Regulation 16 of the LG Regulations required a council to submit a copy of its audited financial statements to the Minister on or before 30 November in each year. A council is still required to submit a copy of its audited financial statements to the presiding member of the South Australian Local Government Grants Commission.

Section 129(9) of the LG Act requires a council's financial statements be accompanied by the audit opinion on the financial statement and the audit opinion on the controls exercised by the council during the financial year.

Section 131 of the LG Act requires a council to:

- include its audited financial statements in its annual report

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<sup>9</sup> Regulation 15 of the LG Regulations.

- adopt its annual report on or before 30 November in each year
- submit its annual report to the presiding members of Parliament by 31 December in each year.

## 10.2 Examination approach

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I reviewed correspondence between the Minister and the Council since 1 July 2014 to determine when the Council submitted its audited financial statements to the Minister for 2014-15, 2015-16 and 2016-17.

I reviewed the Council meeting minutes from 1 July 2014 to determine when the Council authorised the certification of the financial statements in their final form for 2014-15, 2015-16 and 2016-17.

I reviewed the audited financial statements to determine when they were certified for 2014-15, 2015-16 and 2016-17.

I interviewed the Council's external auditor to determine when the financial statements were presented for audit and whether they were presented in a manner that enabled them to be conveniently and properly audited.

## 10.3 Findings

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### 10.3.1 The Council did not prepare financial statements on time

#### Finding

I found the draft financial statements for the years ended 30 June 2015, 30 June 2016 and 30 June 2017 were not prepared by the second Friday in September of each year.

The Council's external auditor advised that the draft financial statements for the financial years ended 30 June 2015 and 30 June 2016 were provided to them in December 2015 and March 2017, respectively.

The Council's external auditor also advised that the draft financial statements for the years ended 30 June 2015 and 30 June 2016 were not easy to audit as they had difficulties obtaining quality accounting records.

I found the:

- Council's audit fee increased by about \$6000 for 2014-15 as additional time was required to work through complications and audit changing balances. A qualified audit report was issued for the Council's financial statements for the year ended 30 June 2015

- Council's external auditor's report for 30 June 2015 records issues with the Council's poor record keeping practices, as important supporting documentation was not readily available. The external auditor highlighted an increased risk that the Council may not have adequate supporting documentation for its decision-making processes and entries to the accounting system
- Council's external auditor's report for 30 June 2016 records that the original trial balance contained various errors and the management accountant had performed extensive reconciliation work between the general ledger and subsidiary systems
- independent audit report for the Council's financial statements for the year ended 30 June 2016 was also qualified. The qualification paragraphs records there was insufficient evidence to support the:
  - valuation, existence and completeness of property, plant and equipment
  - accuracy and completeness of depreciation
  - valuation of inventory.

The Council advised me that the delays in finalising the 2015-16 financial statements were due to:

- issues with opening balances (ie as at 1 July 2015) and errors identified in the 2014-15 audited financial statements
- dysfunctional accounting system, which was unable to produce the required reports to populate the financial statement templates
- problems with staff turnover
- problems with the competence of staff preparing the various reconciliations
- problems with the asset data.

On 15 August 2017 the then CEO wrote to the Minister outlining the reasons for not complying with the statutory reporting requirements for 2016-17. The reasons given were:

*continued staff turnover throughout the 2016-17 financial year leading to inexperienced staff being forced to undertake the work*

*insufficient resources being employed to deliver the requirements of the finance function. This occurred due to the lack of reliable financial information available for report preparation as well as insufficient financial resources being available*

*a completely dysfunctional accounting system unable to provide the reporting requirements of the organisation at both management and elected member level*

*an antiquated IT system prone to crashing and just simply unable to run modern software packages such as Microsoft exchange.*

I found that some matters that delayed the 2015-16 financial statements being finalised had not been fully addressed and contributed to the delay in preparing the 2016-17 financial statements.

On 17 January 2018 the Council advised me that it had not met its statutory requirements for the annual financial statements for the year ended 30 June 2017. The Council certified its financial statements for the year ended 30 June 2017 on 17 September 2018. The Council's external auditor's Independent Audit Report noted that it did not express an opinion on these financial statements as they were unable to obtain the sufficient appropriate audit evidence to provide the basis for an audit opinion.

## Conclusion

The Council has not maintained its accounting records in a manner to enable the timely preparation of its financial statements and for them to be conveniently and properly audited. I concluded that the Council failed to comply with section 124(1) of the LG Act.

The Council did not prepare its financial statements for three financial years by the prescribed day. I concluded that the Council failed to comply with section 127(2) of the LG Act.

### 10.3.2 The Council did not submit audited financial statements to the Minister on time or at all

## Finding

My review of correspondence between the Council and Minister did not identify evidence that the Council had submitted copies of its audited financial statements to the Minister for the financial year ended 30 June 2014.

Further, the Council did not submit a copy of its audited financial statements for the years ended 30 June 2015 and 30 June 2016 to the Minister by 30 November of each year.

The Council certified the financial statements for the year ended 30 June 2015 on 15 February 2016 and submitted a copy to the Minister on 10 March 2016.

The Council certified the financial statements for the year ended 30 June 2016 on 26 June 2017 and submitted a copy to the Minister on 15 August 2017.

I also found that the Council did not provide its annual report, including its audited financial statements, for the years ended 30 June 2015, 30 June 2016 and 30 June 2017 to Parliament by 31 December in each year.

## Conclusion

The Council did not submit its audited financial statements to the Minister for the financial year ended 30 June 2014.

The Council did not submit its audited financial statements for the financial years ended 30 June 2015 and 30 June 2016 to the Minister within the prescribed timeframe.

I concluded the Council failed to comply with section 127(4) of the LG Act and Regulation 16 of the LG Regulations.

The Council did not submit its annual report for the years ended 30 June 2015, 30 June 2016 and 30 June 2017 to Parliament within the prescribed timeframe.

I concluded that the Council failed to comply with section 131 of the LG Act.

### 10.3.3 The Council's financial statements were certified without proper authority

#### Finding

The minutes of Council meetings did not record that the Council authorised the then CEO and the presiding member to certify the financial statements for the years ended 30 June 2014 and 30 June 2015. The Council received the financial statements for both financial years after they had been certified.

The financial statements for the year ended 30 June 2016 were certified after receiving the Council's authorisation on 26 June 2017.

#### Conclusion

The financial statements for the years ended 30 June 2014 and 30 June 2015 were certified without the Council's authority. I concluded that the Council failed to comply with section 127(1) of the LG Act and Regulation 14 of the LG Regulations.

### 10.3.4 The Council's certification of internal controls was inadequate

#### Finding

Regulation 14 of the LG Regulations requires the CEO and the Mayor to certify that the council's internal controls provide reasonable assurance that its financial records are complete, accurate and reliable and were effective throughout the financial year. The Model Financial Statements require any exceptions to be outlined in the certification.

#### *Certificate for the 2014-15 financial statements*

The Council received the DFK Gray Perry report on 17 November 2015. It highlighted significant weaknesses in the Council's internal controls during 2014-15.

I found that the certificate for the 2014-15 financial statements was signed by the then interim CEO and the then Mayor on 15 February 2016. This certificate did not include any statement regarding the Council's internal controls. The interim CEO and the then acting Mayor were both present at the Council meeting that received the DFK Gray Perry report.

The Council was aware of the significant weaknesses in controls at the time of adopting its 2014-15 financial statements and failed to report these weaknesses in the certificate of the 2014-15 financial statements.

### *Certificate for the 2015-16 financial statements*

The Council adopted its 2015-16 financial statements and authorised them to be certified at its meeting on 26 June 2017. The certificate for the financial statements was signed by the then CEO and the then Mayor on 26 June 2017.

The certificate for the 2015-16 financial statements states that the Council's internal controls provide reasonable assurance that its financial records are complete, accurate and reliable and were effective throughout the financial year.

I found that the Council agenda papers and minutes for this meeting did not record any consideration of the Council's internal controls. The agenda paper did not explain the basis of Council management's assessment of its internal controls.

On 11 July 2017 the Council's external auditor issued their opinion on controls as follows:

#### ***Qualified Opinion***

*In our opinion, the council has not complied, in all material respects, with Section 125 of the Local Government Act 1999 in relation to Internal Controls, established by the Council in relation to the receipt, expenditure and investment of money, acquisition and disposal of property and incurring of liabilities so as to provide reasonable assurance that the financial transactions of the Council have been conducted properly and in accordance with legislative provisions for the period 1 July 2015 to 30 June 2016.*

#### ***Qualification***

*The council has significant deficiencies in their internal controls to ensure that financial transactions relating to the receipt, expenditure and investment of money, acquisition and disposal of property and incurring of liabilities for the period 1 July 2015 to 30 June 201 [sic] were accordance with legislative provisions. These deficiencies were due to an absence of policies, procedures and robust internal controls.*

I found that the external auditor's report and opinion was provided to the Council at its 15 August 2017 meeting, after the financial statements were certified.

The then CEO's quarterly report to the Minister dated 15 August 2017 records that in 2014-15 and 2015-16 there were poor management practices and ineffective internal controls. These representations were inconsistent with the Council's certificate for the 2015-16 financial statements.

In my opinion, the significant control weaknesses previously identified, high turnover<sup>10</sup> and deficiencies in accounting systems required Council management to explain the basis for the statements made in the certificate for the 2015-16 financial statements on internal controls.

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<sup>10</sup> The then CEO and the then Finance Manager were not council employees in 2015-16.



As set out above, I found sufficient evidence to indicate that the Council's internal controls were not effective throughout 2015-16. The certificate for the financial statements should have disclosed this and outlined the exceptions.

## Conclusion

The certification of the 2014-15 financial statements did not include a statement of the Council's internal controls.

The certification of the 2015-16 financial statements included a statement of the Council's internal controls, however they were not supported by a documented assessment and were inconsistent with representations made to the Minister.

I concluded that the Council failed to comply with section 127(1) of the LG Act and Regulation 14 of the LG Regulations.

### 10.3.5 Incorrect and inconsistent accounting practices

#### Finding

The examination included an analysis of the Council's audited financial statements for the years 2010-11 to 2015-16 to:

- understand the Council's financial performance
- identify when the Council experienced financial difficulties and significant variations.

I asked Council staff to provide accounting records to explain the significant variations in actual balances from one year to the next. They were unable to provide sufficient explanations and documentation to enable me to understand the information disclosed in the Council's audited financial statements.

I consulted with the Council's former external auditor to help me to understand specific aspects of the financial statements.

I found it difficult to compare the Council's actual financial performance over the years I reviewed due to:

- incorrect accounting practices and treatment
- inconsistent classifications in account balances.

These matters inhibited my ability to understand and assess the Council's financial performance and explain the significant variations. Some examples of the issues I found are provided below.

#### *Cash and cash equivalents*

Prior to 2014-15, the cash and cash equivalents balance reported in the Statement of Financial Position included an amount disclosed as 'add debtors'. It accounted for more than 50% of total cash and cash equivalents in each financial year.

The Council’s former external auditor advised me that this amount represented a short-term loan granted to the SA Government, which was repayable within three months, arising from the outstanding electricity RAES grant reconciliation payment. As explained elsewhere, the reconciliation payment amount is intended to be determined after the Council has submitted the audited financial statements required by the RAES agreement. In my view, the reconciliation payment was characterised incorrectly and does not meet the definition of cash and cash equivalents provided by AASB 107 ‘Statement of Cash Flows’ and the Model Financial Statements. The cash and cash equivalents balances was therefore misstated in the Council’s financial statements for years 2010-11 to 2013-14. The Council discontinued this accounting treatment in 2014-15.

*Internally generated revenues*

The Council invoices itself for its internal water and electricity use for management reporting purposes and to meet the reporting requirements of the RAES agreement. In my opinion, these transactions should have been eliminated when preparing the annual financial statements.

My review of the available accounting records used to prepare the financial statements found that the Council did not eliminate the internally generated revenues for water in 2013-14 and 2015-16, and for electricity from 2012-13 to 2015-16.

The Council’s former external auditor was unable to provide any further explanation or accounting records to substantiate the appropriateness of this accounting treatment.

I could not determine the financial impact on the Council’s financial position and performance due to the limitations in the accounting records. I acknowledge that, logically, the failure to eliminate these income and expense items should not have affected the Council’s reported surplus or deficit as the income and expenses should be of equivalent amounts.

*Operating expenses – power purchase agreement*

My analysis of material, contracts and other expenses identified significant variations in the power purchase agreement operating expenses from 2010-11 to 2013-14. Figure 10.2 shows these operating expenses.

**Figure 10.2: Power purchase agreement operating expenses**

	2010-11*	2011-12*	2012-13	2013-14	2014-15
	\$'000	\$'000	\$'000	\$'000	\$'000
Power purchase agreement operating expenses	4 435	6 502	6 990	5 462	5 451
Percentage change		47%	7%	(22%)	0%

\* The audited financial statements did not provide a breakdown of power purchase agreement operating expenses in 2010-11 and 2011-12. The amounts shown were obtained from the general ledger trial balance to provide a comparative trend.

I found that these significant variances were due to inconsistencies in accrual and cut-off procedures affecting the account balances as follows:

- overstated expenditure and trade payables by \$409 000 in 2011-12
- overstated expenditure and trade payables by \$971 000 in 2012-13
- understated expenditure and trade payables by \$497 000 in 2013-14.

The impact on the Council's operating result in any one year was significant and may have significantly affected the RAES reconciliation payment calculation.

The Council's letter to the Minister dated 15 August 2017 reported that:

- the Council's audited financial statements for 2015-16 contained material amendments to the 2014-15 comparatives for errors identified by Council staff when preparing the 2015-16 financial statements
- continued staff turnover led to inexperienced staff undertaking finance work.

The Council's letter to the Minister dated 15 August 2017 acknowledged the high and continued staff turnover throughout the 2015-16 and 2016-17 financial years meant inexperienced staff were being forced to undertake finance work. Further commentary on the Council's finance staff is provided in section 9.3.3.

## Conclusion

The Council adopted accounting policies and practices which were not consistent with the requirements of the Australian Accounting Standards. Adopting inappropriate accounting policies and practices may have caused the financial statements to be materially misstated.

As a consequence, the inconsistency and incorrect accounting practices impacted the ability for users to understand the Council's financial performance from one year to the next.

I concluded the Council failed to comply with section 127(1) of the LG Act and Regulation 11 of the LG Regulations.

# 11 Borrowings

## What I found

At 30 June 2018 the Council had loans outstanding of \$6.7 million, mainly incurred to fund past operating deficits. This level of indebtedness imposes a significant debt servicing load on a small council with a prior record of reporting operating deficits and difficulty generating cash to repay the loan principal.

Council staff do not appear to have provided elected members with regular and/or proper reports to understand and monitor the Council's financial performance and respond strategically to emerging financial risks.

The Council incurred significant and unplanned debt to respond to its financial difficulties. Some loans were procured without Council approval. When debts were approved or incurred, the Council's records did not adequately:

- explain the need for the loans
- explain how the loans would be repaid
- assess the impact of the planned borrowings on the Council's long-term financial sustainability.

The Council's practice of approving loans based on inadequate information or when facing a specific financial crisis condoned the Council's poor approach to financial management and masked the Council's emerging financial difficulties, which had serious implications for its financial sustainability.

The Council has confirmed its commitment to mitigating its financial risks, but it has demonstrated limited capacity to implement the planned strategies and respond to its challenges.

## What I concluded

The Council has not demonstrated the capacity to generate additional cash to repay its borrowings as it falls due. In my view, the Council's debt level is unsustainable and has a significant impact on its financial sustainability.

During 2012-13 to 2015-16, the Council's then CEO failed to provide timely, sufficient and accurate information to the Council to support recommendations to incur debt. I concluded the CEOs failed to fulfil the functions of that office prescribed by section 99 of the LG Act, in that they failed to provide advice and reports to the Council on the exercise of its powers and functions.

The failure to consider timely, sufficient and accurate information before approving and incurring significant debt supports my conclusion that the Council did not take a strategic approach to incurring and managing its debt and its long-term financial sustainability. I concluded the Council failed to comply with sections 8 and 122 of the LG Act.

The Council failed to comply with sections 44 and 134 of the LG Act in that Council staff did not obtain the approval of the elected members before incurring debt in August 2012, August 2013, August 2014 and June 2015.

## 11.1 Introduction

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### 11.1.1 Purpose

This section focuses on whether the Council upheld certain principles, as required by sections 8 and 122 of the LG Act, when making decisions to incur and manage its debt. In this context the LG Act requires Council staff to provide timely, sufficient and accurate information to its elected members to inform its decision to incur debt and ensure debt is managed as approved by the Council.

In my view the information required to make these decisions should at least explain:

- the purpose of the loan
- how and when the loan is to be repaid
- the impact on the council's long-term financial sustainability.

The examination considered whether:

- the Council's outstanding debt level is sustainable
- loans were approved by the Council in line with the LG Act
- Council staff provided timely, sufficient and accurate information to elected members to enable them to make informed decisions on incurring debt
- loans were managed in line with the Council's approval.

### 11.1.2 Relevant law

Section 8 of the LG Act requires a council to uphold certain principles in performing its functions and making decisions, including the need to:

- ensure council resources are used fairly, effectively and efficiently
- achieve and maintain standards of good public administration
- ensure the sustainability of the council's long-term financial position and performance.

Sections 134 and 137 of the LG Act require a council to observe these principles in making decisions to incur debt and spend its funds. It is particularly important that this occur in deciding to incur significant debt as future generations of ratepayers can be impacted if the council's debt service capacity and future capital needs are not properly understood and managed.

Section 134 of the LG Act allows a council to borrow money and other forms of finance<sup>11</sup> it considers appropriate. Section 44(3)(c) of the LG Act prohibits a council to delegate the power to borrow money.

Section 99 of the LG Act requires a CEO to provide advice and reports to the council on the exercise of its powers and functions under the LG Act. In my opinion compliance with this requirement implicitly requires a CEO to provide timely, sufficient and accurate information to the council to enable it to observe these principles when deciding to incur significant debt.

Section 122 of the LG Act requires a council's strategic management plans to assess the sustainability of its financial position and performance and proposals with respect to debt levels. Any impact on the council's long-term financial sustainability of incurring debt should be considered in its strategic management plans, specifically its LTFP.

Section 123 of the LG Act requires the council's annual business plan to take into account its LTFP. The council's source of funds to meet operating and capital needs is guided by its annual budgets and LTFP.

## 11.2 Examination approach

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I examined the Council's borrowings to:

- determine whether its debt at 30 June 2018 was sustainable
- understand how it arrived at the financial position it is now in
- determine whether Council staff, including the then CEO, provided timely, sufficient and accurate information to support the loan proposals
- understand its consideration of the terms and purposes of its loans and repayment strategies
- determine whether the loans were approved by the Council as required by the LG Act
- determine whether the loans were managed in line with the Council's approval.

My assessment of the sustainability of the Council's borrowings was based on my analysis of the Council's audited financial statements, which I believe are fit for the purpose of this analysis. Further commentary on my analysis of the Council's borrowings and financial performance is provided in section 8.

I reviewed the Council's meeting minutes and agenda papers for specific Council meetings. I found they did not record the Council's approval for all loans. I requested Council staff to explain and provide, for each loan:

- the proposal presented to the Council for approval
- the loan applications and agreements.

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<sup>11</sup> Other forms of finance include overdrafts, finance leases, credit facilities, loans and debentures.

Council staff were unable to provide all the relevant documents and information I requested. Due to gaps in the Council's accounting records, I requested LGFA to provide documents relevant to the Council's borrowings. LGFA provided the following information for the years from 2011-12 to 2017-18, which I considered in the examination:

- details of interest on loans statement for all loans held by the Council
- details of outstanding loan balances at year end
- loan applications and agreements for all loans held by Council.

## 11.3 The Council's borrowings

The Council borrowed money from LGFA, with the loans secured against general rates revenue. Since 2010-11 the Council has incurred additional debt of \$8.94 million<sup>12</sup> with an outstanding debt of \$6.7 million as at 30 June 2018. Figure 11.1 shows details of the Council's current borrowings.

**Figure 11.1: The Council's borrowings as at 30 June 2018**

Loan no.	Council resolution	Purpose	Approved limit	Borrowed	Outstanding	Status
51	16/02/2010	To build a new terminal building at the Coober Pedy Airport	500 000	500 000	128 359	Current
52	11/04/2012	Purchase Council house	210 000	210 000	96 713	Current
53	6/08/2012	To supply working capital for projects while going through electricity funding changes	1 000 000	1 000 000	N/A	Rolled over to loan 58
54	18/09/2012	To supply working capital for projects while going through electricity funding changes	1 500 000	1 500 000	N/A	Rolled over to loan 58
55	18/12/2012	New bore pipeline project	800 000	800 000	N/A	Rolled over to loan 62
56	8/08/2013	Purchase new garbage compactor	330 000	330 000	72 540	Current
57	4/08/2014	Water production pre-treatment upgrade	600 000	600 000	422 724	Current
58	15/09/2015	Repay loans 53 and 54	2 500 000	2 500 000	2 500 000	Current
59	17/06/2015*	Working capital for disaster recovery April 2014	1 000 000	1 000 000	1 000 000	Current
60	22/09/2015	Working capital	1 000 000	1 000 000	N/A	Rolled over to loan 63
61	22/09/2015	Working capital	1 000 000	700 000	N/A	Rolled over to loan 63
62	15/12/2015	Repay loan 55	800 000	800 000	N/A	Rolled over to loan 63
63	17/05/2016**	Loan consolidation and working capital	4 300 000	2 500 000	2 500 000	
Total loans outstanding as at 30 June 2018					6 720 336	

\* Actual Council resolution was 11 August 2015.

\*\* Actual Council resolution was 15 September 2016.

Source: Prepared from documents provided by LGFA. I have not audited this data.

<sup>12</sup> The sum of all loans taken out since 2010-11 (loans 52, 56, 57, 58, 59 and 63).

## 11.4 Findings

### 11.4.1 The Council's debt levels are not sustainable

#### Finding

At 30 June 2018 the Council had loans outstanding of \$6.7 million, mainly incurred to fund past operating deficits. The Council reported large operating deficits in 2012, 2014 and 2015. Its borrowings increased in the financial years after reporting these operating deficits as shown in figure 11.2.

Figure 11.2: Borrowings and operating result



Source: The Council's audited financial statements.

The Council demonstrated limited capacity to repay its loans and over the six years I reviewed, as it:

- made minimal principal repayments
- repaid existing loans from the proceeds of new borrowings.

My review of the Council's meeting minutes records the elected members were first alerted to the extent of the Council's financial difficulties in August 2015. The Council's 2016-17 annual business plan confirms its commitment to mitigate its financial risks when:

*... Council have determined that a financial strategy needs to be enforced that will lead to a significant reduction in debt each year for the next three years followed by more moderate reductions in the years that follow ...*

*... a target reduction of up to \$1 million per annum for the next three years. This will involve a significant change in how Council operates. The savings will be a combination of increased rates and charges, identifying operational efficiencies and reviewing of the current range and level of services ... to reduce operating costs.*

The Council's 2016-17 and 2017-18 annual business plans provide financial strategies which include:

- conducting reliable and robust service reviews to determine the future range and level of services the Council can afford to provide



- delaying capital expenditure on non-essential renewal expenditure.

Further commentary on these strategies is provided in section 7. In that section I concluded that the Council has demonstrated limited capacity to implement the planned financial strategies and respond to its immediate financial risks.

My analysis of the Council's financial operations found that the nature of its operations limits its capacity to restructure its services to generate extra cash flow to repay its debt. While its gross income is large relative to its debt, it mainly relates to electricity and water supply operations. These operations are challenging due to the Council's remoteness and the technology and infrastructure required to provide these services. Commentary on the financial risks associated with the Council's functions is provided in section 8.4.2.1.

The Council has limited capacity to generate extra cash flow from its electricity supply operations because this function is part of a regulated state subsidy scheme designed to subsidise the Council's costs and not to generate profits. Further commentary on this scheme is provided in section 12.

As reflected in the Council's 2016-17 and 2017-18 annual business plans, a significant cost reduction in services (potentially discontinuing some discretionary services) and significant increases in rates and user charges would be required to generate the cash to reduce its debt. The Council's 2017-18 annual business plan highlights that the increases in user charges for water supply and child care services do not raise sufficient revenue to cover the service costs. These shortfalls have contributed to the Council's operating deficits. The Council's 2017-18 annual business plan also states that the shortfall in revenue from these services were funded in the past by borrowings and in 2016-17 from rate revenue.

At the time of performing this examination, the Council's 2016-17 and 2017-18 audited financial statements were not available. My review of LGFA loan documents found the Council reduced its outstanding borrowings by \$192 000 in 2016-17 and \$202 000 in 2017-18. As at 30 June 2018 the Council's outstanding debt was \$6.7 million. The Council did not meet its target of reducing its borrowings by up to \$1 million p.a. in the first and second years of its strategy.

I determined that at the current repayment levels, the Council will not be debt free before 2035. This is based on the following assumptions:

- a minimum repayment amount of \$526 000 p.a.
- interest rates remaining unchanged at the LGFA daily weighted average rate of 3.6%
- no new loans until 2035
- break-even operating results or small operating deficits.

## Conclusion

At 30 June 2018 the Council had loans outstanding of \$6.7 million, mainly incurred to fund past operating deficits. Loan repayments in recent years were largely paid from the proceeds from new loans. This level of indebtedness, which is not supported by saleable or income producing assets, imposes a significant debt servicing load on a small council with a prior record of reporting operating deficits and difficulty generating available cash to make loan

repayments. The Council has not demonstrated the capacity to generate additional cash to repay its borrowings as it falls due.

The Council's future debt servicing capability is heavily reliant on successfully implementing its strategies, making operating surpluses and avoiding new borrowings. The Council has confirmed its commitment to mitigating its financial risks, but it has demonstrated limited capacity to implement the planned strategies and respond to its challenges.

This supports my conclusion that the Council's debt level is unsustainable and has a significant impact on the Council's financial sustainability.

#### 11.4.2 The Council failed to assess the impact on its financial sustainability

##### Finding

Sections 122 and 123 of the LG Act provide a framework to ensure:

- a council's source of funds to meet its operating and capital activities is guided by its short and long-term plans
- a council assesses its long-term financial sustainability for any (unplanned and planned) loans prior to incurring the debt. The LG Act requires a council's LTFP to include this assessment
- a council reviews its LTFP after adopting its annual business plan and, where necessary, amends or adopts new plans.

The Council adopted its LTFP for 2013-14 to 2022-23 in March 2013. This plan projects that the Council's financial position and performance will remain steady over time. This is based on the achievement of its financial strategies, which included:

*Significant quantities of debt will not be incurred until a strategy has been identified that will highlight how Council will repay the additional debt. This will be reflected in an updated LTFP to be prepared at the time.*

While the LTFP makes reference to 'forecast debt', it does not provide details of any planned borrowing for the ten-year period it covers. It includes the following commentary which indicates the Council did not expect to incur high levels of debt:

*Council is operating in a financially sustainable manner as it is funding its operating services from its operating revenue as well as fully funding its asset renewal requirements without the need to incur high levels of debt.*

The Council's 2015-16 annual business plan, adopted on 4 August 2015, budgeted new borrowings of \$800 000 and an outstanding loan balance of \$4.2 million at 30 June 2016. Shortly after this plan was adopted, the Council incurred new and unplanned borrowings of \$2.7 million (loans 59, 60 and 61) between August and September 2015. At this time the Council was experiencing cash flow shortages and had accumulated significant amounts due to its creditors.

In my opinion, the new borrowings substantially changed the Council's financial position and required reassessment of its LTFP.

Council staff, including the CEO and the Finance Manager, are responsible for providing the elected members with advice and reports on its financial matters. As reported in section 13, Council staff do not appear to have provided the elected members with regular and/or proper reports to:

- adequately understand and monitor its financial performance
- identify and respond to its emerging financial risks.

In the absence of regular and/or proper reports, the Council's elected members were asked to approve significant and unplanned borrowings to respond to an immediate financial crisis which was not previously foreshadowed.

In performing its function and making decisions a council is required to ensure its resources are used effectively and efficiently and ensure the sustainability of its long-term financial position and performance. In my view, the following information is required to make an informed decision about incurring new debt:

- a proper analysis to justify the unplanned debt
- an assessment of the impact of the unplanned debt on the Council's long-term financial sustainability
- a repayment strategy.

I found that the Council staff did not provide this information and the Council's LTFP was not updated for the new debts as required by its financial strategy and the LG Act.

Further commentary on the inadequacies of the information provided at the time of incurring of debt is provided in section 11.4.3.

## Conclusion

Council staff do not appear to have provided elected members with regular and/or proper reports to understand and monitor the Council's financial performance and respond strategically to its emerging financial risks. In that regard I concluded that the CEOs failed to fulfil the functions of that office prescribed by section 99 of the LG Act, in that they failed to provide advice and reports to the Council on the exercise of its powers and functions.

The Council incurred significant and unplanned debt to respond to its financial crisis. At the time of incurring this debt, the Council did not properly assess the impact on its long-term financial sustainability and its ability to repay the debt. As a consequence, I concluded that the Council failed to comply with sections 8 and 122 of the LG Act.

The Council failed to amend its plans after incurring significant and unplanned debt. Accordingly, I concluded that the Council failed to comply with sections 122 and 123 of the LG Act.

### 11.4.3 The Council failed to adequately explain its debt requirements

#### Finding

The papers provided to Council supporting recommendations to borrow from LGFA between 2012-13 and 2015-16 do not record sufficient information to understand:

- why it was necessary to borrow and why each new loan was appropriate
- the strategy to repay the new loan
- the impact of the debt on the Council's long-term financial sustainability.

In 2015-16, for example, the Council borrowed \$2 million (loans 60 and 61) for working capital. The Council agenda paper for its 22 September 2015 meeting recommended the Council approve a \$1 million loan for one year. The agenda paper did not explain why the borrowing was necessary and how it would be repaid. The Council minutes for this meeting, however, record the Council resolved to secure \$2 million in loans. They do not record why the borrowing approved was \$2 million when the agenda paper recommended \$1 million.

Further, the proposals to rollover loans recorded purposes which were inconsistent in describing the purposes for the original loan and did not explain why the original loan had not been repaid. For example, on 18 September 2012, the Council approved an increase in line of credit of \$1.5 million (loan 54) which was fully drawn down on 28 September 2012. The Council's agenda paper records specific issues that would affect its cash flow over the next 18 months and the need for the loan to ensure the Council paid its contractors on time. These issues related to a short-term delay in receiving grant funding for expenditure incurred for the electricity supply and specific capital projects. This loan, however, was taken out for three years.

On 15 September 2015, the Council approved the rollover of loans 53 and 54 for a total of \$2.5 million for a five-year term. At the time, the purpose given for the original loan 54 was:

*... originally setup to provide cash flow for Council based on the change in payments we were to receive at that point from the government in way of electricity subsidy. The loan is there to fund out [sic] non-liquid current assets.*

This purpose is not consistent with information provided to the Council on 18 September 2012, which indicated that loan 54 was required to fund cash flow requirements while waiting for grant funding for specific capital projects.

I found for most borrowings the recommendation noted that loans were required to fund short-term cash shortages (ie to supply working capital). In my opinion this was not accurate and debt was incurred to fund operating losses and deficiencies in the Council's cash management practices.

#### Conclusion

Council staff failed to provide the elected members with documented loan proposals which explained, with sufficient detail, why loans were required, how they were going to be repaid

and the impact on the Council’s long-term financial sustainability. The purpose recorded repeatedly referred to working capital requirements without sufficient specific details.

The elected members approved borrowings for generic/unspecified purposes and to respond to immediate financial crisis. The Council’s practice of approving loans based on inadequate information or when facing a specific financial crisis condoned the Council’s poor approach to financial management and masked the Council’s emerging financial difficulties, which had serious implications for its financial sustainability.

Furthermore, the Council’s then CEO failed to provide timely, sufficient and accurate information to the Council to support recommendations to incur debt. Accordingly, I concluded the CEOs failed to fulfil the functions of that office prescribed by section 99 of the LG Act, in that they failed to provide advice and reports to the Council on the exercise of its powers and functions.

The Council failed to receive or consider timely, sufficient and accurate information prior to approving and incurring significant debt. I concluded the Council did not properly understand and manage its debt requirements and ensure the Council’s long-term financial sustainability as required by section 8 of the LG Act.

### 11.4.4 Funds were borrowed without the Council’s approval

#### Finding

The LG Act allows a council to borrow money and other forms of finance it considers appropriate but prohibits a council from delegating this power. Therefore, funds can only be borrowed after obtaining council (ie the governing body) approval.

Loan applications record the dates the Council approved the loan, the loan amount and purpose, and the authorised person’s signature. Figure 11.3 provides the details noted on the loan applications for specified loans.

**Figure 11.3: Loan application details**

Loan no.	Loan amount	Date of Council approval	Purpose of loan	Signed by
53	\$1 000 000	6 August 2012	To supply working capital for projects while going through electricity funding changes	CEO
56	\$330 000	8 August 2013	Purchase new garbage compactor	CEO
57	\$600 000	4 August 2014	Water production pre-treatment upgrade	CEO
59	\$1 000 000	17 June 2015	Working capital for disaster recovery April 2014	Finance Manager

Source: Documents provided by LGFA.

The minutes of the council meetings did not record that the Council had approved the above loans except loan 59.

The minutes record that the Council approved loan 59 on 11 August 2015. The loan application, however, records the Council approved the loan on 17 June 2015, the loan application was submitted by Council staff to LGFA on 5 August 2015 and approved by LGFA

on 7 August 2015. Further, the Council resolution approving the loan records the loan term as one year, whereas the loan agreement was executed for five years.

**Conclusion**

The Council failed to comply with sections 44 and 134 of the LG Act in that Council staff did not obtain the approval of the elected members before incurring debt in August 2012, August 2013, August 2014 and June 2015.

**11.4.5 Loans were not repaid on receipt of expected funds**

**Finding**

The minutes of the Council meetings held between 1 July 2014 and 30 June 2017 record that the Council resolved to borrow money as provided in figure 11.4.

**Figure 11.4: Loans**

Loan no.	Loan amount	Date of Council’s approval	Council resolution	Amount reimbursed or grants received
53	\$1 000 000		Not available.	\$622 000
54	\$1 500 000	18 September 2012	<i>Council authorises the Finance and Administration Manager to seek loan borrowings of \$1,500,000 in the form of a Line of Credit for the purpose of cash flow for the Water for Growth project and Electricity budget.</i>	
55	\$800 000	18 December 2012	<i>That Council applies to the Local Government Finance Authority to increase its line of credit for the pipeline project tender RFT12/0010 from \$500,000 to \$1,300,000.</i>	\$1 665 000
59	\$1 000 000	11 August 2015	<i>That Council take out a loan with the Local Government Financing Authority (LGFA) for the period of 1 year for the purpose of providing Working Capital for Disaster Recovery in April 2014 and that the money from the Disaster Recovery Fund be applied to this loan when it is received</i>	\$381 000

Source: Council meeting minutes. Based on the agenda paper dated 18 September 2012, it is understood that loan 53 was to be repaid using the RAES subsidy reconciliation payment for 2011-12.

The papers supporting the recommendations to borrow money indicated that the loans would be required for short periods and would be repaid from the expected receipt of grant money or reimbursements.

I found that the Council did not receive the expected amounts. It only received \$2.8 million to repay an outstanding debt of \$4.3 million. LGFA’s loan documents record that these loans remain outstanding in full as at 30 June 2018. This supports my conclusion that on receipt of these funds, the Council did not repay the debt as initially intended.

At the time of realising the shortfall in the anticipated funds, the Council did not:

- assess the impact on the Council’s finances and ability to repay the loans

- review its repayment strategy to repay the outstanding loans
- consider a revised repayment strategy.

## Conclusion

The Council did not repay the outstanding debt when it received the expected funds. It is my view that at the time of realising the shortfall in the anticipated funds, Council staff should have informed the elected members of the Council's financial position and the impact on its long-term financial sustainability, and provided a revised strategy to repay the debt for Council resolution.

Council staff's failure to keep the elected members informed on these matters supports my conclusion that the Council did not properly understand and manage its outstanding debt and ensure the Council's long-term financial sustainability as required by section 8 of the LG Act. In addition, as a consequence of the central role played by the then CEO in relation to those matters, I concluded that the then CEO failed to comply with the functions of that office prescribed by section 99 of the LG Act.

## 12 Electricity grants

### What I found

Council staff were unable to provide accounting records to explain the grants the Council received under the Remote Areas Energy Supplies (RAES) scheme.

The Council did not provide quarterly reports and audited financial statements for years 2013-14 to 2015-16 within the time frames required by the RAES agreement.

The Council did not provide audited financial statements for years 2010-11 to 2015-16 in the prescribed form required by the RAES agreement.

The SA Government calculated the reconciliation payment, as provided for in the RAES agreement, for 2014-15, 2015-16 and 2016-17 and determined that the 2018-19 grant payments will be reduced by \$1.1 million. This adjustment recognises that the value of grants paid to the Council by the SA Government under the RAES scheme for these years exceeded the Council's net cost of providing the electricity function.

Information provided by the officers responsible for calculating the reconciliation payment on behalf of the SA Government highlight that they revised the calculations as the Council provided more and better information. This supports my view that the Council's failure to provide reliable information to the SA Government, in the form and within the timeframes specified by the RAES agreement, has caused uncertainty about the integrity of the reconciliation process, the amount of the adjustment and the impact of the adjustment on the Council's finances.

The Council failed to prepare regular, timely and reliable reports to effectively manage the impact of variations between the budgeted and actual net cost of the electricity function. These reports would enable the Council to engage with the SA Government to validate, and if necessary challenge, an assessment that future grant payments should be adjusted due to past outcomes.

In summary, the Council failed to comply with the reporting regime established by the RAES agreement that was designed to protect the Council from excessive over/under payments and avoid significant impacts on its cash flows.

### What I concluded

The Council failed to maintain its accounting records to explain the grants it received under the RAES scheme and prepare the financial information in the form and within the timeframes required by the RAES agreement.



The Council failed to:

- develop and implement systems which enabled Council officers to identify and understand emerging operational problems and to manage those problems
- proactively manage its financial position by understanding its financial performance and future financial commitments
- ensure it was adequately informed about its financial position and performance and empowered when it engaged with external decision makers.

The reconciliation payment assessments were not based on audited financial statements prepared in line with the RAES agreement. Instead, the reconciliation assessments determined by the SA Government were calculated using information which was not fit for purpose and consequently it is not possible to conclude that the reconciliation adjustments for the years 2010-11 to 2015-16 were correctly calculated.

The Council failed to comply with sections 8 and 124 of the LG Act.

## 12.1 Introduction

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The Council is the sole supplier of electricity to its community, and the electricity supply function is a significant part of its operations. The town is geographically isolated and not connected to the State's electricity grid, which means that electricity users in Coober Pedy rely on electricity generated locally. Significant technical, financial and management expertise is needed to operate and manage the Council's electricity generation, distribution and retailing activities.

Until 2016-17, the Council largely depended on expensive diesel generators for electricity generation. Under a new agreement, 70% of the Council's electricity supply is generated from renewable energy from 1 July 2017.

Without a subsidy, the cost of generating and distributing electricity to users in Coober Pedy would be much higher than for users who are connected to the State's electricity grid.

The SA Government, through the RAES scheme, subsidises the electricity supply costs for independent operators like the Council, to make electricity supply viable and affordable in regional areas.

The SA Government regulates the electricity prices the Council charges users to ensure they pay no more than the prices charged to metropolitan users. The shortfall in net cost to the Council from supplying electricity and recoveries from users is funded by RAES scheme grants.

In 2015-16, electricity supply costs represented 40% of the Council's total expenditure. The Council recovered 67% (\$4.7 million) of its electricity supply costs from subsidies (which includes diesel fuel tax credits from the Commonwealth Government) and 33% (\$3.9 million) from users.

## RAES scheme grants

RAES scheme grants are managed through a Deed of Grant agreement between the then Minister for Energy and the Council for the period 1 July 2010 – 30 June 2015 (the RAES agreement). On 29 April 2016 a new deed of grant commenced, which expires on 30 June 2020. The new reporting time frames outlined in this agreement are provided below in brackets.

The RAES agreement aims to ensure there is no financial impact on the Council from supplying electricity to its community. To achieve this, the RAES agreement supports Council's grant management through a prescriptive reporting regime. It requires the Council to submit the following reports to the Minister in specified formats and timeframes:

- a budget forecast on or before 31 March (15 April) for the next financial year for the Minister's approval
- quarterly reports on its actual performance against the approved budget within 21 (28) days of the end of each quarter
- an independently audited financial statement, setting out the actual revenues and expenses related to the electricity supply function, by 30 November (1 June) for the previous financial year.

The approved budget forecast is the basis for quarterly grant payments to the Council. This ensures the Council receives regular cash payments to subsidise its electricity supply costs.

The quarterly reports help the Council identify, within reasonable timeframes, any significant variations between the actual net cost of supplying electricity and the approved budget and avoid significant impact on the Council's cash flows.

If the Council's net costs exceed the approved budget, the RAES agreement allows it to seek variations to the budget if the shortfall is above \$30 000 or 10% of a revenue or expense item, whichever is higher.

The independently audited financial statement must be reconciled against the actual grant payments made during the financial year to calculate any over/under payment (the reconciliation payment). The next quarterly grant payment to the Council is then adjusted for the over/under payment.

The reports are structured so that once established, ongoing reporting should be a simple exercise. I understand that it can substantially be integrated into the Council's management accounting system.

If managed correctly, the Council is protected from financial losses that may arise from the electricity function, but this requires the Council to comply with the RAES agreement reporting regime.

## 12.2 Examination approach

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The examination of the Council's borrowings found the Council explained its need to borrow by reference to working capital shortfalls relating to funding the electricity operations.

The examination included procedures to understand the

- Council's electricity function (both management and financial activities)
- RAES scheme and its impact on the Council finances
- reasons for the significant reduction in RAES grant funds in 2016-17.

I asked Council staff to provide the following documents for the years 2010-11 to 2015-16:

- the Minister's grant approval confirmations showing the grant amount for the financial year
- the Council's Energy SA subsidy budget prepared for the RAES scheme and approved by the Minister, including workings, calculations and supporting documents.

Council staff were unable to provide these documents. Instead I relied on documents I obtained from the SA Government agency to perform this part of the examination.

## 12.3 Findings

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### 12.3.1 Council failed to meet its reporting obligations under the Remote Areas Energy Supplies agreement

The SA Government confirmed that the Council did not provide quarterly or annual reports within the prescribed times required by the RAES agreement, in that the:

- September 2013, December 2013 and March 2014 quarterly reports were submitted in April 2015
- June 2014 and June 2015 quarterly reports, which should have been provided within 21 days of the end of June, were not submitted until July 2016.

Instead of providing the independently audited financial statements for each year required by the RAES agreement, the Council provided the SA Government with its 2014-15 and 2015-16 audited general purpose financial statements in August 2017. The SA Government confirmed the Council did not provide its 2013-14 audited general purpose financial statements.

### Conclusion

Council staff were unable to provide accounting records to explain the grants the Council received under the RAES scheme.

The Council did not meet its obligations under the RAES agreement to submit quarterly reports and audited financial statements within the specified timeframe. This supports my earlier conclusion that the Council did not maintain its accounting records in a way that explained its accounts and enabled the timely preparation of financial information.

I concluded that the Council failed to comply with section 124 of the LG Act and its obligations under the RAES agreement.

### **12.3.2 Council failed to provide annual audited financial statements in the form specified in the Remote Areas Energy Supplies agreement**

I reviewed documentation prepared by the Council to meet its annual reporting obligations under the RAES agreement to provide an independently audited financial statement of the actual revenue and expenditure, as defined in the agreement, from its electricity operations.

I understand the Council responded to these obligations by providing a spreadsheet containing unaudited details of electricity business revenue and expenditure and, at a later date, a copy of the Council's audited general purpose financial statements.

I understand that the SA Government reconciled these two documents to determine the reconciliation payment. The audited general purpose financial statements, however, did not provide the revenue and expenditure from electricity operations in the detail required by the RAES agreement. Consequently, the unaudited financial information in the spreadsheet could not be reconciled, with an appropriate degree of confidence, to the audited general purpose financial statements.

### **Conclusion**

I concluded that the Council did not prepare and provide the SA Government with audited financial statements for the years from 2010-11 to 2015-16 in the form required by the RAES agreement.

### **12.3.3 Reconciling actual revenue and expenses to budgets and adjusting for calculated overpayments**

I sought to understand the outcomes of the annual reconciliation of the electricity supply function actual revenues and expenses to the annual budget approved by the Minister. As noted above the Council could not provide me with relevant documentation and documentation was obtained, instead, from the responsible SA Government agency.

I established that the SA Government assessed the reconciliation payments for 2013-14 to 2015-16 based on unaudited financial information provided by the Council. The SA Government calculated that the net cost of the scheme was \$1.266 million less than the grants paid to the Council for those years based on the approved budget. Based on this calculation the 2016-17 grant payments to the Council were reduced by this amount to recover the apparent overpayment.

In August 2017, the Council provided the SA Government with its audited general purpose financial statements for 2015-16. I understand that when the SA Government received these statements it sought to reconcile the audited information, including the 2014-15 comparative data, to the unaudited details of electricity business revenue and expenditure previously provided by the Council.

I further understand the SA Government was unable to reconcile the earlier provided unaudited financial information with the audited general purpose financial statements. However, it reduced the 2014-15 to 2015-16 estimated overpayment from \$1.266 million to \$486 000, a reduction of \$780 000.

The Council had not finalised its 2016-17 audited general purpose financial statements on time. I understand the SA Government has again used unaudited financial information provided by the Council to assess whether the Council's actual revenues and expenses varied from the approved budget for the year. This assessment determined that actual net expenses associated with the Council's electricity supply function for the 2016-17 year were less than the budgeted net expenses by \$1.921 million.

The SA Government advised me that the reconciliation recovery for the 2016-17 estimated overpayment will be reduced by the \$780 000 adjustment to the 2014-15 and 2015-16 years. This means the Council's 2018-19 grant payment will be reduced by \$1.141 million. Until the Council prepares the audited financial information required by the RAES agreement, it cannot be assured that the reconciliation payment is correctly calculated.

The matters I considered highlight that the payment adjustments determined by the SA Government are likely to have a significant impact on the Council's finances and the SA Government has not received the information it requires to reliably determine the reconciliation payment adjustments.

## Conclusion

I concluded that the reconciliation payment assessments were not based on audited financial statements prepared in line with the RAES agreement. Instead, the reconciliation assessments determined by the SA Government were calculated using information that was not fit for purpose and consequently it is not possible to conclude that the reconciliation adjustments for 2010-11 to 2015-16 were correctly calculated.

### 12.3.4 Understanding the significance of the Council's failure to prepare and submit quarterly returns

In examining the Council's accounts in relation to the RAES scheme I considered the significance of my findings to broader considerations of the Council's accounting and financial management.

The matters considered and discussed above support my conclusion that the electricity supply function was a significant part of Council operations and the Council did not comply with its obligation to provide quarterly reports and annual audited financial statements to the SA Government. When reports were provided they were late, not in the form required by the RAES agreement and unreliable.

It is evident that the SA Government has, acting on information provided by the Council, reduced grants to the Council to recover amounts overpaid in previous years. It is also evident that the information provided by the Council was subsequently revised and the amount of the repayment was reduced.

These findings demonstrate that the Council should have developed and implemented timely and reliable financial reporting for its electricity supply function.

In my opinion developing a capacity to regularly report timely and reliable financial information for the electricity function would also enable the Council to:

- identify and investigate variations between actual outcomes and budgets
- develop and implement appropriate changes to the electricity function to manage variations in revenues and expenses.

This aspect of capturing and analysing financial information is, in my opinion, a fundamental element of effective management of the electricity supply function.

The need to manage the impact of variations between the budgeted and actual net cost of the electricity function also required preparation of regular, timely and reliable reports. The RAES agreement provides a mechanism for adjusting future grant payments for the variations between prior year's budgeted and actual revenues and expenses. In essence this required the Council to put aside funds arising from an underspend of grant money to be applied to fund the next year's electricity supply function.

Developing and maintaining a capacity to prepare regular, timely and reliable analysis of actual and budgeted revenues and expenses for the electricity function would enable the Council to engage with the SA Government to validate and, if necessary challenge, an assessment that future grant payments should be adjusted due to past outcomes.

## Conclusion

The Council's failure to produce the reports required by the RAES scheme is not just about meeting an abstract reporting obligation but also, and more importantly, about its failure to:

- develop and implement systems that enabled Council staff to identify and understand emerging operational problems and to manage those problems
- proactively manage its financial position by understanding its financial performance and future financial commitments
- ensure it was adequately informed about its financial position and performance and empowered when it engaged with external decision-makers.

## 13 Strategic management

### What I found

Over the six years to 30 June 2016, the Council spent beyond its approved budget, incurred significant debt and reported significant operating deficits.

From late 2014 the Council experienced significant turnover in the CEO and Finance Manager roles. The CEO plays a key role in ensuring that the Council's daily operations and affairs are managed and legislative requirements are complied with.

This level of turnover was particularly significant because the Council has limited management staff, and therefore limited capacity to:

- cover vacancies in these two key positions
- support the new acting and permanent appointees while they developed an understanding of the Council's operations.

The frequent turnover in these key positions also appears to have contributed to the breakdown in monitoring and reporting on the Council's financial position and performance, and complying with LG Act requirements.

The Council did not:

- comprehensively review its strategic management plans by November 2016, within two years of the general council election
- review its LTFP annually and update it when required
- prepare adequate and regular reports to enable the effective review of its financial performance after 1 July 2014
- maintain adequate records to explain the significant variances between its budgeted and actual results.

I found no evidence that the Council operated with an appropriate long-term focus as required by the LG Act. The Council's strategic management plans were not properly integrated into its annual budgets and operational plans.

The lack of monitoring, reporting and evaluating of its financial performance is further evidence of the Council's failure to discharge its legislative responsibilities to the Coober Pedy community and ensure its long-term financial sustainability.

### What I concluded

The Council failed to comply with the requirements of sections 122(4) and 122(4a) of the LG Act, in that it did not comprehensively review and update its SMPs when required.

The Council failed to comply with the requirements of section 123(13) of the LG Act and regulations 9 and 10 of the LG Regulations, in that it did not prepare adequate, and regular, reports to monitor its financial position and performance for 2014-15, 2015-16 and 2016-17.

The Council failed to comply with section 44 of the LG Act in that Council staff were permitted to incur expenditure beyond the approved budget without proper authority in 2014-15 and 2015-16.

## 13.1 Introduction

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### 13.1.1 Purpose

This section considers whether the Council implemented and maintained proper financial management practices including:

- strategic and financial planning for the short and long term
- regular monitoring and review of approved plans
- regular reporting and evaluation of its financial position and performance.

Sections 122 and 123 of the LG Act provide the legislative framework for councils to establish and maintain proper and robust financial management practices. This framework is intended to enable a council to be accountable for its financial position and performance and demonstrate its long-term financial sustainability to its stakeholders.

As outlined in the LGA's 'Guide to Preparing a Strategic Management Plan', dated December 2012, strategic management planning is an important activity to ensure a council's long-term financial sustainability. It requires a council to have a long-term focus, beyond the four-year council term. It also requires a council to establish long-term objectives for its area and assess its capacity to continue providing the current range and level of services in its changing environment.

The LG Act establishes a framework for each council to:

- set the range and level of services it intends to provide to its community
- implement strategies to deliver these services and achieve its strategic objectives
- identify the infrastructure and financial resources required to support its strategies and protect its long-term financial sustainability.

The LG Act requires councils to prepare LTFPs and infrastructure and asset management plans, which specify their resource requirements, and to integrate these plans into the council's daily operations through the operational plans (such as the annual business plan, annual budget, division plans and project plans) and council policies. This provides assurance that a council's resources are allocated to activities that will achieve its long-term objectives.



The financial management framework in the LG Act also requires a council to regularly monitor, report and evaluate its performance in achieving its strategic objectives. The LG Act requires timely financial reporting to enable the council to identify emerging issues and take timely and appropriate action to respond. The council discharges its financial accountability to its stakeholders by reporting on its actual financial results (what the council did) against its budget (what the council agreed to do).

A council's audit committee plays an important role in this process. This is reflected in the audit committee's function provided for by the LG Act which includes proposing, and providing information relevant to, a review of the council's strategic management plans or annual business plan. Further commentary on audit committees is provided in section 14.

### 13.1.2 Relevant law

#### Planning

Section 122(1) of the LG Act requires a council to develop and adopt plans for the management of its area, to be collectively called the strategic management plans.

Section 122(1a) of the LG Act also requires a council to develop and adopt an LTFP and an infrastructure and asset management plan, both for a period of at least 10 years. A council is required to develop these plans at the same time it develops its strategic management plans.

Section 123(1) requires a council to have an annual business plan and budget for each financial year.

Section 123(2) requires a council's annual business plan:

- to include a summary of the council's long-term objectives as outlined in its SMPs
- to outline the objectives, activities to achieve those objectives and measures for the financial year
- to summarise the financial requirements and set out the rates structure and policies for the financial year
- to take into account the council's LTFP and any issues related to the management and development of infrastructure and major assets.

Section 123(11) requires a council's annual business plan to include an assessment of the extent to which the council's objectives for the previous financial year have been achieved.

Section 123(8) requires a council to adopt its annual business plan and budget after 31 May for the ensuing financial year and, except in a case involving extraordinary administrative difficulty, before 31 August for the financial year.

Section 123(10) of the LG Act requires the Council's budget to include budgeted financial statements presented in a manner consistent with the Model Financial Statements. In this way the Council can compare its budgeted to actual financial results when reviewing its financial performance.

## Monitoring, review and evaluation

Section 122(4) of the LG Act requires a council to:

- review its LTFP after adopting the council's annual business plan each financial year
- comprehensively review its SMPs within two years of a general council election.

Section 122(4a) of the LG Act requires councils, when reviewing their LTFP, to consider a report from the CEO on the sustainability of its long-term financial position and performance, considering the provisions of the council's annual business plan and SMPs.

Section 123(13) requires a council to review its annual business plan or budget during the financial year and make any necessary revisions.

Regulation 9(1) of the LG Regulations requires a council to prepare and consider:

- at least twice, between 30 September and 31 May, a report showing a revised forecast of its operating and capital investment activities compared with its annual budget. A council is also required to consider one report before and another report after the report below is considered
- between 30 November and 15 March, a report showing a revised forecast of each item in the budgeted financial statements compared with the annual budget. This report is to include revised forecasts of the council's financial sustainability ratios compared with the annual budget.

Regulation 10 of the LG Regulations requires a council to consider a report comparing the audited financial results to its annual budget by no later than 31 December in each year.

Section 59 of the LG Act provides that the role of council members will include:

- keeping the council's objectives and policies under review to ensure that they are appropriate and effective
- keeping the council's resource allocation, expenditure and activities, and the efficiency and effectiveness of its service delivery, under review.

Section 99(1) of the LG Act specifies the functions of the CEO and requires the CEO to provide information to the Council to help it assess its performance against its SMPs and to provide advice and reports to the Council.

### 13.1.3 The Council's strategic management and annual plans

On 19 March 2013, the Council adopted its SMPs comprising the:

- Strategic Plan for 2013-14 to 2017-18
- Long-term Financial Plan for 2013-14 to 2022-23
- Asset Management Plan – Utility Assets for 2013-14 to 2022-23
- Asset Management Plan – Local Government Assets for 2013-14 to 2022-23.

The SMPs were prepared by the Council with the assistance of two external consultants.

Figure 13.1 shows when the Council adopted its annual business plan and budget for four years to 2017-18.

**Figure 13.1: Annual business plan and budget – dates adopted**

Financial year	Date adopted
2014-15	4 August 2014
2015-16	31 August 2015
2016-17	16 August 2016
2017-18	31 August 2017

### 13.1.4 Key concerns with the Council’s future operations

#### The Council’s response to the Minister’s concerns

As mentioned in section 2.1, the Minister was concerned with the Council’s future operation due to instability in its membership, financial management issues and potential breaches of the LG Act. From September 2015, the Council provided progress reports to the Minister on the work undertaken to address the Minister’s concerns.

In July 2016 the acting CEO met with OLG representatives to discuss concerns with the Council’s financial position and performance. After this meeting, in a letter dated 4 August 2016, the Minister asked the Council to explain all material variances between its actual and budgeted financial results for 2014-15 and 2015-16.

In a letter to the Minister dated 31 August 2016 the Council’s external advisor and former acting CEO reported that:

- sufficient detailed working papers to understand the assumptions to formulate the Council’s 2014-15 and 2015-16 annual budgets were not available
- given the final reported result, it was reasonable to assume that the assumptions used were not realistic and the budget was not of a reliable robust nature
- the annual financial statements were qualified and therefore somewhat unreliable
- the forecast for 2015-16 included in the 2016-17 annual budget was a high level estimate and was not supported by detailed estimates at the individual departmental level.

#### Budget variances and deficits

As discussed in section 6.3.1, the Council reported large variances between actual and budgeted operating results, with large deficits in 2012, 2014, 2015 and 2016. The variances were mainly due to:

- expenditure exceeding the approved budget
- revenue earned being lower than expected.

Further commentary on the Council's financial performance is provided in section 8.

## Deficits funded by borrowings

The Council's borrowings increased significantly in the financial years that followed operating deficits. My analysis in section 11 shows that the deficits were mainly funded by borrowings.

## Deficiencies in reporting and evaluation of the Council's performance

My review of Council minutes and agenda papers supports a conclusion that the Council did not receive proper and regular financial information to enable a proper and robust assessment of its financial position and performance. The financial information provided to the Council did not indicate any deterioration in its financial position until there was a crisis.

The Council was first alerted to its poor financial position at its meeting on 11 August 2015. In responding to this financial crisis the Council resolved to approve a \$1 million loan and initiate a financial investigation under section 130A of the LG Act.

The section 130A investigation reported significant weaknesses in the Council's financial systems and internal controls. It did not identify the cause(s) of the Council's poor financial performance and how it could be more efficient with its financial resources. Further commentary on this investigation is provided in section 7.5.

The Council could not explain to the Minister all the material variances between its actual and budgeted financial results for 2014-15 and 2015-16.

My review of Council meeting minutes and reports did not identify any evidence that the Council received regular and proper financial reports to explain these material variances as required by section 123(13) of the LG Act and Regulation 8(1) of the LG Regulations. I identified reports that were provided to the Council in November 2014, March 2015 and February 2016.

## 13.2 Examination approach

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I reviewed the Council's meeting minutes from 1 July 2014 to determine whether it had undertaken a proper and robust review of its SMPs and annual budgets to ensure its long-term financial sustainability. I looked for evidence that the Council had:

- reviewed its SMP in line with the requirements of section 122 of the LG Act
- adopted an annual business plan and budget for 2014-15, 2015-16 and 2016-17
- prepared and considered the reports required by Regulations 9 and 10 of the LG Regulations for 2014-15, 2015-16 and 2016-17.

I reviewed the Council's annual business plans for 2014-15, 2015-16 and 2017-18 to understand the financial strategies underpinning the plan and budget.

The examination was limited because Council staff were unable to provide detailed working papers to support the annual budgets. I would expect the Council to have prepared and to hold on file documents showing calculations and assumptions to substantiate the revenues and expenses projected in the annual budgets for 2014-15 and 2015-16.

Without this information, I could not determine whether the financial information presented in the annual budgets was based on reasonable assumptions and correctly calculated.

## 13.3 Findings

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### 13.3.1 The Council has not reviewed its strategic management plans since March 2013

#### Finding

In line with section 122 of the LG Act, the Council was required to comprehensively review its SMPs by November 2016.

Council meeting minutes did not record that the Council reviewed its SMPs after March 2013. Further, the minutes of audit committee meetings held after 1 July 2014 did not record any proposal to the Council to review the SMPs.

The Council's 2016-17 annual business plan records that the Council planned to review its SMPs before 31 December 2016. When I started the examination in May 2017, the then CEO advised me that the SMPs had not been reviewed.

The Council's 2017-18 annual business plan records that its SMPs will be reviewed in 2017-18.

#### Conclusion

The Council has not reviewed its SMPs as required by section 122(4) of the LG Act. I concluded the Council failed to comply with section 122(4) of the LG Act.

### 13.3.2 The Council failed to review and update its long-term financial plan

#### Finding

Section 122(4) of the LG Act requires a council to review its LTFP after adopting its annual business plan. This ensures that the LTFP is updated to reflect any long-term financial implications of the annual business plan. In undertaking this review, a council must take into account a report from the CEO on the sustainability of the council's long-term financial position and performance.

The Council's annual business plans for 2014-15, 2015-16 and 2016-17 record that the LTFP and asset management plans are to be reviewed annually to take account any change in service delivery or other circumstances.

The minutes of Council meetings, however, do not record that the Council reviewed its LTFP after adopting the annual business plans for 2014-15, 2015-16 and 2016-17. During the course of the examination, I was advised by the then CEO that she understood the LTFP had not been reviewed.

The LTFP records that the Council's financial position and performance over the ten-year period covered would remain steady. This was based on the continued achievement of the financial strategy outlined in the LTFP and assumptions made in its forecasting calculations. The LTFP outlines when a revision of the LTFP is required and provides that the Council should have reviewed and updated its LTFP to reflect the long-term financial impact of:

- the significant debt it incurred
- capital projects as each project was approved and costed.

## Conclusion

In 2014-15 and 2015-16 the Council incurred significant additional debt and large operating losses. The Council failed to review and update its LTFP to reflect these events. This meant it failed to understand and respond to the medium and long-term implications of them.

The Council did not review its LTFP. I concluded the Council failed to comply with section 122(4) of the LG Act.

### 13.3.3 The Council failed to prepare reports to adequately monitor its financial performance over three financial years

#### Finding

Section 123(13) of the LG Act requires councils to reconsider their annual business plan or budget during the financial year and make any revisions required. Regulation 9 of the LG Regulations requires reports to be prepared to ensure a council is aware of the emerging need to reconsider its annual business plan or budget. The financial reports required by the LG Act and regulations provide a robust and integrated approach to reporting on financial position and performance.

The minutes of Council meetings held between 1 July 2014 and 30 June 2017 do not record that the Council received the financial information required by Regulation 9 of the LG Regulations.

Council staff were unable to locate these reports for 2014-15, 2015-16 and 2016-17.

The financial information and reports that the Council received in those years is explained below.

## *2014-15*

The minutes of Council meetings held in 2014-15 record that the Council received budget review reports on 16 December 2014 and 17 March 2015 for November 2014 and February 2015, respectively.

My review of these reports as at 28 February 2015 found:

- the reports stated the Council was operating within forecasts and in a good position as long as nothing unexpected happened
- the overall budgeted operating result was under by \$2.7 million, with expenses under by \$1.8 million and revenue over by \$850 000
- no budget revisions were made
- they provided detailed information by division but were not summarised at the Council level or presented in the form required by the LG Regulations
- the actual financial statements as at 28 February 2015 were provided, however they were not compared to the corresponding line items in the budgeted financial statements to easily identify significant variances
- the Council's meeting minutes recorded that the Council received and noted the review.

The Council was first alerted to its poor financial position at its meeting on 11 August 2015 when Council management recommended an increase in borrowings.

The minutes of the Council meetings held between March and July 2015 do not record that the Council received financial reports explaining the significant deterioration in the Council's financial position and performance since February 2015.

On 15 December 2015 the Council received its financial statements for the year ended 30 June 2015, which reported an operating deficit of \$2.9 million against a budgeted operating surplus of \$214 000.

In my opinion, in 2014-15 the financial reports required by the LG Act were not prepared regularly and in a way that enabled the elected members to undertake a proper and robust review of its financial performance against its budget.

## *2015-16*

The minutes of Council meetings held in 2015-16 record that the Council received a financial report providing meaningful information on one occasion, on 23 February 2016. This report provided the outcome of management's detailed assessment of the Council's financial position and performance. Further commentary on this report is provided in section 13.3.6.

In my opinion, in 2015-16 the financial reports were not prepared regularly and in a way that enabled the elected members to undertake a proper and robust review of its financial performance against its budget. In early 2016 Council management took action to prepare proper financial reports, however this then ceased with the appointment of a new CEO and Finance Manager.

2016-17

The minutes of Council meetings held in 2016-17 record that the Council received financial information limited to the following balances:

- creditors
- loans
- debtors (rate, water, electricity and sundry)
- cash at bank
- employee expenses.

The then Finance Manager's report to the Council dated 16 May 2017 recorded that:

- limited financial information was provided due to difficulties with the current chart of accounts
- management was unable to provide the Council with an income and expenditure account that met the level of integrity required
- the Council would not receive regular and accurate financial reports until a new chart of accounts and revised accounting system reporting structure was implemented.

The then CEO advised me the chart of account and financial reporting system upgrade project has stalled.

In my opinion, in 2016-17 the financial reports required by the LG Act were not prepared regularly and in a way that enabled the elected members to undertake a proper and robust review of its financial performance against its budget.

Regular and proper financial reporting would have enabled the Council to:

- evaluate its financial position and performance and identify the emerging financial trends and underlying causes of its financial issues
- promptly identify and explain any significant variances between actuals and budgets
- take appropriate and timely action to respond to the issues.

In my opinion, it was appropriate for the Council to review the assumptions underpinning the annual budget in preparing future budgets.

## Conclusion

In the three years I reviewed the Council did not prepare the reports required by section 123(13) of the LG Act and Regulation 9 of the LG Regulations.

As a consequence, the Council could not:

- undertake a proper and robust review of its financial performance against its approved budget
- identify and seek explanation for significant variances in the approved budget and consider any necessary budget revisions



- most importantly, take timely and appropriate action to respond to and reduce or avoid the significant deterioration in its financial position and protect its medium to long-term financial sustainability.

The Council failed to regularly review and update its annual budget for 2014-15, 2015-16 and 2016-17 as required by section 123(13) of the LG Act. I concluded the Council failed to comply with section 123(13) of the LG Act and Regulation 9(1) of the LG Regulations.

### 13.3.4 The Council failed to report on its financial results for three years

#### Finding

Regulation 10 of the LG Regulations requires a council to prepare a report comparing its audited financial results with budget estimates. The Council is required to consider this report by 31 December in each year.

In section 10 I concluded that the Council had not prepared financial statements on time for 2014-15, 2015-16 and 2016-17. Consequently, Council was unable to report the Council's financial results for those years for Council to consider by 31 December in each year. Council staff confirmed that these reports were not prepared.

The report on its financial results provides information the Council needs to discharge its financial accountability to its community and other stakeholders. It may indicate that the Council needs to reconsider its current budget. Significant variances between estimated and audited financial results may indicate that the budget assumptions in prior years were inappropriate and highlight the need for Council to review its budget assumptions to confirm they are valid. Figure 13.2 provides, where available, the budgeted, estimated and actual results reported in the Council's budgets for the three years reviewed.

**Figure 13.2: Revenue, expenditure and result – budgeted, estimated and actual**

	2014-15			2015-16			2016-17		
	Budget \$'000	Estimated result <sup>(1)</sup> \$'000	Actual <sup>(2)</sup> \$'000	Budget \$'000	Estimated result \$'000	Actual \$'000	Budget \$'000	Estimated Result \$'000	Actual <sup>(3)</sup> \$'000
Operating revenue	16 400		14 262	16 804	13 825	14 033	15 639	13 829	
Operating expenditure	16 186		17 291	16 422	15 225	17 646	15 289	14 578	
Operating surplus (deficit)	214		(3 029)	382	(1 400)	(3 613)	350	(749)	

<sup>(1)</sup> The estimated result figures for 2014-15 were not included in the 2015-16 budget.

<sup>(2)</sup> These are the original figures reported in financial statements certified on 15 February 2016.

<sup>(3)</sup> The audited financial statements for the year ending 30 June 2017 were not available at the time of performing this examination.

Figure 13.2 shows that despite the significant variances between the budgeted and actual operating results for 2014-15 and 2015-16 of \$3.2 million and \$4 million, respectively, the Council continued to budget for an operating surplus in 2016-17.

The Council was not aware of the audited result for 2015-16 until the financial statements were certified on 26 June 2017, nearly 12 months after the 2016-17 budget was adopted on 16 August 2016.

This failure to prepare audited financial statements on time prevented timely review by the Council of its results against its budget. The Council was therefore unable to seek explanations and consider measures to mitigate losses.

## Conclusion

Council failed to prepare adequate reports to enable the Council to undertake a proper and robust review of its financial performance and take timely action to protect its financial sustainability.

The Council failed to prepare and consider the report required by Regulation 10 of the LG Regulations.

The Council failed to reconsider its annual budgets for 2014-15, 2015-16 and 2016-17 as required by section 123(13) of the LG Act.

I concluded the Council failed to comply with section 123(13) of the LG Act and Regulation 10 of the LG Regulations.

### 13.3.5 The Council incurred expenditure without proper authority

#### Finding

The Council has delegated specific powers and functions, recorded in its instrument of delegations under section 44 of the LG Act.

However, section 44(3) of the LG Act limits the powers a council may delegate by prohibiting the delegation of powers to approve the expenditure of money on works, services or operations of the council not contained in a budget adopted by the council.

The Council's instrument of delegations provides the CEO with the power, under section 36(1)(c) of the LG Act:

*... to do anything necessary, expedient or incidental but within any policy or budgetary constraints set by the Council to perform or discharge the Council's functions or duties or to achieve the Council's objectives.*

This prohibits the CEO or any other delegate from incurring expenditure that is not in the approved budget. Such expenditure would require Council approval before it was incurred.

The minutes of Council meetings held in 2014-15 record that the Council received and noted a list of individual payments made each month. The list for June 2015 was the last report provided to the Council. Council staff provided these reports for information purposes

without any recommendations. The reports did not indicate to the Council whether the budget had been exceeded and a budget revision needed to be formally approved. Except for a budget revision in December 2014, the minutes of the council meetings did not record the approval of any revisions to the annual budgets for 2014-15 and 2015-16. I could not locate any record of a financial approval for expenditure which exceeded the adopted budget.

## Conclusion

In 2014-15 and 2015-16, the Council spent beyond its approved budget and reported significant operating deficits. In the absence of a proper and robust budget review, the Council failed to identify the significant expenditure over its approved budget and take timely action.

I concluded the Council failed to comply with section 44 of the LG Act in that Council staff were permitted to incur expenditure beyond the approved budget without proper authority in 2014-15 and 2015-16.

### 13.3.6 The Council failed to consider key financial information

#### Finding

The interim CEO's agenda report for the Council meeting held on 19 January 2016 recorded that Council's management had started to prepare an update to the 2015-16 annual business plan and budget. This involved a detailed assessment of the Council's forecast financial performance and capabilities over the 18 months ending June 2017. It was intended to help management prepare the 2016-17 annual business plan and budget.

The agenda report for the Council meeting held on 23 February 2016 recorded that Council's management recommended the Council receive the current environment report. This report provided the outcome of management's detailed assessment of the Council's financial position and performance. It provided:

- half-yearly financial statement balances (income and expenditure statement and balance sheet) as at 31 December 2015
- the audited financial statement balances for the years ended 30 June 2015 and 30 June 2014
- the forecasted income and expenditure balances for the year ended 30 June 2016
- the estimated income and expenditure for the 2016-17 budget.

My review of Council meeting minutes found that this was the first time since March 2015 the Council was provided with information on its financial position and performance. The minutes of the Council meeting held on 23 February 2016 record that, as recommended, the Council received the current environment report. There was no record of further discussion of this report.

In light of the Council's concerns with its finances, in my view it should have considered the report in detail, made further inquiries of management and sought to understand any impact on the 2015-16 budget.

I reviewed the report and found that it did not:

- consider the need to review Council's approved budget for 2015-16. The forecast financial statements for that year were not compared with the approved budget to identify any significant variances
- compare the different sets of data to identify and explain any significant variances
- recommend that the Council reconsider its 2015-16 budget.

In my opinion, this review and report could not be regarded as robust because it failed to identify and explain the following:

- a significant variance of \$2.5 million between the forecast operating deficit of \$2.1 million as at 30 June 2016 compared with a budgeted operating surplus of \$382 000
- the basis of the 2016-17 budget operating surplus of \$392 000 when the Council had reported operating deficits since 2013-14
- the basis of the 2016-17 budget estimate of a decrease of \$1.2 million in employee costs with a budget of \$3.9 million when the average employee cost over the previous three financial years was \$5.1 million.

## Conclusion

The Council did not receive sufficient information to enable it to undertake a proper and robust review of its financial position and performance, and nor was there any evidence that the Council requested such information.

The Council failed to consider the financial report in detail and seek the further information and explanations required to undertake a proper and robust review of its financial position and performance. Such a review should have prompted the Council to reconsider its 2015-16 budget and make any necessary revisions.

I concluded that the Council failed to comply with section 123(13) of the LG Act.

### 13.3.7 Annual budgets were inconsistent with the financial statements

#### Finding

As required by section 123(2) of the LG Act, the Council's 2014-15, 2015-16 and 2016-17 annual business plans included budgeted financial statements presented in a manner consistent with the account balance descriptions reported in the financial statements.

The Council also prepared a budget report providing a more detailed version of the annual budget. It showed budgeted revenues and expenses by Council function (eg electricity, water, administration) at the chart of account level.

I found that these budget reports did not agree to the annual budgets and that Council staff could not reconcile them.

Further, I found that, for some account balances the account composition and classification in the annual budgets did not align with the financial statements as required by section 123(2) of the LG Act. Any comparative analysis of these account balances would be misinformed because the data was not comparable.

## Conclusion

The Council did not present its annual budgets in a manner that enabled it to properly compare its budget to actual financial results.

I concluded that the Council did not comply with section 123(2) of the LG Act.

## 14 Audit committee

### What I found

The Council's audit committee:

- did not meet in 2014-15
- met only once in 2015-16, on 10 September 2015
- met only twice in 2016-17, on 10 November 2016 and 6 April 2017.

The audit committee did not perform its legislative functions by failing to:

- provide advice to the Council on its finances and the section 130A investigation process as requested
- oversee the section 130A investigation process and implementation of the recommendations to address the findings
- provide advice on the Council's financial statements for the years ended 30 June 2015 and 30 June 2016
- provide information relevant to the Council's strategic and annual planning processes, including reviewing the SMPs and annual business plan
- regularly review the adequacy of the Council's financial management systems and practices
- provide independent assurance to the Council on the effectiveness of its internal controls.

Further, the audit committee did not provide sufficient oversight and advice to the Council for a number of key events that required the audit committee's attention. The audit committee's lack of oversight was a serious deficiency in the Council's overall control environment.

### What I concluded

I found that from November 2014 the Council did not have an effective audit committee because the audit committee did not meet regularly or at all and failed to perform its functions under the LG Act.

I concluded that the Council failed to comply with section 126 of the LG Act.

## 14.1 Introduction

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### 14.1.1 Relevant law

The LG Act requires a council to establish an audit committee that performs the functions

set out in the LG Act and the LG Regulations. The Council is empowered to establish committees under section 41 of the LG Act.

### *Membership*

Section 126(2) of the LG Act provides for the audit committee's membership and requires it to be determined in line with the LG Regulations. Regulation 17 requires the audit committee to:

- have between three and five members
- include at least one independent member with relevant financial experience.

### *Functions*

Section 126(4) of the LG Act specifies the functions an audit committee must perform:

- (a) reviewing annual financial statements to ensure that they present fairly the state of affairs of the council; and*
- (ab) proposing, and providing information relevant to, a review of the council's strategic management plans or annual business plan; and*
- (ac) proposing, and reviewing, the exercise of powers under section 130A; and*
- (b) liaising with the council's auditor; and*
- (c) reviewing the adequacy of the accounting, internal control, reporting and other financial management systems and practices of the council on a regular basis.*

### *Responsibilities*

A council determines its audit committee's membership, responsibilities and procedures. Section 41(8) of the LG Act requires a council to determine the committee's reporting and other accountability requirements. These requirements are commonly documented in a committee's terms of reference.

Section 130A(1) of the LG Act provides that a council may request a person, as determined by the council, to examine and report on any matter relating to financial management, or the efficiency and economy with which the council manages or uses its resources to achieve its objectives.

Section 130A(5) of the LG Act requires that the report of an examination must be provided to the council's audit committee.

## 14.1.2 Why audit committees are important

The Australian National Audit Office's 'Public Sector Audit Committees' better practice guide explains that audit committees have an important role in an entity's governance framework.

It outlines key aspects of an audit committee's role which are consistent with the LG Act. An audit committee:

- provides an independent source of assurance and advice to a council on key financial and internal control matters
- assists a council to be financially accountable to its community and other stakeholders and to ensure compliance with relevant legislative requirements
- membership includes independent members and members who are properly skilled in audit practices and have financial expertise.

In addition to having the appropriate membership, an effective audit committee:

- meets regularly and at appropriate times to perform its functions
- ensures management provides the required information for it to perform its role. Section 87(9) of the LG Act requires the CEO to ensure that committee members are provided with any documents or reports that are to be considered at the meeting
- adequately scrutinises information and knowledge gained in performing its role to provide appropriate and timely advice to the council on matters requiring attention.

In that regard, the Council's audit committee's terms of reference required it to

- meet at least quarterly
- report to the Council, including making recommendations on matters where action or improvement was needed.

### 14.1.3 Key events requiring the audit committee's attention

From 2014-15 there were significant matters that required the audit committee's attention and action:

- the Council's concerns with its finances due to the significant increase in loans to fund operating deficits
- the initiation, results and remediation progress of a section 130A investigation
- the results and remediation progress of an IT review
- significant delays in preparing the financial statements for 2014-15, 2015-16 and 2016-17
- the findings raised by the Council's external auditor, and qualified opinions issued for 2014-15 and 2015-16.

Consideration of these matters was consistent with the audit committee's legislative functions.

It was critical that the Council could rely on an effective audit committee to address these significant matters and provide appropriate and timely advice.



#### 14.1.4 The Council's audit committee

The minutes of Council meetings record that the Council re-established its audit committee after the local government elections held in December 2014. The Council established the audit committee's terms of reference at various times to meet the requirements of section 41 of the LG Act and relevant regulations. On 16 December 2014 the Council appointed three elected members (of which two were reappointed) to the audit committee, effective from 1 January 2015. The independent member continued on the audit committee.

The audit committee held its first meeting on 10 September 2015, nine months after it was re-established. Its terms of reference, adopted on 10 September 2015, required it to:

- report to the Council after every meeting to provide advice or recommendations
- report annually to the Council with a summary of its activities
- meet quarterly, and authorised the audit committee to determine a quarterly schedule of meetings.

In October 2015 the Council's section 130A investigation recommended that it develop an effective audit committee to support and promote effective financial governance and ensure compliance with relevant legislation. At this time the Council continued to experience significant organisational instability, including a high turnover in the CEO's position.

On 15 March 2016, the Council granted an elected member of the audit committee leave of absence from 1 March 2016 to 1 June 2016.

The independent member resigned from the audit committee on 15 March 2016.

On 16 August 2016 the Council re-established the audit committee and appointed two elected members to the audit committee. The Council appointed two independent audit committee members on 20 September 2016.

On 20 September 2016 the Council also appointed an external consultant as Executive Officer to provide administrative support to the audit committee. The Executive Officer reported to the audit committee chair and was required to:

- in consultation with the chair, prepare the agendas
- in consultation with the chair, prepare and update the audit committee work program
- prepare requested reports
- attend meetings and provide advice to audit committee members as required.

On 15 November 2016 the Council appointed one of the independent members as the audit committee chair, and adopted an audit committee work program for 2016-17 and a revised terms of reference. The revised terms of reference required the audit committee to:

- undertake additional functions, including reviewing the effectiveness of the Council's risk management systems
- meet at least four times a year at appropriate times in the reporting and audit cycle

- provide minutes of committee meetings to the Council
- make recommendations to the Council on any areas within its terms of reference where it considered action or improvement was needed.

## 14.2 Examination approach

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My aim was to determine whether the Council's audit committee met its legislative obligations to proactively assist the elected members to provide appropriate oversight of Council finances and internal controls.

I reviewed the audit committee's activities and actions to address the significant matters outlined in section 14.1.3.

In performing this element of the examination I considered the following documentation provided by Council staff:

- the audit committee's policy and various terms of reference
- audit committee meeting minutes and agenda reports and Council meeting minutes for meetings held from 1 July 2014 to 31 August 2017
- relevant correspondence between the Minister and the Council
- the DFK Gray Perry report
- the Council's external auditor's reports and audit opinions for the years ended 30 June 2015 and 30 June 2016.

I noted gaps in records relating to audit committee meetings and the performance of its functions. The gaps included:

- minutes to support some audit committee meeting agendas
- reports to support some agenda items
- minutes of confidential meeting proceedings
- detailed descriptions of key items discussed at meetings.

In the absence of this documentation, I interviewed the then Mayor on 13-14 November 2017 who was also a member of the Council's audit committee at the relevant times to assist with determining the accuracy and completeness of the documentary evidence provided.

## 14.3 Findings

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### 14.3.1 The Council did not have an audit committee for six months in 2016

#### Finding

Section 126(2) of the LG Act provides for the audit committee's membership and requires it

to be determined by the regulations. Regulation 17 of the LG Regulations 2011 requires a council's audit committee to:

- have between three and five members
- include at least one independent member with relevant financial experience.

On 15 March 2016:

- the Council granted a councillor who was also a member of the audit committee leave of absence from 1 March 2016 to 1 June 2016
- the independent member resigned from the audit committee.

The minutes of the council meetings did not record an appointment to replace the independent member until the audit committee was re-established on 20 September 2016.

Following the resignation of the independent member, the audit committee had less than three members and no independent member. Consequently, the Council did not comply with Regulation 17 of the LG Regulations from 1 March 2016 to 19 September 2016.

## Conclusion

The Council did not have a properly constituted audit committee between 1 March 2016 and 19 September 2016 as it did not have enough members.

I concluded the Council failed to comply with section 126 of the LG Act.

### 14.3.2 The Council's audit committee did not meet regularly

#### Finding

The minutes of the council meetings held since 1 July 2014 indicate that the audit committee:

- did not meet in 2014-15
- met only once in 2015-16, on 10 September 2015
- met only twice in 2016-17, on 10 November 2016 and 6 April 2017.

Council staff were unable to provide any documentary evidence that other audit committee meetings occurred in these years. This was confirmed by:

- the Council's external auditor's report for the years ended 30 June 2015 and 30 June 2016, which record that the audit committee was not active in these financial years
- my interview of the then Mayor on 13-14 November 2017.

The Council's records of audit committee meetings support my conclusion that the audit committee did not meet quarterly as required by its terms of reference.

On 12 April 2016 the Council's external auditor advised the Minister that the Council was in breach of section 126 as it had established an audit committee but the committee was not active in 2015. The Minister's subsequent letter to the Council's external auditor recorded that he was advised this was not a breach of the LG Act. The OLG, a division of DPTI, provides advice to the Minister on local government matters.

I wrote to DPTI to understand the basis of the advice provided to the Minister. DPTI advised that it formed the view that the audit committee not meeting did not technically constitute a breach of the LG Act. However, DPTI also advised that the Minister was of the view that there is a clear policy intent for an audit committee to be active and carry out its responsibilities under the LG Act. The OLG advised that it had raised this matter with the Minister and legislative amendments to clarify his intent will be considered.

In my opinion the position taken by the OLG (as reflected in the Minister's letter) was not correct and the Council was in breach of section 126 of the LG Act as the audit committee did not meet quarterly, did not perform its functions and did not provide proper oversight and timely advice to the Council. Its failure to meet was particularly significant because it coincided with a critical time when the Council had identified concerns with its financial situation and viability and initiated a section 130A investigation. It meant the Council was not supported by an effective audit committee to address those concerns and to provide independent and proper oversight of the section 130A investigation.

Sections 14.3.3 and 14.3.6 below provide further commentary on the audit committee's failure to perform its legislative functions.

## Conclusion

The Council did not have an effective audit committee between 1 July 2014 and 30 June 2017 as its audit committee did not meet as required by its terms of reference and at the appropriate times to perform its legislative functions and fulfil its reporting obligations to the Council.

I concluded that the Council failed to comply with section 126 of the LG Act.

### 14.3.3 The audit committee failed to provide advice at the Council's request

#### Finding

The Council was first alerted to its poor financial position at its meeting on 11 August 2015. At this meeting, the Council resolved to initiate a section 130A investigation of the efficiency and economy with which it managed its financial resources to achieve its objectives.

On 31 August 2015 the Council resolved that the audit committee:

*... meet immediately and discuss the Council's financial position ...*

*... receive a second and third quote for an efficiency and economic audit or audit decided on by the audit committee and approved by the elected body.*

The Council required the audit committee to determine the terms of reference of the section 130A investigation. This is consistent with the audit committee's functions which include proposing, and reviewing, the exercise of powers under section 130A of the LG Act.

The minutes of Council meetings did not record that the Council received advice from the audit committee on:

- the outcome of its review of the Council's financial position
- the proposed terms of reference for the section 130A investigation
- the independent organisation to perform the investigation.

The then Mayor confirmed that the audit committee did not meet to discuss these matters. Further commentary on the section 130A investigation is provided in sections 14.3.4 and 14.3.5.

## Conclusion

The Council failed to ensure the audit committee provided independent and timely advice on its finances and the financial investigation, both matters being directly relevant to the audit committee's statutory functions. In my view, the audit committee failed to perform its legislative functions and support the Council in exercising its power under section 130A to initiate an investigation process.

I concluded that the audit committee failed to comply with section 126 of the LG Act.

### 14.3.4 The audit committee failed to oversee the section 130A investigation process and outcomes

#### Finding

Section 126(4)(ac) of the LG Act requires an audit committee to propose, and review, the exercise of powers under section 130A of the LG Act. Section 130A(5) of the LG Act requires the audit committee to receive reports on a section 130A investigation.

These legislative requirements require the audit committee to oversee the investigation process and outcome. This is supported by the LGA's 'Financial Sustainability Information Paper 3' on audit committees, revised February 2015, which provides that the audit committee's functions include overseeing any investigation of relevant council activities. The Council reflected this requirement in its audit committee's terms of reference when the audit committee was re-established in November 2016.

The important elements of a section 130A investigation are that it is:

- initiated by the elected body
- performed by an independent and qualified organisation/person without undue influence from any individual elected member, the CEO or council staff
- not an audit of the financial statements and internal controls, which is performed by a council's external auditor.

As mentioned in section 7.4, in my view, the Council acted appropriately to address its concerns with its financial management practices when it:

- initiated a section 130A investigation into the efficiency and economy with which it managed its financial resources to achieve its objectives
- sought advice from its audit committee in relation to the section 130A investigation.

As also mentioned, the audit committee failed to provide timely advice to the Council on the proposed terms of reference of the section 130A investigation.

When the Council did not receive timely advice from its audit committee, based on the interim CEO's recommendation, on 1 October 2015 the Council resolved to set aside its own procurement policy and directly appoint DFK Gray Perry to perform an investigation into the Council's financial structure, position, integrity and reporting.

I found that the Council agenda papers and meeting minutes did not record any further details on the terms of reference for these investigations.

DFK Gray Perry was also engaged to help Council management to implement any recommendations arising from its investigation, as by that time the Council's Finance Manager had resigned.

On 17 November 2015 the Council received reports prepared by DFK Gray Perry and the Vectra Corporation, who undertook a high-level information technology audit. These reports found significant weaknesses in the Council's financial systems, practices and internal controls.<sup>13</sup> While these weaknesses led to inefficiencies, the section 130A investigation did not identify where the Council was not being efficient and economical in managing its financial resources. They did not identify the cause of the Council's poor performance and action that needed to be taken to address the Council's concerns.

The minutes of the audit committee meetings held in 2015-16 did not record that the audit committee had:

- received and reviewed these reports as required by section 130A(5) of the LG Act
- ensured that the intended purpose of the investigation was achieved
- considered whether Council management's responses to the investigation findings were adequate
- monitored Council management's progress in implementing the recommendations.

The investigation process and outcome was relevant to the audit committee's functions. The findings were significant and required the audit committee's immediate attention. The audit committee should have had proper oversight of the investigation process and monitored the timely progress of implementing the recommendations. Thereafter, the audit committee

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<sup>13</sup> The Council's external auditor found many of the internal control deficiencies as part of the Council's controls audit for the year ended 30 June 2015.

should have provided independent assurance to the Council that management was taking appropriate and timely action to address the investigation findings.

As the audit committee had not met since September 2015, the interim CEO and then the acting CEO<sup>14</sup> took control of the investigation process without the proper oversight of the audit committee.

The Council meeting minutes for 19 April 2016 record that the acting CEO updated the Council on management's progress in addressing the section 130A investigation findings. The then acting CEO reported an improvement in the Council's financial governance as a result of the services provided by an external consultant employed by DFK Gray Perry. The then acting CEO discontinued these services in mid-March 2016 to reduce the Council's costs. A further external consultant was subsequently engaged by the Council to provide these services as from May 2016.

Council staff were unable to provide consultancy agreements to support these services. In my view, the audit committee should have overseen the engagement process and the outcomes of the external consultants.

I found the audit committee did not regularly review the implementation of the recommendations of the section 130A investigation and the adequacy of the Council's financial management systems and practices. As a consequence, the audit committee failed to consider and provide independent assurance to the Council on the effectiveness of its internal controls. Further commentary on the certification of internal controls is provided in section 10.3.4.

Further commentary on the Vectra Corporation report is provided in section 15.

## Conclusion

From 1 July 2014, the audit committee did not

- provide advice to the Council on the section 130A investigation.
- oversee the investigation process and implementation of the recommendations to address the findings.
- regularly review the adequacy of the Council's financial management systems and practices
- provide independent assurance to the Council on the effectiveness of its internal controls.

I concluded that the audit committee failed to perform its legislative functions.

I concluded the Council failed to comply with section 126 of the LG Act.

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<sup>14</sup> The Council terminated the then interim CEO's appointment on 15 March 2016 and appointed an acting CEO on 21 March 2016.

### 14.3.5 The audit committee failed to provide advice to the Council on its financial statements for the years ended 30 June 2015 and 30 June 2016

#### Finding

Section 126(4)(a) requires the audit committee to review a council's annual financial statements to ensure that they present fairly its state of affairs.

The audit committee's review and advice on the financial statements should help a council decide whether to adopt and certify the financial statements as required by Regulation 14 of the LG Regulations.

The LGA's 'Financial Sustainability Information Paper 3' on audit committees, revised February 2015, describes what is expected of an audit committee in performing this function. These expectations are consistent with the Australian National Audit Office's 'Public Sector Audit Committees' better practice guide. To perform this function effectively it is expected that the audit committee will:

- review the financial statements and provide advice to the Council before they are certified. It is common practice for an audit committee to meet and discuss the draft financial statements before they are presented to the auditors. In some cases, depending on the outcome of the audit, it may be necessary for the audit committee to review the financial statements again once the audit is completed
- review and challenge, where necessary:
  - the appropriateness of accounting policies and disclosures
  - areas of significant judgements and estimates
  - significant or unusual transactions
  - management's process to certify the quality of the financial statements and internal controls and its approach to maintaining an effective internal control framework
  - the Council's external auditor's findings and opinions on the financial statements and internal controls
  - the appropriateness of Council management's response to audit findings
- ensure it has been provided with sufficient information to understand the Council's financial position and performance to then confidently provide advice to the Council.

I reviewed the minutes of the Council and audit committee meetings held since 1 July 2014 and found that the Council did not follow a logical process that was consistent with the audit committee's functions.



### *Review of the 2014-15 financial statements*

In 2015-16 the audit committee only met once, on 10 September 2015. The minutes of this meeting do not record any reference to the status of the financial statements for the year ended 30 June 2015. I found no documentary evidence that the audit committee had asked management to explain any issues in preparing the financial statements and meeting the legislative requirements or that it had considered the draft financial statements.

The then CEO and then Mayor certified the financial statements for the year ended 30 June 2015 on 9 November 2015 and then again on 15 February 2016. At the Council meetings held on 15 December 2015 and 23 February 2016, the Council resolved for the audit committee to review and comment on its financial statements for the year ended 30 June 2015. As the financial statements had already been certified, any review by the audit committee would have been redundant.

I found the audit committee failed to meet and review the financial statements for the year ended 30 June 2015. These statements were certified without receiving advice from the audit committee.

### *Review of the 2015-16 financial statements*

The audit committee reviewed the draft financial statements for the year ended 30 June 2016 at its 10 November 2016 and 6 April 2017 meetings.

The minutes of the audit committee meeting held on 6 April 2017 report that the audit committee received and noted the draft 2015-16 financial statements.

The minutes of audit committee and council meetings did not report any recommendations to the Council regarding the outcome of the audit committee's review of the draft 2015-16 financial statements.

I found the audit committee failed to provide assurance to the Council that the financial statements presented fairly the state of its affairs and performance prior to certification.

My review of the draft 2015-16 financial statements and relevant documents presented to the audit committee at its April 2017 meeting found that:

- the draft 2015-16 financial statements provided were incomplete and did not include all the notes to the financial statements
- the presentation of the Council's financial position and performance identified significant variances between the original budget and audited actuals. The presentation report stated that significant variances were to be further investigated to explain the reasons for them. My review of subsequent audit committee meeting minutes and papers did not identify any record that the audit committee received explanations prior to the certification of the 2015-16 financial statements
- in considering the financial statements, the audit committee did not receive the Council's external auditor's report of findings and any proposed qualifications of its controls and financial statements. I found this report was provided to the audit committee on 2 August 2017, after the financial statements were certified.

## Conclusion

The audit committee failed to meet and review the Council's financial statements for the year ended 30 June 2015.

The audit committee failed to provide independent assurance to the Council that its financial statements for the year ended 30 June 2016 presented fairly the Council's state of affairs and results of operations.

I concluded that the audit committee failed to perform its legislative functions.

I concluded the Council failed to comply with section 126 of the LG Act.

### 14.3.6 The audit committee failed to provide information relevant to the Council's strategic and annual planning processes

#### Finding

Section 126(4)(ab) provides that an audit committee's functions include proposing, and providing information relevant to, a review of the council's strategic management plans or annual business plan.

It further provides that the audit committee can recommend to the Council to consider a review of its SMPs or annual business plan at any time. The audit committee's recommendation may be prompted by:

- financial information it has considered relevant for the Council to review its SMPs or annual business plan
- its understanding of the legislative timeframes that require review of SMPs
- a specific request by the Council to provide independent advice on relevant matters.

The LGA's 'Financial Sustainability Information Paper 3' on audit committees, revised February 2015, provides that the audit committee has responsibilities to ensure the Council is aware of the impact on its financial sustainability of proposals in its SMPs and annual business plans. The guidance provides that the audit committee should be satisfied there is consistency between the Council's strategic management plans, and that they are based on a sound framework and consider the likely impact on the Council's service levels and standards and its financial sustainability.

The minutes of the audit committee meetings held since November 2014 did not record that the audit committee had reviewed or discussed the Council's SMPs or annual business plans, including annual budgets.

As mentioned in section 7.4, in August 2015 the Council raised concerns about its finances and resolved for the audit committee to review its financial position in addition to the section 130A investigation that was to be undertaken simultaneously. The Council relied on

the audit committee to provide independent and financial expert advice. In my view, this review would have required the audit committee to consider the Council's actual financial performance against its budget and make necessary recommendations to the Council. I found that the audit committee did not respond to the Council's request.

Further commentary on the importance of the audit committee's role in the Council's strategic and annual planning processes is provided in section 13.

## Conclusion

The audit committee did not review and consider the Council's strategic and annual plans.

I concluded that the audit committee failed to perform its statutory functions.

I concluded the Council failed to comply with section 126 of the LG Act.

# 15 Information technology controls impacting financial data

## What I found

My high level review of IT controls over the confidentiality, integrity and availability of the Council's financial data identified:

- a lack of user access controls to the Council's systems and data
- known high risk general IT control deficiencies existed
- limited vendor support contracted to assist the Council.

## What I concluded

I concluded that no control reliance could be placed on the Council's systems to ensure the integrity of the Council's financial data stored and processed within its IT systems.

## 15.1 Introduction

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The Council's IT environment is primarily supported by an external IT company under a two-year contract agreement. At the time of my review this agreement was due to expire in February 2018.

Key IT systems that store, process or transmit council financial data included:

- SynergySoft financial system (also supported by a separate application vendor)
- file server (network drive) which stores some financial data
- network devices (eg firewall), which also allow remote connectivity to financial system data.

### 15.1.1 Definitions<sup>15</sup>

The Council's IT system controls need to ensure adequate protection of the confidentiality, integrity and availability of its data.

**Confidentiality** – Privacy or the ability to control or restrict access so that only authorised individuals can view sensitive information. In effect, access to vital information should be limited only to those individuals who have a specific need to see or use that information.

**Integrity** – Information is accurate and reliable and has not been changed or tampered with by an unauthorised party.

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<sup>15</sup> Taken from <http://ishandbook.bsewall.com/risk/Methodology/CIA.html>, viewed 21 June 2017.

Availability – Information and other critical assets are accessible to customers and the business when needed. Note, information is unavailable not only when it is lost or destroyed, but also when access to the information is denied or delayed (ie information is available on a web site, but the server is overwhelmed by a denial of service attack and no one can access it).

## 15.2 Examination approach

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The focus of my examination of the Council's IT system were the high level information technology controls that could potentially impact the confidentiality, integrity and availability of financial data, with particular emphasis on its integrity.

Between June and July 2017 I requested:

- a listing of all active user accounts and audit logging on the Council's network. This included user accounts that had the ability to remotely access the council network, audit logging settings and password controls
- copies of any security assessments performed over the IT environment
- a copy of the IT service provider contract.

The results of my draft IT control testing were provided to the Council in July 2017.

Although some of the findings I raised may be longstanding, my control testing of the IT information provided can only establish controls at a point in time. Hence my control conclusion does not necessarily reflect the status of IT controls over the last two financial years and subsequent remediation work (if applicable) since July 2017.

## 15.3 Findings

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### 15.3.1 Lack of user access controls to the Council's systems and data

#### Finding

The identified absence of user access controls to the Council's systems and data included user accounts that had the ability to remotely access the Council network.

On 30 June 2017 the IT service provider sent the following details:

- active user account listings, including those accounts that had full administrator access to Council systems
- user accounts that had remote access to the network
- audit logging details.

On 1 August 2017, the IT service provider also sent the following details:

- a listing of users who had their network user account and mailbox (email) disabled since 1 January 2016
- password settings details.

I reviewed this information and found:

- a number of users that had left the Council (including a previous Chief Financial Officer) still had an active administrative access account, remote access to the system still defined and no system audit logging applied to record any access attempts. These former employees could potentially log into the Council's network and either delete or modify financial data without any logging of what was changed
- some legitimate existing user accounts had too much access. In particular, external vendors, apart from the approved IT service provider, had been assigned full administrative access to the Council's network. This included access to all Council documents, such as contracts
- the purpose and owner of some administrative accounts were not known
- audit logging in general was not sufficient to review user account activity
- password control settings could be strengthened. For example, account lockout should be enabled after 3 to 5 incorrect login attempts.

Concerns about user access vulnerabilities were raised by the IT service provider with the Council in the past. This included issues raised in a formal report by Vectra Corporation dated 12 November 2015.

## Conclusion

No control reliance could be placed on the Council's systems to ensure the integrity of financial data within the Council's computer systems while conducting the examination.

When I raised this issue with the Council I was advised that some of the high risk user account vulnerabilities, such as former employees with full access to the system, would be promptly addressed.

### 15.3.2 Known high risk general IT control deficiencies exist

#### Finding

A report from Vectra Corporation, dated 12 November 2015, raised a number of significant IT deficiencies.<sup>16</sup> These deficiencies were impacting both the quality of IT service and security controls over the data that is transmitted, processed and stored on the Council's network.

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<sup>16</sup> My review did not validate the deficiencies highlighted in Vectra Corporation's report.

In response to these issues the Council advised me that many of these known issues could not be remediated due to cost constraints. In particular, resolution of some issues would require new IT infrastructure, such as servers and firewalls.

Until these issues are resolved, the Council is exposed to a number of risks to the confidentiality, integrity and availability of its data.

Since the examination I have been advised that some progress has been made to resolve some of the issues raised several years ago. Despite this progress, Vectra Corporation's follow-up IT control status report, presented to the Council in October 2016, highlighted that a number of high risk control deficiencies remained and identified critical areas of the IT network requiring immediate action.<sup>17</sup> The report noted the following:

- Account security deficiencies – there were gaps in user access controls, with the file server folder structure open to all staff.
- Server hardware and software deficiencies – some production servers are running old hardware and operating systems that are not vendor supported or appropriately patched. This includes the server infrastructure used by the Council's core financial system, SynergySoft. This increases security risks and the potential for system downtime.
- Deficiencies in backup and recovery – although the Council's servers replicated data to a secondary site only one day of backups were kept. Hence long-term backups did not exist. These short-term backups were stored at the same location of the Council's servers. This arrangement limited the ability to fully restore file(s) that have been removed or corrupted over several days.
- Business continuity gaps – in addition to the above backup issues the secondary site does not have enough infrastructure and configuration issues exist. As a consequence, in the event of a disaster at the primary site only minimal services could be kept operational for a short period of time.
- Deficiencies in network security – firewall rules need to be updated to provide better security to block malicious network traffic.
- Internet access drops out and is slow – the Council's internet is used in many areas of the District. This includes the Library for public use and the Airport. This internet service was slow, with drop outs experienced. Although this does not impact the integrity of financial data it does impact its availability, the provision of services by Council staff and the ability of data to be backed up to the secondary site.

The IT support provider advised me on 1 August 2017 that the deficiencies identified in the second report 'were impacting both the quality of IT service and security controls over the data that is transmitted, processed and stored within the council network. These deficiencies are impacting the Council's core business activities ...'.

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<sup>17</sup> My review did not validate the deficiencies highlighted in the updated Vectra Corporation report.

The IT support provider also stated that as a consequence they 'could not guarantee a continued network operation because of interruptions and break downs in equipment within the IT network'. Since October 2016, the IT support provider indicated that known breakdowns in network operations have occurred.

I could not determine whether these known issues were being highlighted to appropriate Council forums at the time, with any residual risks approved and monitored (such as formal Council risk registers.)

## Conclusion

Until resolved the confidentiality, integrity and availability of financial data remains exposed to a number of high risk vulnerabilities and network disruption.

### 15.3.3 Limited vendor support contracted to assist the Council

#### Finding

At the time of my review the Council had contracted an external specialist IT service provider under a two-year contract agreement to help it manage its IT environment. This agreement was due to expire in February 2018.

The overall objective of the IT support contract was to:

- ensure maximum possible service continuity (ie reduce outages)
- minimise time for Council staff to spend running the IT environment
- maintain the security of the IT infrastructure, through the installation of critical and recommended patches
- provide a secure environment for computer workstations, protected from viruses, spam and malware
- provide a single helpdesk number to log requests for IT infrastructure assistance.

Under the arrangement most IT support was conducted remotely as the IT service provider did not have a physical onsite local presence. On occasions the IT service provider would send its personnel to Coober Pedy.

The contract included provision for general infrastructure monitoring, antivirus, malware and spam protection, backup replication and reporting. However due to cost constraints its 'extra support hours' was limited (six help desk support hours per month, one full day and two half day onsite visits per quarter). Support beyond this contract allocation required extra payment from the Council.

Council representatives and the IT support provider advised me that due to funding issues the Council had not engaged the IT support provider to resolve the many known IT vulnerabilities. This would incur additional service contract costs and would also require the purchase of new IT hardware and software.



The IT support provider indicated that numerous known breakdowns in network operations have occurred since October 2016. In the course of the examination I also noted on many occasions the Council's email system was not available, impacting my communication with Council staff.

I did not follow up the IT contract arrangements after February 2018. The objective of testing the IT controls at the commencement of the examination was to provide assurance of the integrity of the financial data provided by the Council at the time of my information gathering process.

## Conclusion

The known Council IT vulnerabilities heightened the risk of network disruption. Remediation of these network breakdowns were considered out of scope to the support managed service contract and hence incurred additional fees.

# 16 Policies, practices and procedures of internal controls

## What I found

The Council was unable to provide any documented policies and procedures of internal controls to support key account balances and finance functions.

The Council was unable to provide evidence that reconciliations of its subsidiary ledgers to the general ledger, a significant control procedure, were performed as at 30 June 2014, 2015, 2016 and 2017.

## What I concluded

The Council has not implemented and maintained appropriate policies and procedures of internal control to ensure the accuracy and reliability of its accounting records.

The Council has not performed significant or adequate control procedures to ensure the accuracy and reliability of its accounting records.

The Council failed to comply with section 125 of the LG Act.

## 16.1 Introduction

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### 16.1.1 Purpose

This section considers whether the Council implemented and maintained adequate policies and procedures of internal controls to support the accuracy and reliability of its accounting records. The obligation to implement and maintain policies and procedures of internal controls is established by section 125 of the LG Act.

In this context, policies and procedures should aim to:

- establish the Council's expected accounting and financial management practices
- ensure correct and consistent accounting treatments are applied across the years
- ensure the accounting system is operating effectively
- ensure accurate and reliable accounting records are maintained to prepare various financial reports
- capture and retain corporate knowledge of financial arrangements and accounting operations
- ensure the continuity and quality of the finance function after staff turnover.

## 16.1.2 Relevant law

Section 125 of the LG Act requires councils to implement and maintain appropriate policies, practices and procedures of internal controls to:

- assist the council to carry out its activities in an efficient and orderly manner to achieve its objectives
- adhere to management policies
- safeguard the council's assets
- secure (as far as possible) the accuracy and reliability of its records.

Section 125 of the LG Act does not specify the nature of the internal controls or the form of a council's policies, practices and procedures. Instead it emphasises the objectives to be met and the qualities to be supported by a council's internal controls.

Although the LG Act does not require councils to document their policies, procedures and practices, in my opinion the requirements of the LG Act cannot be met without some level of documentation. Without this, it is not possible, in my opinion, to define and communicate to relevant council officers, with clarity, what a council's policies, practices and procedures are or to evidence that they are authorised by the council.

## 16.2 Examination approach

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The examination included procedures to understand and evaluate the adequacy of the Council's documented policies and procedures of internal controls for ensuring the accuracy and reliability of its accounting records.

I sought to obtain evidence that significant or adequate control procedures had been performed. I also considered the outcomes of work performed, during the period of interest of examination, by the Council's external auditor and DFK Gray Perry. As noted elsewhere, these reviews have the advantage of having been prepared by experts engaged by the Council for purposes relevant to the examination. They also provide contemporary insights into the Council's position at a point in time and before key Council staff left the organisation.

I sought to place primary reliance on information I obtained directly while using the insights I gained from considering the work of other parties and the Council's own evaluation to corroborate and test my findings.

## 16.3 Findings

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### 16.3.1 Lack of documented policies and procedures

#### Finding

I requested Council staff to provide me with copies of documented policies and procedures

of internal control supporting the following account balances and finance functions:

- rates
- user charges – water sales
- user charges – electricity sales
- payroll
- fixed assets.

In response the Council was only able to provide a copy of its rates revenue rebates policy.

## Conclusion

My findings support an assessment that the Council has not implemented and maintained comprehensive and appropriate policies and procedures of internal control to ensure the accuracy and reliability of its accounting records.

As a consequence, I concluded the Council failed to comply with section 125 of the LG Act.

### 16.3.2 The Council had not performed significant accounting control procedures

#### Finding

I asked Council staff to provide evidence that significant accounting control procedures, which supported the accuracy and reliability of its accounting records, were performed. The control procedures I sought to evaluate were the reconciliation of the following subsidiary ledgers to the general ledger for years ending 30 June 2014 to 30 June 2017:

- rates revenue
- electricity sales and debtors
- water sales and debtors
- fixed assets
- provisions – employee leave liability.

The subsidiary ledgers selected for evaluation recorded material financial activity and account balances. In the usual course, the control procedures provide specific assurance that transactions were reliably processed to the general ledger and account balances recorded in the general ledger, and subsequently in financial reports, were accurate.

I consider that effective implementation of these control procedures requires that they are:

- performed regularly to identify reconciling items and to support timely corrective action if required
- appropriately documented to enable independent review and to provide a basis for future reconciliations.

Council staff were unable to provide me with any documentation evidencing that any of the above reconciliations were performed as at 30 June 2014, 2015, 2016 and 2017.

## Conclusion

My findings support an assessment that the Council has not performed significant or adequate control procedures to ensure financial transactions were accurately and reliably recorded in its accounting systems and recorded account balances were accurate. The Council did not maintain appropriate internal control procedures to ensure the accuracy and reliability of its accounting records.

As a consequence, I further concluded the Council failed to comply with section 125 of the LG Act.

### 16.3.3 Assessment of the Council's controls by other parties

#### DFK Gray Perry review

In October 2015 the DFK Gray Perry review found a lack of formal internal control and operating policies and procedures to ensure the Council's records are accurate and reliable and financial functions are performed correctly and efficiently.

#### External auditor's review

The Council's external auditor raised significant issues in its report of audit findings for the year ended 30 June 2015. These issues included:

- key reconciliations were not performed, including reconciling the general ledger to LGFA borrowing statements
- the cash at bank reconciliation did not balance
- the Council's record keeping was ad-hoc and important supporting documentation was not readily available.

The external auditor reported that, if an audit opinion on controls was required, it would have issued an opinion that the Council had not complied, in all material respects, with section 125 of the LG Act.

Some issues were still outstanding in 2015-16 and the Council's external auditor's opinion on the Council's controls for the year ended 30 June 2016 stated:

*... the Council has not complied, in all material respects, with Section 125 of the Local Government Act 1999 in relation to internal controls, established by the Council in relation to the receipt, expenditure and investment of money, acquisition and disposal of property and incurring liabilities ...*

I note that the Council's external auditor reported that:

- the control matters were considered material weaknesses in the Council's internal controls and non-compliance with section 125 of the LG Act

- some key reconciliations were performed regularly from October 2015
- the Council had policies and procedures in place, however they did not appear to be complied with.

As mentioned in section 3.4, the Council's external auditor also determined that the Council continued to have significant deficiencies in its internal controls for 2016-17. These deficiencies were described as being due to an absence of policies, procedures and robust internal controls.

## Conclusion

DFK Gray Perry's and the Council's external auditor's assessment of the Council's controls are consistent with my findings. The assessments support my view that the Council did not maintain appropriate internal control procedures to ensure the accuracy and reliability of its accounting records.

### 16.3.4 The Council's own assessment as communicated to the Minister

The Council's progress reports provided to the Minister between 6 October 2015 and 15 August 2017 reported that:

- there was emerging evidence that there was no integrity in the Council's financial systems, functions and operating procedures
- the Council's financial general ledger did not balance and may not have balanced for some time (prior to October 2015)
- the dysfunctional accounting system and poor reconciliation processes led to the delay in completing the 2015-16 financial statements.

The Council advised the Minister of its planned strategies to address these issues, which included an internal financial control framework, and a policies and procedures upgrade.

The Council's then CEO advised me in a letter dated 17 January 2018 that the project to upgrade the internal financial control framework, policies and procedures had stalled.

## Conclusion

The Council's assessment of its internal controls supports my view that it did not maintain appropriate internal control procedures to ensure the accuracy and reliability of its accounting records.

## 17 Other observations

### 17.1 Failure to document the appointment of the acting CEO

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#### Finding

Section 96 of the LG Act requires a council to have a CEO. Section 98 provides the appointment procedures when there is a vacancy in the office of CEO and requires a council to appoint a person to act in the position of CEO until the vacancy is filled.

The Council authorised the then acting Mayor to appoint an acting CEO on 7 September 2015. The council's meeting minutes for 15 September 2015 record that the Council:

- confirmed the appointment of the interim CEO effective from 9 September 2015
- determined, consistent with the remuneration of previous CEOs, that the interim CEO's remuneration would be \$3150 per week, plus GST, superannuation, travel, accommodation and hospitality.

The interim CEO was employed from 9 September 2015 to 15 March 2016.

I asked Council staff to provide me with the interim CEO's employment contract to understand the terms and conditions of his employment. A copy was unable to be provided.

An email dated 8 September 2015 between the then Mayor and the then interim CEO recorded that the interim CEO was to draft a formal agreement for the Council to consider and adopt. Council meeting minutes and agenda papers do not record that the Council ever received and considered this formal agreement. In the course of the examination the then Mayor confirmed that there was no employment contract.

I found that the interim CEO's remuneration payments were made to an entity associated with him named Cerca Trova on receipt of tax invoices that attracted GST. The invoices were approved for payment by either the then finance officer or the then acting Finance Manager. These payments were disclosed under materials, contracts and other expenses in the notes to the audited financial statements. Council staff were unable to:

- provide me with a copy of the contract between the Council and Cerca Trova
- explain why the interim CEO's remuneration was paid to Cerca Trova.

The Council meeting minutes for 15 September 2015 did not record any rationale or discussion as to why a statutory appointment would attract GST.

The Council meeting minutes for 15 March 2016 record that the Council terminated the engagement of Cerca Trova, and specifically the provision by that entity of the interim CEO, a partner in that business.

The office of CEO is a statutory appointment, a position held by a person under section 98 of the LG Act. On appointment, the CEO is required to perform the role and functions required by section 99(1) of the LG Act. This includes ensuring that lawful decisions of the council are implemented in a timely and efficient manner and providing advice and reports to the council on the exercise and performance of its powers and functions.

The then interim CEO failed to draft a formal agreement for the Council to consider and adopt to support its decision to appoint him.

The Council failed to follow up the status of this agreement and ensure that the interim CEO's appointment was supported by an employment contract with terms and conditions that were consistent with its decision.

Council staff made the interim CEO's remuneration payments to an entity associated with him without the authority of a Council decision or any signed contractual arrangements.

## Conclusion

I concluded that the Council failed to comply with section 124 of the LG Act by not keeping proper accounting records to adequately explain the terms and conditions of the interim CEO's employment arrangements and the basis of the payments it made to Cerca Trova.



# Appendix 1 – The Treasurer’s request

The Hon Tom Koutsantonis MP  
Member for West Torrens



Government  
of South Australia

TRS17D0549

Mr Andrew Richardson  
Auditor-General  
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Treasurer  
Minister for Finance  
Minister for State  
Development  
Minister for Mineral  
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minister.koutsantonis@sa.gov.au

Dear Mr Richardson *Andrew,*

## **Request under section 32(1b) of the *Public Finance & Audit Act 1987* to examine the accounts of the District Council of Coober Pedy**

Section 32(1) of the *Public Finance and Audit Act 1987* (PFA Act) provides that you may examine the accounts of a publicly funded body and the efficiency and economy of its activities. The District Council of Coober Pedy (the Council) is a council constituted under the *Local Government Act 1999* and is therefore a “publicly funded body” under the PFA Act.

Section 32(1b) provides that you must conduct such an examination if requested to do so by me.

In accordance section 32(1b), I am writing to you to request that you examine the accounts of the Council under subsection 32(1)(a) of the PFA Act.

### *Background*

To provide context to this request, I note that I have been made aware of the following background.

The Office for Local Government (OLG) has for some time now been in communication with the Council regarding its financial position and financial management practises.

Of particular concern is the apparent large adverse variance between the actual and budgeted financial results for the last two financial years.

In continuing correspondence with the OLG, the Council has emphasised that it is continuing to address these financial governance problems.



However, the Council has recently confirmed that a number of financial reporting requirements under the *Local Government Act 1999* and the *Local Government (Financial Management) Regulations Act 2011* have still not been met.

These shortcomings include the failure to provide the Minister for Local Government, audited financial statements for 2015-16 within the statutory timeframe.

In the absence of the 2015-16 audited financial statements, the overall financial position of the Council is not clear. However, the Office for Local Government has been informally advised that the audit will reveal significant levels of debt and a significant operating deficit for 2015-16.

If you require further information regarding this request, please contact Mr Kevin Cantley, Executive Director, Public Finance Branch at [kevin.cantley@sa.gov.au](mailto:kevin.cantley@sa.gov.au) or on telephone 8226 9401.

Yours sincerely



**Hon Tom Koutsantonis MP**  
Treasurer

/ May 2017

cc: Minister for Local Government

## Appendix 2 – Correspondence between the Minister and Council

The table below lists key correspondence between the Minister and the Mayor and/or CEO of the Council.

Date	Details
8 September 2015	<p>The Minister wrote to the then Acting Mayor about advice he had received that suggested a cause for concern for the Council’s future operations and the effective management of Council operations. The possible need for Ministerial action in the future. The letter outlined the following issues:</p> <ul style="list-style-type: none"> <li>• The Mayor’s resignation, less than 10 months into a four-year term.</li> <li>• The Council terminated the CEO’s contract, less than three months into a contract.</li> <li>• Some concerns regarding financial management, however not formally reported.</li> <li>• A lack of evidence that the Council’s Audit Committee had met since the new Council was elected in November 2014.</li> <li>• Difficulties in achieving regular attendance of members at council meetings.</li> <li>• Resignation of one councillor and the reported resignation of another two councillors.</li> </ul>
21 September 2015	<p>The then Acting Mayor wrote to the Minister on the progress of the Council’s activities, including:</p> <ul style="list-style-type: none"> <li>• the appointment of an interim acting CEO</li> <li>• formal review of the Council’s financial services had commenced with reports on the Council’s current financial position and an initial financial model</li> <li>• preparing for an independent legislative compliance audit, including a review of policies and procedures.</li> </ul>
1 October 2015	<p>The then Acting Mayor wrote to the Minister on the progress of the Council’s activities, including that the Council:</p> <ul style="list-style-type: none"> <li>• had developed an initial plan to mitigate the defects present at the Council</li> <li>• was in the process of developing a comprehensive and wider reaching plan around the structural integrity of the council’s operations.</li> </ul>

6 October 2015	<p>The then Acting Mayor wrote to the Minister on the progress of the Council's activities which included some matters the elected body had not been aware of:</p> <ul style="list-style-type: none"> <li>• The Council had not lodged a BAS for four months and was in default with the ATO. The interim acting CEO had negotiated special arrangements for the settlement of outstanding debts.</li> <li>• The Council paid annual and sick leave to some employees without any entitlements.</li> <li>• The Council was told the application for the disaster recovery funding was submitted when in fact it had not been.</li> <li>• The Council's initial findings of the legal compliance audit suggested long-term and systemic non-compliance with the LG Act.</li> <li>• There was emerging evidence there was no integrity in the Council's general ledger and subsidiary ledger systems, functions and operating procedures.</li> </ul>
24 October 2015	<p>The Minister wrote to the then Acting Mayor to request that future information be provided to the OLG. OLG would keep the Minister fully informed of the Council's ongoing activities and results of a review of its financial management and governance processes and procedures.</p>
4 August 2016	<p>The Acting CEO raised concerns about the Council's financial position and performance with the OLG. In response the Minister wrote to the then Mayor requesting the following information in line with section 271A of the LG Act:</p> <ul style="list-style-type: none"> <li>• The 2014-15 report on financial results required by Regulation 10, of the LG Regulations.</li> <li>• An explanation for all material variances between actual and budgeted financial results for 2014-15 and 2015-16.</li> <li>• The Council's commitment to achieve and maintain future financial sustainability by achieving at least an operating break-even result each year.</li> <li>• Clarify the Council's loan activity between November 2015 and January 2016 and provide relevant documents.</li> </ul>
31 August 2016	<p>The Council's advisor and former Acting CEO advised the Minister that:</p> <ul style="list-style-type: none"> <li>• the Council remains unified and committed to implementing the financial strategy in the 2016-17 annual business plan under the new CEO's leadership. This included to: <ul style="list-style-type: none"> <li>— undertake a significant service review to quantify savings and determine the future service levels</li> <li>— delay non-essential capital renewal expenditure and no new capital construction</li> <li>— undertake service cost reviews to ensure costs are fully recovered</li> </ul> </li> </ul>

	<ul style="list-style-type: none"> <li>— implement project plans to ensure key projects are delivered and project reporting is improved</li> <li>• a report on the 2014-15 financial results as required by Regulation 10 of the LG Regulations was not prepared</li> <li>• sufficient detailed working papers to understand the assumptions to formulate the Council's 2014-15 and 2015-16 annual budgets were not available. Given the final reported result, the assumptions used were not realistic and the budget was not of a reliable robust nature</li> <li>• the forecast for 2015-16 included in the 2016-17 budget is a high level estimate and was not supported by detailed estimates at the individual departmental level</li> <li>• three different management teams had worked on the general ledger throughout 2015-16. There were issues with the accuracy of allocation to revenue and expenses. Also the Council's trial balance was not reconciled to source documents when the 2016-17 budget was prepared</li> <li>• the Council's net debt was \$6.4 million as at 12 April 2016.</li> </ul>
7 October 2016	<p>The Minister wrote to the then Mayor in response to the information provided in the Council letter dated 31 August 2016 and a briefing from the then Acting CEO in July 2016.</p> <p>The Minister:</p> <ul style="list-style-type: none"> <li>• commended the Council's financial strategy and commitment to implement</li> <li>• recognised the difficulty of making hard decisions to reduce or discontinue some services</li> <li>• emphasised the need for elected members to: <ul style="list-style-type: none"> <li>— recognise that they are accountable for the Council's long-term financial sustainability</li> <li>— commit to managing risks in the administration of ratepayer funds. The Minister understood that poor management practices of the electricity supply function had caused significant problems. The Minister encouraged the Council to consider alternative electricity supply arrangements</li> </ul> </li> <li>• the CEO and senior managers are aware that the policy advice they provide and the systems, plans and processes they put in place are focused on achieving and maintaining financial sustainability.</li> </ul>
3 February 2017	<p>The then CEO wrote to the Minister on the Council's progress to rectify its issues. The then CEO advised:</p> <ul style="list-style-type: none"> <li>• improvements needed to the Council's financial governance function have been prioritised and summarised in the Finance Function Action Plan</li> </ul>

	<ul style="list-style-type: none"> <li>• the Internal reporting system upgrade and strategic reporting projects are well under way, including a complete new chart of accounts</li> <li>• asset revaluations were required in 2016-17. This data will be used to compile meaningful LTFP and asset management plans</li> <li>• the 2015-16 financial statements were nearly complete with amendments to the comparatives. It was anticipated that the Council’s external auditors would issue a qualified opinion on the financial statements and controls</li> <li>• the Council appointed an audit committee advisor who re-established the audit committee and is responsible for providing local government advice at meetings. They are also responsible for the audit committee work program</li> <li>• it is anticipated that the following reports will be presented at the Audit Committee meeting held on 2 March 2017: <ul style="list-style-type: none"> <li>— a report on the revised forecast of operating and capital investment activities compared with the budget for 2015-16</li> <li>— a report on the revised forecast of each item in the budgeted financial statements compared with the annual budget for 2015-16</li> <li>— the 2015-16 financial statements</li> <li>— a report comparing the audited financial results to the budget for 2015-16.</li> </ul> </li> </ul>
16 March 2017	<p>The Minister wrote to the then Mayor that he:</p> <ul style="list-style-type: none"> <li>• noted the Council had taken some steps to address financial governance problems. However, he was extremely concerned that several statutory requirements had not been met and no time frames had been provided</li> <li>• required Council to rectify the statutory shortcomings. If this did not occur, he would need to consider exercising his powers under Chapter 13 Part 3 of the LG Act.</li> </ul>
7 April 2017	<p>The then Mayor wrote to the Minister to advise:</p> <ul style="list-style-type: none"> <li>• the elected members had noted the Minister’s concerns and assured the Minister that they were monitoring Council management’s progress to implement the required improvements to the Council’s financial governance, reporting and systems</li> <li>• Council management have been requested to continue relating with the OLG on Council’s progress</li> <li>• the elected members would appreciate the opportunity to discuss matters with the Minister before he exercised his powers under the LG Act.</li> </ul>

7 May 2017	<p>The Minister wrote to the then Mayor to advise that he had spoken to the Treasurer about his concerns. The Treasurer informed the Minister that he had instructed the Auditor-General to conduct an examination of the Council's accounts under section 32(1)(b) of the PFAA.</p>
15 August 2017	<p>The then CEO wrote to the Minister to provide an update on its financial performance. The then CEO advised:</p> <ul style="list-style-type: none"> <li>• improvements in the 2016-17 financial performance of a reduction in operating deficit of \$2.9 million and net financial liabilities of \$1.3 million</li> <li>• forecasted improvements in 2017-18 of a further reduction in operating deficit of \$470 000 and net financial liabilities of \$799 000</li> <li>• the improved financial results are due to successful implementation of the financial strategy</li> <li>• the 2016-17 statutory reporting requirements were not met due to: <ul style="list-style-type: none"> <li>— continued staff turnover in 2016-17 leading to inexperienced staff being forced to undertake the work</li> <li>— insufficient resources employed to deliver the finance function</li> <li>— a completely dysfunctional accounting system</li> <li>— an inadequate IT system</li> </ul> </li> <li>• it is anticipated the Council will meet the requirements of Regulation 10 of the LG Regulations and section 127 of the LG Act for 2016-17</li> <li>• the external auditor issued a qualified opinion on the 2015-16 financial statements</li> <li>• the Council incurred significant liabilities during 2014-15 and 2015-16 to fund operating deficits resulting from the provision of services at a level it could not afford, poor management practices and ineffective internal controls. This led to inefficiency in service delivery, overstaffing and general waste of money</li> <li>• the incurring of debt proved to be extremely unsatisfactory from a financial sustainability perspective as there was no plan as to how the long-term debt would be repaid and the loans was spent on non-income producing short-term operating services</li> <li>• it was now clear to elected members that due to the lack of reporting and poor management practices these issues were not apparent to them at the time it was occurring.</li> </ul>

# Appendix 3 – Full copy of the Council’s response to my Report (Some names and contact details have been redacted)



## District Council of Coober Pedy

PO BOX 425 COOBER PEDY SA 5723  
COUNCIL OFFICE (08) 86 724 600  
FAX (08) 86 725 932  
Email: [dcep@cpCouncil.sa.gov.au](mailto:dcep@cpCouncil.sa.gov.au)

Andrew Richardson  
Auditor General  
Level 9  
State Administration Centre  
200 Victoria square  
Adelaide 5000

Dear Auditor General

### RE EXAMINATION OF COOBER PEDY ACCOUNTS

Please find attached the District Council of Coober Pedy’s response to your report. In responding the council wished that I highlight that the current council supports the general findings of the report and have expressed concerns raised by the Acting Mayor through the formal council meetings dating back to 2012. The council have also expressed the view recently that a degree of political independence is required to strategically put the council on a path to financial stability. Whist staff with council’s imprimatur are implementing programs and systems to address over the long term resolution of these issues the position has now been reached where a close relationship with a sympathetic government is required. For that reason we seek a rapid response to our submission and referral to parliament such that the minister can make a rapid response to appointing an administrator ,

  
Colin Pitman  
Acting CEO



# RESPONSE TO THE AUDITOR GENERALS REPORT ON COOBER PEDY COUNCIL

## INTRODUCTION

The council have now received two reports of significance. The first, from the Ombudsman. The council have responded publically to the minister of Local Government on the Ombudsmans report. It is important to note that the concluding response to the Ombudsman's report was predicated on a detailed report from the Ombudsman for which council provided a submission;

The council's final response was

**Moved:** Cr A McCormack

**Seconded:** Cr P Reynolds

### **SC20180927**

- 1. That the Council adopts the attachment as a response to the defence to the findings and accuracy of the Ombudsman's report.**
- 2. And consider as an alternative to a popularly elected council an amendment to the conclusions as follows**
  - "5. That the council advise the minister that it supports the appointment of an administrator for the reasons mentioned in the attached report "**

**CARRIED UNANAMOUSLY**

The council is now in receipt of the final version of a report from the Auditor-General. The report was initially first received on 17 September 2018, and written response relating to factual errors and inaccuracies report was made in October 2018. The following is in response to the final version of the report.

### **Historical Context of Councils Reponse**

**It is important to note that a group of concerned councillors brought to the notice of the government their concerns in 2015/16 in relation to the financial administration of the council over a period of years. They were seeking government intervention to resolve the perceived financial problems at the council a copy of the communication from the minister of local government is attached as attachment C**

**Council submit that they are concerned that the attachments which acknowledge the concern expressed by the council and in particular the now acting mayor at the time was not acted upon but was referred we believe to the then attorney general and time was wasted in not urgently responding to the councils concerns**

**Taking each item in attachment C individually the council wish to make the following comments**

- Paul Athanasiadis by way of motions at a council meeting on the 16<sup>th</sup> sept 2015 brought to the notice of the council the financial mismanagement of loan borrowings taken out without approval of council
- The CEO [REDACTED] gave the impression that all was satisfactory with the councils financial management and for an inordinately small fee gained council approval to undertake a financial audit which was to be granted to an ex colleague [REDACTED] The financial assessment was not thorough
- at the meeting of council on the 28<sup>th</sup> June 2016 Paul Athanasiadis again pursued the matter of the councils compliance with the accounting regulations and a staff member and [REDACTED] councils accountant assured the council of compliance contrary to the fact that all was not well financially
- the successive auditors over this period and the accountant should have divulged the state of the councils financial position
- That minister Geoff Brock in his correspondence with the council through Mayor [REDACTED] dated the 20<sup>th</sup> of august 2016 new of the financial condition of the council after council brought it to his notice and did not act
- Numerous other instances where reports were made to investigative bodies and ombudsman,s reports of maladministration of a financial nature can be identified going back to 2012 which were reported to other investigative bodies were not acted upon by governments of the day

## **Introduction**

The response to the Auditor-General's report below follows the order of the issues raised in the report. The response abbreviates the issues raised by the report and responds to them. As a preface to the response, council has no argument with the broad thrust of the report and is in general agreement with the report's content.

### **1.2.1**

1. The current level of accumulated indebtedness, including unpaid rates, water, sewerage and electricity bills owed to the council, is extremely high.

## **Response**

There has been cumulative debt over the period of the report which reflects to some extent the lack of due diligence in seeking to recover the debt and the general inability of council to recover the debt because of the socio economic aspect of a section of the community. Many in the community use the hardship clauses of the councils policy as a shield to meeting their financial responsibilities. The current council accepts the reduction in debt is slow and intends to elevate the debt repayment through further service level reductions and further austerity programs and a generally compassionate but firm response to community debt recovery. Operating grants such as the recent \$1million grant over 5 years for child care and the recently approved long outstanding Natural Disaster grant of \$4.7 million for a 2016 flood, a portion of

which relates to the operating expenses already incurred, will go some way to limiting the short term exposure

Tenders for a new debt collection agency have been called and let. Kemps have been appointed in a positive attempt to recover some of the debt.

THE RAES subsidy is not designed to meet the hardship debt and some assistance in covering this debt is required.

On a positive note council has continued to service its short and long-term debt and current long-term debenture commitments progressively reduce until they are extinguished in 2024. However, any significant increase in interest rates will place a strain on council's limited financial resources as the council's short-term debt level comprises the bulk of its indebtedness.

2. The council's financial performance was inadequate

#### **Response**

The council agrees that over the reporting period 2011 to 2016 planned responses to improving financial performance were not implemented. This is in part due to recommitted unaffordable services not being constrained and the identified errors in the RAES funding arrangements where council received payments to which it was not entitled. Attachment A to this report shows the recent reconciliation of the RAES account by council and RAES staff. The summary differs considerably with that reported in the Auditor-General's report

It should be noted that a draft LTFP is almost complete and the development of the new strategic plan is proposed for the new council in December and early New Year as a lead up to budget presentations in March. This work will be presented to the audit committee and council early in the New Year. This document will highlight the strategy towards a reduction of debt in a manner that addresses council's strategic operating priorities and the required reductions in services over the short, medium and long term.

3. The councils accounting system and records are clearly inadequate. Reference is made to rectification later in this report and responded to below.

#### **1.2.2**

1. The accounting records remain in a state similar to that t which existed before

2016. However the annual financial plan which is the first year of the LTFP has been prepared within the context of the council's financial position

#### **Response**

**The following actions have been initiated in the last 3 months;**

\* The Long Term Financial Plan (LTFP) has been completed in draft form and will be presented to the new council and or administrator.

\* The production of the Asset management plan has been initiated by the acquisition of the asset management planning software (NAMS Plus) recommended by the peak body for local government engineering, IPWEA, and the engagement of one of the original developers of the NAMS templates to guide the council through the process.

\* The budget has been prepared in accordance with the local government accounting regulations and presented twice to the audit committee and council for review and adoption. The budget reflects full cost allocation of overheads and allocation of depreciation costs not fully allocated previously.

\* The risk management plan is being prepared and will be presented to the audit committee and the council or administrator.

\* An experienced local government financial consultant and a new financial manager have been engaged to facilitate the introduction of a contemporary internal control framework and the completion of this task is a high priority in the next 6 months.

2. Council failed to comply with the state records act. **Response**

**A records manager has been engaged to introduce a systematic approach to financial record keeping. The non-financial records system is generally being implemented well. Further work is necessary to improve financial record keeping, including the introduction of a new chart of accounts and better utilisation of the council's financial management information system.**

3. Internal control is unsatisfactory

**Response**

**See comment above.**

4 The meetings of the audit committee have been poor over the reporting period. **Response**

**The audit committee did not meet on a regular basis or carry out its responsibilities Even after the 2016 financial year.**

**Audit committee meetings are now being held accordance with the Act with two audit committee meetings held recently and the adoption of a resolution requiring the preparation of a draft audit committee work plan for the next audit committee meeting**

5. The Council have not reviewed its strategic management plan since the end of the 2016 reporting period.

**Response**

**Council agrees with the Auditor-General's findings.**

**Comments have been made above on current actions to ensure that the council brings its strategic management plans up to date. Council will take action to comply with the relevant provisions of the Act to maintain its strategic management plans in the future.**

6. The council have failed to report its financial position since the 2016 completion of the audit report.

**Response**

**The council agrees with the Auditor-General's findings.**

**The 2017/18 financial statements are currently under preparation, unfortunately later than planned due to the loss of a key member of the finance team.**

**A fully detailed up-to-date financial report will be prepared for council or the administrator and for a budget review before the end of the 2018 year. Work is underway to update the financial management information system with the current budget and to provide monthly management reports to managers.7. Failure to prepare reports comparing audited financial results with budgets**

**Response This is acknowledged and agreed**

8. Failure to prepare financial statements on time.

**Response**

**This is acknowledged by council**

**Likewise the financial statements for 2016/17 were only recently completed with a remarkable turnaround from the previous financial year from a deficit of \$3.8 million to an audited deficit of \$54,000 – This result was aided by the prepayment of \$370,000 of FAGS funding by the Commonwealth.**

1.2.3 The council's financial position is not sustainable

**Response**

**1. The council agrees that the financial position of the council is unsustainable. This position is supported irrespective of the financial improvements in 2016/17. The financial position for 2017/18 is likely to be a deficit of approximately \$1 million offsetting many of the timely gains made in the previous year. Council's low rate base, past poor financial decisions, significant debt level and almost zero ability to raise other funds mean that the way forward is bleak.**

**2. Financial management practices across the organisation have not been maintained at an appropriate level and the lack of an internal control framework that includes regular management reporting and efficient and sustained efforts to collect moneys due has exacerbated the problems. Steps are being taken to improve the council's financial management as referenced above but they will take time to implement and have an effect.**

3. The accounting records were poor during the period

**Response this is supported by the council**

**See comments above.**

4. Maintenance of accounting records relating to RAES funding was poor

**Response**

**The calculation of the RAES adjustments has been revisited by RAES and council staff and a deficit of \$0.5 mill has been agreed. 4. Council Failed to Recover Debt in a timely manner**

**Response:**

**See comments above. Debt recovery is a complex issue as it runs across three functions as mentioned earlier in the response to the report.**

**the report needs to be taken into account that Coober Pedy is one the poorest community townships in the state, with a high percentage of poor families, The**



hardship policy and the ESCOSA rules present a significant challenge to collect all outstanding amounts and arrangements to pay are often not adhered to with outstanding payments quickly escalating beyond the individual's capacity to pay.

5. The provision of water and power services was not resourced by qualified staff

**Response.**

The council have considerable difficulty in retaining qualified staff .To resolve this the current administration have retained specialist staff under contract in the short term. This is not sustainable. To resolve this the financial specialist services have been given defined tasks to facilitate support in setting up for water and power charges which reflect full cost recovery with no subsidisation .However on the power front there is a considerable gap between the RAES position on overhead charges compared with that of the council. Recovery of overheads is only for the proportion of the cost incurred compared with water services which are now close to full cost recovery levels.

#### **1.2.4 Deficiencies in Governance**

##### **1. Risk Management**

Council does not have a risk management plan

**1. See comments above.**

2. The audit committee's role is not properly documented

**Response.**

**See comments above.**

3, the governance arrangements have been poor and strategies to resolve the issue have lacked regular process.

**Response**

A Council diary (calendar) of requirements has now been prepared to provide management with guidance on what is required on a monthly, quarterly, annual and ad hoc basis to comply with the Local Government Act and Regulations and council policies. This diary includes actions related to the council's strategic plans, rating, budgeting, annual planning, personnel practices, and financial management and reporting. When the internal control framework is completed it will be expanded to include the requirements for monthly reconciliations.

4. THE council lacked stable and effective leadership

**Response;**

The council concedes there was a lack of stable and effective leadership .The council also concedes to some extent stable leadership is still not in place however the council have undertaken the following

- They have employed professional engineering and accounting staff
- \* An experienced CEO is in charge and is acting CEO due to the recent resignation due to ill health of the incumbent and the

uncertainty relating to the governance of the organisation after the Ombudsman's report was released

- The appointment of a permanent CEO was constrained by the delayed formal resignation of the CEO and the council elections where restrictions on such appointments is not permitted during the caretaker period
- The council have employed professional OHS staff
- The council have employed local Sub professional accounting staff
- THE council have employed professional records management staff
- Professional contract accountants risk managers and asset management staff have been engaged.

Much more could be done within the monetary constraints of the organisation. It should be noted with a rates base of approx. 1500 ratepayers and reducing and water rates twice Adelaide prices and power generation costs twice that of Adelaide prices the council must be careful to ensure that the operating costs of the council are minimised The capacity of the council to employ professional staff is limited by the income of the council .Coober Pedy council is required to administer in the same way as a large urban council with the same administrative responsibilities

5. The council use of external consultants to assist in preparing their planning documents

#### **Response**

This is a practise that is common in small rural councils as they cannot justify the expense of full time planning staff with the full range of expertise The rate of development in Coober Pedy does not justify full time planning staff .

6 The mitigating against the financial risk associated with delays in the power subsidy (RAES) which requires the council to bankroll the wholesale costs...

#### **Response**

The subsidy has relied on the timely preparation and approval of the final accounts by the internal and external auditor for the previous year ., the approval of the councils Budget (generally approved in august ) and subsequently the RAES budget. budget preparation traditionally resulted in strong differences of opinion between the RAES function staff and the council staff. This year the difference of opinion has resulted in a considerable delays in the first and second quarter RAES subsidy payments .Councils debt increased during that period to in excess to \$1.5 mill combined with the council debt for the quarter during that period. This placed an unfair burden on the council and EDL the wholesale generator of power

7 The mitigation of the financial risks associated with the water supply  
Function and understanding the revenues and expenses

**Response**

**The council in the 2018/ 19 year set a budget with full Attribution of overhead costs to provide a break even cost to revenue Budget this was not done during the period of the auditors review The history of budget setting for water supply during the period of the Auditor's report and for many years prior to that time has been not to Include full overhead cost attribution General rates and an over allocation of power subsidy by RAES in Previous quarters was used to subsidise the cost of water production And retail power costs.**

1. The response to unplanned borrowings was raised by staff and not acted upon

**Response**

**The elected council and administration during the period of the study has set a legacy of poor financial management which without external underwriting has now put the current council at considerable financial risk. The income for water and power is regulated by ESCOSA and the operating rate income potentially regulated by ESCOSA by rate capping legislation will not allow for debt recovery The political arm of the council did not support a fee which included a return on investment Poor financial management during that period and an inconsistent approach by RAES to honouring its Deed of agreement by capping the councils power budget will lead to a financial position from which council cannot recover. The council agrees with the Auditor-General's report where it reports that "it does not have the capacity to achieve an effective accounting function to a level required for services that are complex "**

**Further the council agrees as follows**

**"It is unreasonable to expect a council in a remote area with a declining population with limited human resource capability and a financially unsustainable position to meet its current financial obligations and continue to provide essential services with its current governance financial arrangements "**



1.3.1

1. The council have borrowings of \$6.7 Mill as at 30<sup>th</sup> of June 2018

**Response**

**The capacity of council to generate revenue to offset this debt is limited  
The statements in 1.3.1 are supported by the council  
However the council is not struggling to pay its creditors as the financial position has improved over the last two years due to the subsidy for child care and the Natural Disaster funding package of \$4.7 Mill  
The council has also set user charges to match the operating expenditure including overheads for water services. However a revaluation of assets and the asset management plan when factored into the Long Term Financial Plan (LTFP) may reveal otherwise. No cross subsidisation is now occurring**

2 The council did not have adequate corporate financial systems to enable reporting of its financial position

**Response**

**This position is supported by the council.**

**The current council wish to highlight that the budgeting this year is against each of the service areas with an are now accounted for separately in the LTFP, risk management plan. quarterly budget reporting , asset management plan , The Corporate plan will reflect the strategic context of the councils debt position .Regular reporting by each business function is now in place for which there are seven business functions namely Airport :Potable water production distribution and retail : Waste water production distribution and retail : Power distribution and retail Child Care and youth services ,General services (waste collection landfill , parks and landscape dogs and cats : production and Quarry operations**

3 Accounting records the accounting records were found to be dispersed across a range of data bases.

**Response**

**This problem remains as an issue due to the capacity of the councils IT hardware to manage the large volume of transaction data required. This is a high priority for the current IT review to address. The review starts on the 7<sup>th</sup> Nov.**

4. Policies practices and Internal Controls

**Response**

**The council supports the Auditor-General's views  
See comments above.**

5 Borrowings

**Response**

**The council support the Auditor-General's comments.  
There are strategies being developed which are designed to make the changes necessary to report against the long term financial plan**

6 Electricity Grants  
Inadequate compliance with the RAES subsidy reporting requirements

**Response**

**The council supports the comment of the Auditor-General. However after a detailed reconciliation with the RAES council and RAES staff believe the payments reduction is approx. \$.5 mill**

7 Information Technology Controls

**Response**

**The Council supports the comments of the Auditor-General relating to the confidentiality of financial reports.**

**The council have undertaken a review of the internal financial controls with Vectra the IT system managers and put in place levels of access control to limit access to confidential records. Staff have also engaged a specialist team to further review the IT System commencing on the 7<sup>th</sup> Nov**

**The Internal Control review will add both financial and a non-financial aspect to the controls**

8 Audit Committee

**Response**

**See comments above**

**9 Financial Reporting**

**Response**

**The council supports the view of the Auditor-General.**

**The 2016/17 financial statements have been completed and audited, although the council's auditors declined to express an opinion on the statements, reflecting many of the comments in the Auditor-General's report.**

**However the financial turnaround from 2015/16 to 2016/17 was remarkable in part due to the early payment of the FAGS grant and an austerity program in the water business, works function and community development functions.**

10 Strategic Management function

**Response**

**The report correctly highlights the difficulty in maintaining a**

**Consistent strategic program with the repetitive role over of CEOs The report highlights the difficulty in covering the vacancies with leave and succession planning when vacancies occur .**

**The report correctly highlights the lack of strategic management plans. Auditor-General's report in itself consumed two staff and the consultant accountant for at least half a FTE each during the investigation thereby stifling any strategic financial planning by internal staff. The local Government acts requirements for statutory reporting was almost non-existent during the period of the Auditor-General's enquiry (1.5 years)**

**which followed on from the 2016 reporting period where three CEOs were appointed in succession.**

#### **1.3.10**

##### **1 Other observations**

###### **1. Appointment of interim CEO during the period**

**Response,**

**Clearly the appointment of the contracted CEO was not legal nor consistent with sound management principles and reflects a lack of sound legal advice taken by the then Mayor and council on the appointment**



## Attachment A

**From:** Hartwell, Scott (DEM) [REDACTED]  
**Sent:** Friday, 19 October 2018 11:18 AM  
**To:** Colin Pittman  
**Cc:** Duke Nanayakkara [REDACTED]; David Hope; Smith, Nick (DEM); Bye, Steven (DEM)  
**Subject:** RE: RAES subsidy [DLM=For-Official Use Only]

### For Official Use Only

Hi Colin,

As promised, please find attached a revised base budget for the 2018-19 DCCP subsidy for your consideration/agreement.

Note that it proposes a \$1.2m reduction in the subsidy from the initial proposal put forward by DCCP, comprising:

\$0.3 million formula adjustments relating to sundry income, fuel excise and renewable rebates.

\$0.4 million reduction in budgeted administration costs to reflect indexation of the methodology agreed during the setting of the 2017 18 budget.

\$0.5 million reduction associated with the reconciliation of 2016 17 audited actuals (\$1m overpayment) and 2017 18 prelim actuals (\$0.5m underpayment).

Allowing for these adjustments, the proposed budget provides a subsidy for 2018-19 of \$3,015,367 (or \$753,842 per quarter).

As mentioned yesterday, if DCCP agrees with the proposed revisions and approach, then we should be in a position to finalise the formal agreement and process the Q1 payment next week.

Thanks,

Scott

**From:** Colin Pittman [REDACTED]  
**Sent:** Thursday, 18 October 2018 2:47 PM  
**To:** Hartwell, Scott (DEM) [REDACTED]  
**Cc:** Duke Nanayakkara [REDACTED]; David Hope [REDACTED]; Smith, Nick (DEM) [REDACTED]; Bye, Steven (DEM) [REDACTED]  
**Subject:** RE: RAES subsidy [DLM=For-Official-Use Only]

Thanks Scott

**From:** Hartwell, Scott (DEM) [REDACTED]  
**Sent:** Thursday, 18 October 2018 2:41 PM  
**To:** Colin Pittman  
**Cc:** Duke Nanayakkara [REDACTED]; David Hope; Smith, Nick (DEM); Bye, Steven (DEM)  
**Subject:** RE: RAES subsidy [DLM=For Official-Use Only]

## For Official Use Only

Hi Colin,

As mentioned to David earlier in the week, I am almost at the point that I can send back to DCCP a revised base budget that fixes up the minor issues that were identified in the submitted budget, adjusts down the administration component to something in line with what was put forward last year (ie. built up from base data with a reasonable attribution method) and allows for the prior year over/under payments associated with the reconciliation of 2016-17 audited actuals (\$1m overpayment) and 2017-18 prelim actuals (\$0.5m underpayment).

If adopted, the agreed budget would have to note that it is preliminary on the outcome of the AG Report with regard to the audited actuals for 2013-14, 2014-15 and 2015-16 as (per discussions with Duke and David) we have been unable to satisfactorily reconcile the functional split of electricity revenues and expenditures within those reports.

Consistent with what I discussed with David the other day, we would also note that in adopting an indexed 2017-18 administration budget, we would work with DCCP on developing a sustainable and equitable overhead allocation model that could be applied in the future, including for the purposes of the 2017-18 Audited Statements and 2018-19 actuals (and associated reconciliation adjustments).

I will aim to send through the revised base budget later this afternoon/tomorrow morning for DCCP's consideration. If DCCP agrees with the proposed revisions and approach (as outlined above), then I should be able to finalise the formal budget approval early next week, at which point DCCP can submit a Q1 invoice for payment. Further, per the Deed of Grant, upon submission by DCCP of financial reports for Q1 and a valid invoice, the Q2 payment will also become payable.

Thanks,

Scott

8A.



Government  
of South Australia

eA179575

Mayor [REDACTED]  
District Council of Coober Pedy  
PO Box 425  
COOBER PEDY SA 5723

Dear Mayor [REDACTED]

I write in relation to serious concerns that have been raised with me regarding the District Council of Coober Pedy (the Council).

On Friday 22 July 2016, [REDACTED], Acting Chief Executive Officer, met with the Office of Local Government (OLG) to discuss concerns about the Council's financial position and performance.

I emphasise the importance of ensuring the long-term sustainability of the Council's finances. In my view, Council members have a responsibility, on average over time, to ensure that revenue raising effort and other funding available to the Council is sufficiently balanced to meet expenditure responsibilities and policy choices made on behalf of the community.

In response to these concerns, I am writing in accordance with section 271A of the *Local Government Act 1999*— to request the following information relating to the affairs or operations of the Council:

1. Regulation 10 of the *Local Government (Financial Management) Regulations 2011* requires a report to be presented to the Council by December each year setting out audited information on aggregate financial results relative to estimated financial results set out in the Council's original budget for the previous financial year (the latter, of course, being the basis for Council rating decisions).

The report on financial results is a crucial accountability document for Council members to receive. The absence of such a report could potentially create serious internal control weaknesses in that large budget variations might not be disclosed to Council members.

Minister for Regional Development  
Minister for Local Government

Level 17, 25 Grenfell Street Adelaide SA 5000 | GPO Box 2557 Adelaide SA 5001 DX 667  
Tel 08 8226 1300 | Fax 08 8226 0316 | [pirs.MinisterBrock@sa.gov.au](mailto:pirs.MinisterBrock@sa.gov.au)



The report must include each item shown in the statement of comprehensive income and balance sheet of the financial statements, as well as results of the previous year's three key financial indicators compared with estimates adopted in the original budget. After searching the Council's website and meeting agenda papers, staff in OLG have been unable to locate the relevant report for the 2014-15 financial year. If such a report exists, I request that a copy be sent to me.

2. OLG has advised me that the Council's original Budget for 2014-15 targeted an operating surplus of \$0.2 million, yet the actual result for 2014-15 was an operating deficit of \$3.0 million. I note that the operating deficit in 2014-15 may have been of the order of \$4.0 million but for an electricity subsidy claim by the Council (and paid by the Department of State Development) which apparently was overstated.

Similarly, I understand that the Council's budgeted operating surplus in 2015-16 was \$0.4 million and that a revised estimate of the 2015-16 operating result (as shown in the Council's draft 2016-17 Annual Business Plan) is a deficit of \$1.4 million. Further, the 2015-16 operating deficit may have been of the order of \$2.5 million but for a likely overpayment of the electricity subsidy again in 2015-16.

I appreciate that unexpected events in a particular year may be part of the explanation (e.g. the timing of receipt of Federal Government financial assistance grants and expenditure on disaster recovery). Regardless of whether the report for 2014-15 mentioned in (1) above is available, I now seek your comments on the broad figure-work provided to me by OLG on the Council's operating results, as well as an explanation on all material variances between actual and budgeted financial results for each of the last two financial years.

3. I note that the Council's draft 2016-17 Annual Business Plan is targeting an operating surplus of \$0.35 million in each of the next three financial years. While I appreciate that the 2016-17 operating result may be adversely impacted by the need for the Council and the Department of State Development to make an adjustment to the level of the electricity subsidy payment otherwise payable, I seek your confirmation that the Council is committed to achieving and maintaining financial sustainability in the future, including by achieving at least an operating break even result each year.
4. During the period from November 2015 to January 2016, it appears to OLG that the Council arranged to obtain new loans and/or refinance existing loans from the Local Government Finance Authority (LGFA) totalling \$6 million (being five separate Cash Advance Debenture loans). I seek your clarification on this matter together with a copy of all relevant correspondence surrounding those financing transactions (including any representations made by the Council to the LGFA).

I request that this information be provided to me by 1 September 2016.

Yours sincerely



**Hon Geoff Brock MP**  
Minister for Regional Development  
Minister for Local Government

*H* <sup>*gbr*</sup> -  
August 2016



**From Agenda 28<sup>th</sup> June 2016**

**9 Questions on Notice**

Received from: Cr Paul Athanasiadis  
Received On: 14/06/2016

1. Is Council currently complying with the Local Government (Financial Management) Regulations 2011 and if not, how are we non-compliant and what measures are being taken to remedy the non-compliance?

To the best of my knowledge we are complying with the local Government (Financial Management) Regulation 2011(advised by [REDACTED])---But if possible I would like to look in more detail, and take time till August Council meeting to confirm.

2. Why has the 2014/15 Auditors report and recommendations not been presented to Council when it was received on or around the 15<sup>th</sup> February 2016? Has the administration commenced the implementation of our auditor's recommendations and if so what is our progress to date?

This report was not passed to administration and we are endeavouring to obtain a copy from the auditors which will then be actioned.

3. What is the status of Council's 2014/15 Annual Report and when can Elected Members expect to receive a draft copy for review?

Received from: Cr Boro Rapaic  
Received On: 20/06/2016

1. Why has Elected Members not received any of the Tenders to Provide Legal Services to Council which closed on 18 March 2016?
2. How was Mayor [REDACTED] able to amass Legal Expenses charged to Council totalling tens of thousands of dollars in one month? What measures does the Council need to take to ensure that this cannot happen again?

Received from: Cr Paul Reynolds  
Received On: 20/06/2016

Why has the letter concerning a Section 270 Review of a Council decision that was presented to the CEO of the Council from Stuart Range Outback Resort on 29<sup>th</sup> February 2016, not been responded to when Council's own Customer Complaints Policy states that "All complaints will be acknowledged within 5 calendar days" and "when a resolution cannot occur within 14 calendar days a response will be delivered to the customer outlining time frames set by the staff member responsible for resolving the complaint"?

### 5.5.2 Financial Audit

**Report to:** Council  
**From:** [REDACTED] Chief Executive Officer  
**Date:** 18/08/2015  
**Subject:** Financial Audit  
**File:** GR.689

#### Purpose of Report

Seeking Council's consideration and approval to conduct a Financial Audit to determine Council's current and future financial position and outlook.

#### Report

It is essential that the finances of Council are appropriately managed with up to date accurate information being provided to the CEO and Council to assist in good decision making.

The following body of work is a suggested process in the lead up to developing a long term 5 to 10 year financial plan:-

- Review and research the current financial position of Council.
- Have discussions with the Council's Auditor to assess compliance with the local government financial and accounting standards.
- Review the Internal Controls in place.
- Have discussions with the Chair (and members if determined) of the Council's Audit Committee.
- Review the current financial structure and skills within the financial operations of Council.
- Review the quality and timely presentation of financial reports to Council and Management.
- Review the financial reporting and accounting systems in use.

The importance of this stepped approach before undertaking any Strategic and Long Term Financial consideration is essential in order to give an accurate scorecard with respect to Council's overall financial performance currently.

A quote for the above body of work has been sought and received from [REDACTED], who would be assisted by [REDACTED], a highly respected local government financial professional of many years standing.

The cost for the above professional services is approximately \$5,000 - \$7,000 (GST not applicable) which will include 2 visits to Coober Pedy, inclusive of the Final Report Presentation to Council. Travel, accommodation and other expenses incurred as part of this professional support will be separately charged.

**Management Plan Drivers**

Strategic Plan Reference

- Goal 5 – Sustain Local Government Services
- Strategy 5.9 – Practice Good Governance

Finance / Budget

- \$5,000 - \$7,000

Risk / Asset Management

- Moderate

**Recommendation**

1. That Council agrees to [REDACTED] undertaking an audit of Councils current financial position and in doing so agrees to the quote of \$5,000 - \$7,000 for professional services, in addition to reasonable travel and accommodation expenses, for [REDACTED]  
[REDACTED]

**FOR CONSIDERATION AND RESOLUTION**

## From Agenda 15<sup>th</sup> September 2015

### 7. QUESTIONS ON NOTICE

Received from: Cr B Rapaic  
Received on: 8<sup>th</sup> September 2015

Was German Hill Road, Linsky Drive and German Hill Road extension to Oodnadatta Road on the 10 year plan and why wasn't the original German Hill Road completed? Why was the direction of the road changed?

Can we have a full costing inclusive of kerbing, sealing and surveying?

At which Council meeting were these roads approved?

In which budget was the money allocated for these roads?

I would also like any other information in relation to German Hill Road and Linsky Road.

A detailed report will be provided to the Council during the October Ordinary Meeting.

Received from: Cr P Athanasiadis  
Received on: 9<sup>th</sup> September 2015

Why a report was prepared with only one quote when the price was over \$5,000. Who was responsible for this breach? Who is the company that was put in as a recommendation? Can the Elected Members have the history of this consultant in relation to District Council of Coober Pedy and any of its staff?

Received from: Cr P Athanasiadis  
Received on: 9<sup>th</sup> September 2015

Why Elected Members were told on the 11<sup>th</sup> of August they had 24hours to make on urgent decision in relation to \$1,000,000 when the submission was posted off to the Local Government Association on the 5<sup>th</sup> August and the meeting was held on the 11<sup>th</sup> August?

Received from: Cr P Athanasiadis  
Received on: 9<sup>th</sup> September 2015

Can Elected Members have a copy of the various bank statements on all our government funded grants ie Breakaways Reserve, Drive In, Youth Officer and so on, on the day of the 10<sup>th</sup> August?

I would like a copy of a bank statement ending March 2014 – pre floods.

Will the work that was completed out at the Quarry be covered by the Flood Relief Funding?

Have we been compliant with Council's Policies as far as tendering is concerned with works done out at the Quarry?

Received from: Cr P Athanasiadis  
Received on: 9<sup>th</sup> September 2015

Why Elected Members were not going to be consulted about the overdraft loan extension? Who is responsible and is this a serious breach?

Received from: Cr P Athanasiadis  
Received on: 9<sup>th</sup> September 2015

Can we have a copy of all Auditing Committee Meetings for the past 8 years including reports given to Council?

Can we have a copy of all overdraft loans with the Local Government Association that have been signed off by the District Council of Coober Pedy and a copy of the minutes where the approval was given by the Elected Body for each document.

## Appendix 4 – Glossary of abbreviations and terms

<b>Abbreviation/Term</b>	<b>Description</b>
Accounting records	Section 4 of the LG Act defines accounting records as all records and documents relevant to any receipt or payment of money and includes the working papers and other documents necessary to explain the methods and calculations by which statements and accounts are made up
Accounts	A formal record of financial transactions, such as in a ledger, journal or statement of financial position
DPTI	Department of Planning, Transport and Infrastructure
FFAP	Finance function action plan
Financial sustainability	A council’s long-term financial position and performance is sustainable where planned long-term service and infrastructure levels and standards are met without unplanned increases in rates or disruptive cuts to services, LGA 2017 ‘Financial Indicators’ report
LG Act	<i>Local Government Act 1999</i>
LGA	Local Government Association of South Australia
LGFA	Local Government Financing Authority
LTFP	Long-term financial plan
LG Regulations	Local Government (Financial Management) Regulations 2011
Minister	Minister for Local Government (now the Minister for Transport, Infrastructure and Local Government)
Model Financial Statements	Model Financial Statements referred to in Regulation 4(3) of the Local Government (Financial Management) Regulations 2011
OLG	Office of Local Government
PFAA	<i>Public Finance and Audit Act 1987</i>
RAES	Remote Areas Energy Supplies
RAES agreement	Deed of Grant agreement between the Minister for Mineral Resources and Energy and the Council to provide for grants under the RAES scheme, dated 29 April 2016
SMPs	The Council’s strategic management plans, which include the long-term financial plan and asset management plans





