Queensland Audit Office

Results of audits: Local government entities 2011-12

Report to Parliament 10 : 2012-13

Queensland Audit Office

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Queensland Audit Office

April 2013

The Honourable F Simpson MP
Speaker of the Legislative Assembly
Parliament House
BRISBANE QLD 4000

Dear Madam Speaker

Report to Parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled Results of audits: Local government entities 2011–12.

In accordance with s.67 of the Act, would you please arrange for the report to be tabled in the Legislative Assembly.

Yours sincerely

Andrew Greaves
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Contents

Summary

Local governments (councils) operate autonomously and are directly responsible to their communities. They vary widely in size and provide a wide range of community services including infrastructure and waste management.

A council's annual report is its primary accountability document to its ratepayers, residents, funding bodies and users of council services. It sets out councils' operational and financial performance and position and includes audited financial statements. The audit opinion accompanying the financial statements provides readers with added assurance that the financial information is reliable.

This report summarises the results of our audits of the financial statements of the 73 local governments (councils), and of the entities they control.

Audit opinions issued

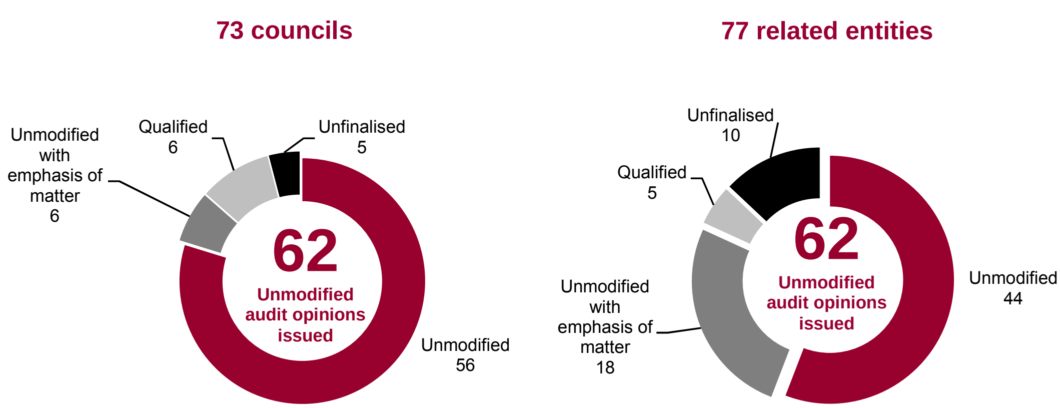
For 2011–12, audit opinions were required for 150 local government entities, including 73 councils: to date, 135 opinions have been issued, including on 68 of the 73 council financial statements.

The majority of audit opinions issued (92 per cent) were unmodified, confirming that those financial statements were prepared according to the requirements of legislation and relevant accounting standards.

The audit opinion is qualified when part or all of the financial statements do not comply with relevant legislative requirements and/or accounting standards. Eleven qualified opinions (six councils and five related entities) were issued for 2011–12 (2010–11: eight councils and four related entities).

The number of unmodified audit opinions for the sector is consistent with last year, demonstrating that it takes a number of years for entities to resolve prior year accounting issues.

Figure A
Analysis of audit opinions



Note: Audit findings on the five remaining councils and ten related controlled entities will be included in the 2013-14 Report to Parliament on local government financial statements for 2012–13.

Source: QAO

Quality of financial statements submitted for audit

Adjustments of $2.6 billion were made to the management certified statements for 51 out of 68 audited councils. This significant reduction compared to last year—down by $4.2 billion (59 per cent) from $6.8 billion—is attributed to earlier finalisation of valuation processes in some councils which, in turn, allowed for enhanced quality review procedures to be undertaken on the draft financial statements prior to providing them for audit.

However, significant changes were required again this year to disclosures made in the notes accompanying the financial statements in order to fully and accurately reflect council policies; describe the processes for the valuation of infrastructure assets; and meet Australian accounting standard disclosure requirements.

There was no clear correlation between the quality of financial statements and the size and location of councils. Contrary to expectations, several small and Indigenous councils with limited resources consistently produce good quality management certified financial statements.

Key financial data

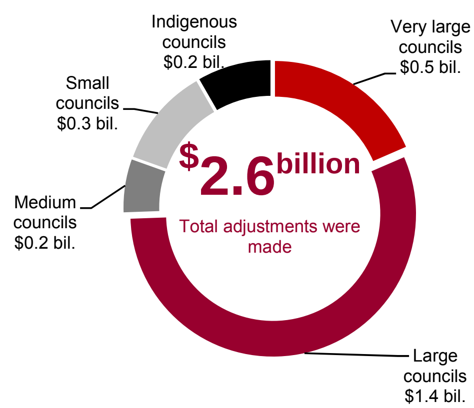
(68 completed councils only)

Income 2012: $9.9 billion 2011: $9.4 billion ▲6 %	Expense 2012: $8.5 billion 2011: $11.6 billion ▼27 %
Assets 2012: $92.2 billion 2011: $88.0 billion ▲5 %	Liabilities 2012: $7.4 billion 2011: $6.6 billion ▲11 %

Figure B

Analysis of audit adjustments

(68 completed councils)



Changes resulting from asset valuation processes are still the primary reason for adjustments to draft financial statements submitted for audit. Ten of the 68 councils completed to date were unable to complete their 2011–12 asset valuations in sufficient time to incorporate the results in the original management certified statements provided to audit.

The valuation of infrastructure assets also remains the most significant financial reporting issue for the sector with high levels of volatility in valuations experienced across councils from one year to the next.

The net asset valuation increment for 2011–12, based on the 68 councils audited to date, comprises 49 councils which reported valuation increments totalling $3.0 billion; 11 councils which reported valuation decrements totalling $1.4 billion; and eight councils which reported no movement in the fair values of their infrastructure assets.

While the use of professional valuers enhances the robustness of the valuation process, responsibility for acceptance of the values ultimately rests with the councils. Many councils do not have an appropriate understanding of the scope of work performed by their valuers, including any limitations or restrictions thereon; or of the methodology adopted by the valuers and the key assumptions and inputs used in applying the valuation methodology. This is a significant issue given the differences in the methodologies adopted by valuers and the subjective nature of the key inputs and assumptions applied in the valuation process.

Timeliness of preparation of financial statements

Local governments continue to be the least timely, and therefore the least accountable, of the three tiers of government. The usefulness and relevance of their annual reports reduce, the longer they take to be published. The undue time taken to prepare and finalise year-end financial statements is a major cause of the delays in finalising annual reports. This serves to weaken transparency and accountability.

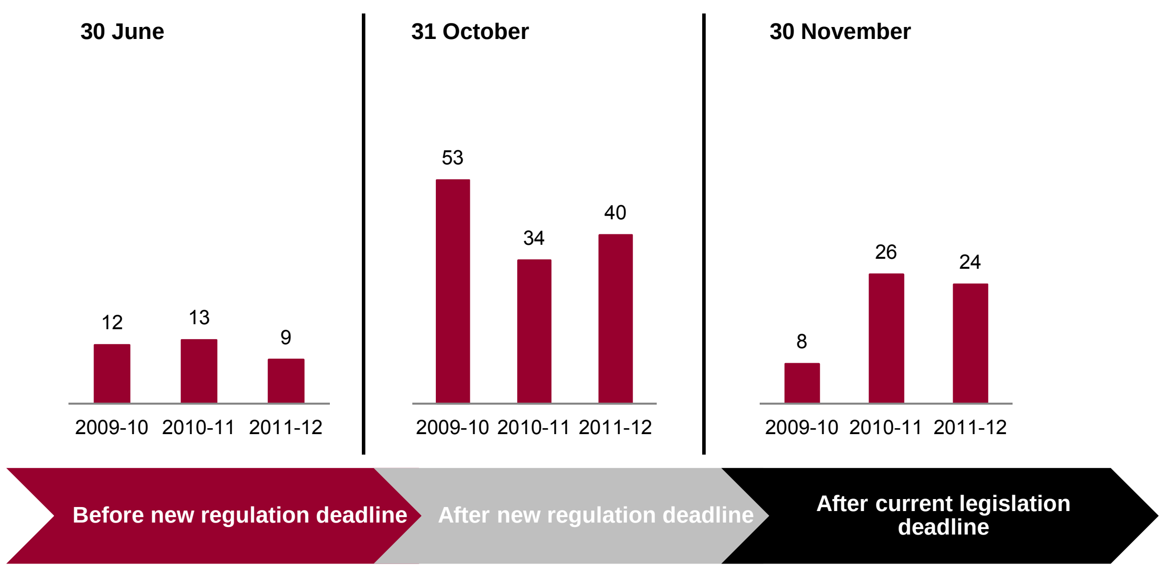
The bar has been raised in this new financial year, with the financial reporting deadline for 2012–13 financial statements and subsequent years having been effectively brought forward by one month. For 2011–12 and previously, the statutory deadline for local governments to finalise their audited financial reports was 30 November. Under the new *Local Government Regulation 2012*, applicable in 2012–13, the deadline for audited financial statements has been brought forward to 31 October.

Only 49 councils (2011: 47) or 67 per cent (2011: 64 per cent) of councils had their financial statements audited by the current legislative deadline of 30 November 2012. This was primarily a result of poor system and report preparation processes, particularly in relation to valuation of non-current assets, and to inadequate planning for system implementations and the unavailability of key staff.

Had the new 31 October deadline been in place this year, only nine councils (12 per cent) would have achieved this date.

Figure C

Council financial statement timeliness



In addition, 22 councils adopted their 2010–11 annual reports after 15 January 2012. This is particularly relevant given that local government elections were originally scheduled for mid-March 2012. Without access to a council's annual report, which is its primary accountability document to the community, and with little time to analyse the report, voters are less informed about the council's performance for the preceding year.

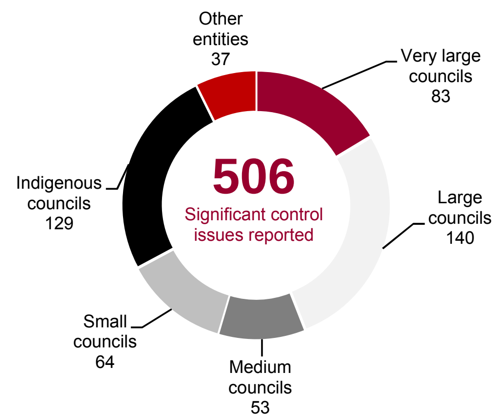
Internal control frameworks

Control weaknesses raised during our audits have reduced significantly. But the number and nature of audit issues reported indicates continuing and systemic problems in establishing strong internal control, relating particularly to a lack of control consciousness and weak governance.

We identified and reported on 506 significant control weaknesses at 81 entities (64 councils and 17 related entities) during 2011–12, compared with 602 issues at 76 entities (65 councils and 11 related entities) in 2010–11.

Figure D

Analysis of significant control weaknesses



The Torres Strait Island Regional Council and Northern Peninsula Area Regional Council accounted for 11 per cent of the significant control weaknesses identified. Torres Strait Island Regional Council's prolonged internal control issues were a catalyst for the appointment of a financial controller to the Council in November 2012.

Burdekin Shire Council also has a particularly poor internal control framework and has shown little regard for legislative control requirements or audit recommendations related to internal controls.

Eight councils continued to have inadequate, incomplete or undocumented plans for business continuity and disaster recovery, while six councils did not have an up to date risk management policy or risk register.

Of particular concern is that ten councils did not have an internal audit function during 2011–12. This has been a legislative requirement since 1 July 2010. A further seven councils spent $5 000 or less each on internal audit services during 2011–12. Burdekin Shire Council also failed to establish an audit committee in contravention of another specific legislative requirement in place since 1 July 2010.

A qualified opinion was issued on the state's Natural Disaster Relief and Recovery Arrangements (NDRRA) acquittals to the Australian Government in respect of the 2009–10, 2010–11 and 2011–12 financial years. The qualification related primarily to the eligibility of council claims which lacked the necessary documentation to allow a reliable assessment of pre-disaster condition and related post-disaster reparation of affected assets.

The acquittal of NDRRA grants by councils up to 2008–09 followed established custom and practice based on the interpretation and understanding of the grant conditions at the time. This included placing primary reliance on certificates issued by engineers and councils regarding eligible expenditure. However, work by the Queensland Reconstruction Authority (QRA), confirmed during our audit, has determined that, up to 2011–12, councils have interpreted and applied the NDRRA grant conditions inconsistently, and that the effectiveness of their systems of control over such expenditure varied widely, with significant weaknesses identified.

This systemic issue has been corrected through stronger control and better oversight since implemented by the QRA, but irregularities continue to be detected, specifically at the Whitsunday Regional Council and Burke Shire Council.

Councils directly control 63 entities and there are a further 41 jointly controlled or related local government entities across the sector (refer Appendix B and Appendix C). The strength of oversight of these entities varies significantly across the sector.

Financial sustainability

We assessed councils using the three financial sustainability measures required by the new *Local Government Regulation 2012*, and the sustainability targets set by the Department of Local Government, Community Recovery and Resilience.

Based on these measures, 16 of the 68 councils audited are at higher risk of becoming unsustainable, including 11 of the 14 Indigenous councils audited to date. This result is largely because these 16 councils incurred operating losses over the last three years.

Figure E
Relative risk assessment

Council category	Higher	Moderate	Lower
Very large	2	6	4
Large	1	3	11
Medium	0	2	9
Small	2	0	14
Indigenous	11	2	1
Total	**16**	**13**	**39**
Per cent	**24**	**19**	**57**

Taking the sector as a whole, the financial sustainability risk overall for 2011–12 is rated as low. Community assets are being constructed, acquired, renewed and replaced faster than the total asset base is being depreciated.

Prior to the most recent natural disaster events, under the NDRRA arrangements, $3.1 billion of outstanding capital works had to be completed by councils before 30 June 2014. Councils not affected by the recent flood events are still required to meet this deadline. Affected councils now have until 30 June 2015 to complete repairs or replacement of recently damaged assets.

Completing the volume of outstanding restoration work associated with the NDRRA within the required time frames remains a major challenge for those councils inexperienced in managing large capital works projects. Failure to complete the works by the required date, or undertaking ineligible works, may reduce the contribution of the Australian Government and result in these costs being met by the respective councils.

In the short-term, the establishment and dissolution of Allconnex Water within a two-year period has cost $53.4 million to date. It ultimately resulted in a similar number of employees and net assets being transferred back to the councils involved as had been originally transferred to Allconnex Water.

Recommendations

A number of recommendations have been made in this report. All councils should assess which ones are relevant to them and implement necessary corrective action.

It is recommended:

1. **The Department of Local Government, Community Recovery and Resilience works with the Office of the Valuer-General and councils to develop an agreed methodology for valuation of infrastructure assets and an agreed approach for engagement of professional valuers.**

2 **Councils affected by recent natural disasters implement the systems, processes and controls to:**

- **demonstrate their funding claims relate only to eligible costs**
- **identify and assess the cost-effectiveness of replacing assets to a more disaster-resilient standard**
- **lodge their funding submissions with QRA in a timely manner**
- **schedule and complete all approved works by the deadlines imposed under NDRRA.**

3. **All councils with 2011-12 audit opinions issued after 31 October 2012 implement changes to their financial reporting processes that address the major reasons for the delay.**
4. **The Department of Local Government, Community Recovery and Resilience determines and publishes criteria for granting ministerial extensions to reporting deadlines in ‘extraordinary circumstances'.**
5. **Those councils without an internal audit function take immediate action to comply with this legislative requirement.**
6. **Those councils spending $5 000 or less on internal audit services annually assess the effectiveness of these services.**
7. **The Department of Local Government, Community Recovery and Resilience revises and reissues the financial sustainability guidelines so that councils are provided detailed guidance (including examples) on the calculation of the three sustainability measures well in advance of councils having to present them for audit in 2012–13.**
8. **The Department of Local Government, Community Recovery and Resilience works with Queensland Treasury Corporation to actively assist councils in refining the assumptions used in their long-term forecasts to heighten council awareness of the impact today’s budgetary decisions have on a council’s long-term financial sustainability.**

Reference to agency comments

In accordance with section 64 of the *Auditor-General Act 2009,* relevant entities referred to in this report were given 21 days to provide comments on any significant matters discussed. The comments received, or a fair summary of them, must be published in the report.

This proposed report was provided to the Director-General, Department of Local Government, Community Recovery and Resilience and the Queensland Reconstruction Authority along with all councils named in this report with significant financial reporting, internal control or sustainability issues.

All comments received within 21 days are included in full in Appendix A.

1 Context

1.1 Local government responsibilities

1.1.1 Local government reporting entities

The local government sector comprises 177 entities; 73 councils and 104 entities that they control, either individually or jointly. As 27 of the controlled entities are classified as non-reporting under the accounting standards, there are only 150 entities that prepare financial statements.

Figure 1A summarises the number of reporting entities, categorised by council size. These classifications are based on the categories used by the Queensland Local Government Remuneration and Discipline Tribunal.

Figure 1A
Local government reporting entities

Category	Type of entities	2012	2011
Very large	Councils	12	12
	Entities they control	26	28
Large	Councils	16	16
	Entities they control	14	11
Medium	Councils	13	13
	Entities they control	1	1
Small	Councils	16	16
	Entities they control	2	2
Indigenous	Councils	16	16
	Entities they control	3	2
Other	Jointly controlled entities	25	27
	Joint local government	2	2
	Audited by arrangement	4	5
Total		**150**	**151**

Note: Councils within each category are shown in Appendix F.

Source: QAO

1.1.2 Financial reporting time frames

Requirements for 2011–12

Legislation for councils is administered by the Minister for Local Government, Community Recovery and Resilience. For 2011–12, all councils, except Brisbane City Council which has its own Act, were subject to the Local Government Act 2009 and its related legislation:

- *Local Government (Beneficial Enterprises and Business Activities) Regulation 2010*
- *Local Government (Finance, Plans and Reporting) Regulation 2010*
- *Local Government (Operations) Regulation 2010.*

The 2011–12 financial reporting time frames for councils are specified in the *Local Government (Finance, Plans and Reporting) Regulation 2010*. This Regulation required a council's financial statements to be provided to audit as soon as practicable after the end of the financial year and no later than 15 September. However, the Minister could grant an extension to this deadline.

The Mayor and Chief Executive Officer had to provide a written certification that their financial statements had been prepared to comply with the relevant accounting and legislative requirements and that they accurately reflected the council's financial performance and position for the financial year.

The audited financial statements and the audit opinion were required to be included in the council's annual report which had to be adopted by the council **before 30 November**, unless a Ministerial extension was obtained.

Brisbane City Council has its own Act, the *City of Brisbane Act 2010* and its own Regulations. Under this legislation, Brisbane City Council had to prepare financial statements and provide these to audit, also by 15 September. These statements are required to be audited and included in Brisbane City Council's annual report, which is due for completion by 31 October.

Comparative requirements

Queensland departments and statutory bodies: In the *Financial and Performance Management Standard 2009*, departments and statutory bodies are required to provide financial statements for audit by a date agreed between the accountable officer or statutory body and the Auditor-General. This date must allow for the audit of the statements to be completed no later than two months after the end of the financial year **(31 August)**. The annual report of these entities, including the audited financial statements, is required to be tabled in Parliament within three months after the end of the financial year **(30 September)**.

Victorian and Tasmanian local governments: The legislative time frame for Victorian and Tasmanian councils to finalise their audited financial reports is **30 September**. This is two months earlier than the 2011–12 statutory deadline for Queensland local governments.

Legislative changes for 2012–13

The local government legislation was revised in late 2012. This resulted in repeal of the 2010 Regulations and the *Local Government Regulation 2012* taking effect from 14 December 2012. The new Regulation requires councils to provide their financial statements to audit by a date agreed between the council's Chief Executive Officer and the Auditor-General. The date agreed must allow for the audit to be completed by 31 October. The council must then adopt its annual report within one month of the audit opinion date.

Disclosure requirements

The *Local Government (Finance, Plans and Reporting) Regulation 2010* (since repealed) was the key legislation for financial management of councils in 2011–12. Figure 1B identifies the key legislative disclosure requirements for council annual reports.

Figure 1B
Key disclosure requirements

Requirements
• General purpose financial statement and the Auditor-General's audit report • Community financial report • Current year and next nine years of relevant measures of financial sustainability and an explanation of the council's financial management strategy • Particulars of councillors' remuneration including total remuneration, superannuation contributions, expenses incurred by and facilities provided to councillors • Overseas travel made by a councillor or council employee including destination, purpose and cost • Summary of expenditure on grants to community organisations • Summary of expenditure from each councillor's discretionary fund including the name of each community organisation allocated funds, and the amount and purpose of the allocation • Details of land that are reserves and roads that the council does not own • Assessment of performance in implementing the long-term community plan, corporate plan and annual operational plan • Report on the internal audit • Finances relating to distributor-retailers including profits received and tax equivalents paid to the council, and payments made and liabilities owed by the council to the distributor-retailer and by the distributor-retailer to the council • Total remuneration packages payable to senior executive employees (including the Chief Executive Officer) and the number of senior executives being paid each of these packages. (Note: following amendment of the *Local Government Act 2009*, executive remuneration will be disclosed in bands of $100 000 in 2012–13).

1.2 Audit responsibilities

Section 40 of the *Auditor-General Act 2009* requires the Auditor-General to audit the annual financial statements of all public sector entities, including those of local governments and their controlled entities, and prepare an auditor's report.

The auditor's report, which includes the audit opinion, provides assurance about the reliability of the financial reports, including compliance with legislative requirements. In accordance with Australian Auditing Standards, one or more of the following audit opinion types is issued:

- An unmodified opinion is issued where the financial statements comply with relevant accounting standards and prescribed requirements.
- A qualified opinion is issued when the financial statements as a whole comply with relevant accounting standards and legislative requirements, but with particular exceptions.
- An adverse opinion is issued when the financial statements as a whole do not comply with relevant accounting standards and legislative requirements.
- A disclaimer of opinion is issued when the auditor is unable to express an opinion as to whether the financial statements comply with relevant accounting standards and legislative requirements.

An emphasis of matter paragraph may be included with the audit opinion to highlight an issue which the auditor believes users of the financial statements need to be made aware. The inclusion of an emphasis of matter paragraph does not modify the audit opinion.

The *Auditor-General Act 2009* requires that, after the audit opinion has been issued, a copy of the certified statements and the audit opinion must be provided to the Chief Executive Officer as well as the Mayor and the Minister.

As part of the financial audit, elements of councils' internal control frameworks are assessed to determine if the controls in place are operating effectively and the extent of councils' compliance with legislative requirements.

Significant issues identified during the audit and recommendations for improvement are reported to the Mayor and Chief Executive Officer at the conclusion of the audit.

The *Auditor-General Act 2009* also requires that the Auditor-General report to Parliament on each financial audit conducted. The report must state whether the audit has been completed and the financial statements audited. It must also include details of significant deficiencies where financial management functions were not performed properly, along with any actions taken to improve deficiencies reported in previous reports. This report satisfies these requirements.

Legislative changes for 2012–13

Section 212 of the new *Local Government Regulation 2012* imposes an additional audit requirement on councils. From 2012–13, all councils are required to prepare a current-year financial sustainability statement which is to be audited by the Auditor-General. The statement is to include the following three measures of financial sustainability:

- operating surplus ratio
- net financial liabilities ratio
- asset sustainability ratio.

Consistent with the time frame for the financial statements, the audit of the current-year financial sustainability statement is to be completed by 31 October and included in the council's annual report.

1.3 Report structure

The report is structured as followed:

- Chapter 2 provides the results of the audits of local government entities and discusses the major financial reporting issues across the sector for the 2011–12 financial year.
- Chapter 3 discusses the timeliness and quality of financial statements for the local government sector in 2011–12.
- Chapter 4 assesses the internal control framework of councils and other local government entities for which the 2011–12 audits were finalised at the time of this report.
- Chapter 5 examines the financial sustainability of the local government sector.

- Appendix A contains responses received from the Department of Local Government, Community Recovery and Resilience and the Queensland Reconstruction Authority as well as particular councils.
- Appendix B contains the status of the 2011–12 financial statements of councils and other local government entities.
- Appendix C contains listing of local government entities for which audit opinions will not be issued in 2011–12.
- Appendix D contains the status of 2010–11 financial statements not previously finalised.
- Appendix E shows the financial sustainability measures of councils where the councils' financial statements were finalised at the time of this report.
- Appendix F shows a map of Queensland depicting each local government area by category.

2 Results of financial audits

In brief

Background

Audited financial statements for councils must be included in their annual reports. We identified significant financial reporting risks and issues, some led us to modify the audit opinion.

Conclusions

- The consistent number of qualified audit opinions is because a number of prior year accounting issues remained unresolved.
- Valuation of infrastructure assets remained the most significant financial reporting issue for the sector.
- Councils continued to face significant financial risks in relation to the potential loss of past and future grant revenues for their expenditures under Natural Disaster Relief and Recovery Arrangements (NDRRA).

Key findings

- Eleven qualified opinions (six councils/five related entities) were issued, due primarily to poor past records to support prior year comparative balances and inadequate internal control systems.
- Significant volatility in infrastructure asset valuations continued across and within councils from one year to the next, signaling underlying issues with the reliability and consistency of valuations. In particular, councils did not have an appropriate understanding of the scope of work performed by their valuers, including any limitations, the methodology adopted and the key assumptions and inputs used in applying the methodology.
- The qualified opinion issued on the state's NDRRA acquittal to the Australian Government was because of inadequate documentation to support the eligibility of council claims processed prior to the establishment of the Queensland Reconstruction Authority (QRA).

Recommendations

1. **The Department of Local Government, Community Recovery and Resilience works with the Office of the Valuer-General and councils to develop an agreed methodology for valuation of infrastructure assets and an agreed approach for engagement of professional valuers.**

2 **Councils affected by recent natural disasters implement the systems, processes and controls to:**

- **demonstrate their funding claims relate only to eligible costs**
- **identify and assess the cost-effectiveness of replacing assets to a more disaster-resilient standard**
- **lodge their funding submissions with QRA in a timely manner**
- **schedule and complete all approved works by the deadlines imposed under NDRRA.**

2.1 Background

The local government sector consists of councils administering local government areas, jointly controlled entities established to administer joint council activities, controlled entities including companies, trusts and incorporated associations, and entities audited by arrangement.

All have a 30 June balance date, apart from South West Queensland Local Government Association with a 31 March balance date, The Burdekin Cultural Complex Board Inc. with a 30 April balance date and Brisbane Festival Limited, Major Brisbane Festivals Pty Ltd and North Queensland Local Government Association with 31 December balance dates.

2.2 Conclusions

The reduction in the number of qualified audit opinions for the sector is a reflection of the resolution of a number of accounting issues that arose from the 2011 natural disasters.

The valuation of infrastructure assets remains the most significant financial reporting issue for the sector with significant volatility in valuations experienced across councils from one year to the next. Comparability and consistency in council infrastructure asset valuations could be enhanced if councils used the skills and experience available in the Office of the Valuer-General in relation to the engagement of professional valuers. This assistance could include:

- developing requests for proposals to engage valuers
- reviewing proposals received by valuers
- selecting valuers
- establishing a panel of pre-approved valuers and model requests for proposals to engage valuers.

Completing the volume of outstanding restoration work associated with the Natural Disaster Relief and Recovery Arrangements (NDRRA) within the required time frames will be a major challenge for small and medium sized councils inexperienced in managing large capital works projects. Failure to complete the works by the required date or undertaking ineligible works may reduce the federal contribution and result in these costs being assumed by the respective councils.

2.3 Audit opinions

2.3.1 Overall result

Audit opinions have been issued for 135 (90 per cent) of 150 local government entities required to prepare them, which is consistent with the same time last year when 135 of 151 entities (89.4 per cent) were issued. Figure 2A shows the entities by type and the overall status of their financial statements.

Figure 2A
Status of the financial statements

Entity type	Total	Unfinished audits	Unmodified opinions issued	Qualified opinions issued	Unmodified but with an emphasis of matter
Councils	73	5	56	6	6
Controlled entities	45	4	31	4*	6
Joint local governments	2	0	1	0	1
Jointly controlled entities	26	6	8	1	11
Audited by arrangement	4	0	4	0	0
Total	**150**	**15**	**100**	**11**	**24**

* Includes two entities that also received an emphasis of matter.

Source: QAO

2.3.2 Unfinished audits

Audit opinions have yet to be issued for five councils and 10 related local government entities. We are working actively with these entities to finalise outstanding audit opinions as soon as possible.

The five councils are:

- Carpentaria Shire Council
- Kowanyama Aboriginal Shire Council
- Maranoa Regional Council
- Whitsunday Regional Council
- Wujal Wujal Aboriginal Shire Council.

2.3.3 Unmodified opinions

For completed financial statements, 124 (91.8 per cent) unmodified opinions were issued, confirming that these financial statements have been prepared according to the requirements of legislation and relevant accounting standards. This percentage is consistent with last year's result of 123 (91.1 per cent) unmodified opinions issued and indicates that there are still a number of prior year accounting issues that require resolution.

2.3.4 Qualified opinions

Qualified audit opinions are issued when part or all of the financial statements do not comply with relevant accounting standards and legislative requirements.

The 11 qualified opinions (8.1 per cent) issued so far this year is consistent with last year, when 12 qualified opinions (8.9 per cent) were issued for the 135 completed financial statements. The reasons for which these opinions were issued, primarily asset valuations, take a number of years to fully resolve.

Figure 2B
Qualified audit opinions

Entity	Reason	Previously qualified
Councils		
Burdekin Shire Council	A full comprehensive revaluation of the council's road and bridge assets in 2011–12 identified significant anomalies in the data recorded in the asset register. This placed significant doubt over the accuracy of the reported balances for road and bridge assets in the prior financial year. As council was unable to quantify the impact of these anomalies on values used for comparative purposes in 2011–12 these amounts cannot be relied upon. Further, the council did not provide sufficient evidence to support condition and useful life assessments over water, sewerage and drainage assets as required by Australian Accounting Standard AASB 116 *Property Plant and Equipment*. The reported written down values of water, sewerage and drainage assets, associated depreciation expenses and the asset revaluation surplus balance reported in 2011–12 cannot be relied upon.	
Cloncurry Shire Council	The council did not have sufficient evidence to demonstrate that its road, drainage and bridge infrastructure assets were valued in accordance with AASB 116 *Property Plant and Equipment*. This affected the property, plant and equipment and the asset revaluation surplus balances and these balances could not be relied upon.	
Gympie Regional Council	In 2010–11, the council could not quantify the impact that the floods had on their road, bridge and drainage assets. As flooding caused extensive damage to the council's road, bridge and drainage assets, the council was unable to demonstrate that the reported value of its road and drainage network was at fair value as required by required by AASB 116 *Property, Plant and Equipment*. These 2010–11 amounts, used for comparative purposes in the 2011–12 financial statements, could not be relied upon.	2010–11
Lockyer Valley Regional Council	In 2010–11, the council did not have sufficient evidence to demonstrate that its road, drainage and bridge infrastructure assets were valued in accordance with AASB 116 *Property Plant and Equipment*. The council did not make necessary corrections following the revaluation of these assets in 2011, affecting the property, plant and equipment and the asset revaluation surplus balances. These 2010–11 amounts, used for comparative purposes in the 2011–12 financial statements, could not be relied upon.	2010–11
Pormpuraaw Aboriginal Shire Council	In 2010–11, the council did not provide sufficient evidence to support condition and useful life assessments over property, plant and equipment as required by AASB 116 *Property, Plant and Equipment*. The valuations assumed no change in remaining useful lives or condition ratings of the council's property, plant and equipment assets. These 2010–11 amounts, used for comparative purposes in the 2011–12 financial statements, could not be relied upon. Also in 2010–11, the council did not maintain effective controls and reconciliations over their kiosk revenue. These amounts which are used for comparative purposes in 2011–12 could not be relied upon.	2009–10 2010–11
Torres Strait Island Regional Council	In 2010–11: • Council failed to maintain effective system of internal control and adequate supporting documentation for its payroll function, including employee benefit liabilities. • Weaknesses existed in the internal controls over cash and cash equivalents and the identification of cash losses. • Significant uncertainty existed over the completeness and accuracy of the reported opening balances for property, plant and equipment and the reported movements in the asset revaluation surplus and retained surplus balances. The associated depreciation expense was also qualified. • Prior period errors and the manner in which these errors were corrected in the financial statements were not adequately disclosed or sufficiently supported by documentation. These 2010–11 amounts, used for comparative purposes in the 2011–12 financial statements, could not be relied upon.	2008–09 2009–10 2010–11

Entity	Reason	Previously qualified
Controlled entities		
Ipswich Mayor's Carols by Candlelight Fund Inc.	The Fund could not demonstrate the appropriateness and validity of expenditure incurred in relation to event management.	
Local Buy Trading Trust	The Trust could not demonstrate it had identified and recorded all revenue owing from tender arrangements. This qualification arose from inherent limitations in the Trust's system of internal control over tender revenue that relies on the completeness and accuracy of statistical returns provided by suppliers.	2008–09 2009–10 2010–11
The Rockhampton Art Gallery Trust	The Trust could not demonstrate it had identified and recorded all revenue from donations. The qualification drew attention to the risk inherent in management assuring the complete recording of cash collected through donations.	2007–08 2008–09 2009–10 2010–11
Western Downs Disaster Relief Fund	The Fund had insufficient documentation to verify that vouchers for goods and services were provided only to eligible recipients. An emphasis of matter paragraph was also included with the opinion as the Fund had been wound up.	2010-11
Woorabinda Pastoral Company Pty Ltd	The company did not undertake a full stocktake of all biological assets, and did not have sufficient evidence to support the existence of all of the total reported number of cattle, or their market value.	2010-11

2.3.5 Emphasis of matter paragraphs

A paragraph can be included with the audit opinion, drawing attention to or emphasising a matter in the financial statements without warranting modification of the audit opinion. Emphasis of matter paragraphs were included with 24 unmodified audit opinions (18 per cent) issued for completed financial statements, compared to 25 audit opinions (18.5 per cent) issued last year.

Of the 24 emphasis of matter paragraphs, 15 emphasis of matter paragraphs drew attention only to the use of Special Purpose Financial Statements as required by Australian Auditing Standards. These entities are detailed in Appendix B.

The remaining nine emphasis of matter paragraphs related to business risk issues (Refer to Figure 2B and Figure 2C).

Figure 2C
Unmodified audit opinions but with an emphasis of matter

Entities	Reason
Councils	
Cherbourg Aboriginal Shire Council	The council used grant monies to meet operational needs, casting doubt on its ability to continue as a going concern.
Gold Coast City Council Logan City Council Redland City Council	Allconnex Water was discontinued and the value of the councils' investment may have been affected.
Moreton Bay Regional Council	The council was reviewing its recorded transport infrastructure and the 2011–12 value disclosed may not have been complete.
Northern Area Peninsula Regional Council	The council used grant monies to meet operational needs, casting doubt on its ability to continue as a going concern.
Controlled entities	
Esk–Gatton–Laidley Water Board	The board was being wound up and the financial statements were not prepared on a going concern basis.
Outback@Isa	The company was reliant on subsidies from its parent entity, Mount Isa City Council to fund its operations, creating uncertainty about its ability to continue as a going concern.
The Brolga Theatre Board Inc.	The board liabilities exceeded assets, creating uncertainty that the board could continue as a going concern.

2.3.6 Status of outstanding opinions from prior years

Audit opinions had not been issued for the financial statements of 11 local government entities when *Report 2:2012 Results of audits—Local government financial statements for 2010–11* was tabled in May 2012. Audit opinions have now been issued and details of these opinions are included in Appendix D.

The financial statements for Burke Shire Council and Central Highlands Regional Council were issued with unmodified audit opinions.

A qualified audit opinion was issued for the financial statements of Kowanyama Aboriginal Shire Council because the council did not have sufficient evidence to demonstrate that its buildings, residential assets, roads, drainage, water, sewerage and other infrastructure assets were valued in accordance with Australian Accounting Standard AASB 116 *Property Plant and Equipment.*

A qualified audit opinion was issued for the financial statements of Western Downs Disaster Relief Fund as the Fund had insufficient documentation to verify that vouchers for goods and services were provided only to eligible recipients. An emphasis of matter was also included with the opinion as the Fund was being wound up.

Emphasis of matter paragraphs were included with seven other audit opinions issued for completed financial statements. Of the seven emphasis of matter paragraphs, five drew attention only to the use of Special Purpose Financial Statements as required by Australian Auditing Standards. These are disclosed at Appendix D. The other two were due to going concern issues, summarised in Figure 2D.

Figure 2D
2010–11 unmodified audit opinions but with an emphasis of matter

Entities	Reason
Cherbourg Aboriginal Shire Council	The council used grant monies to meet operational needs, casting doubt about its ability to continue as a going concern.
Western Sub Regional Organisation of Councils	The entity was being wound up and the financial statements were not prepared on a going concern basis.

2.4 Significant financial reporting issues

As councils are stewards of major public infrastructure, it is unsurprising that the majority of financial reporting issues identified during our audits of councils relate to asset recording, recognition and valuation.

Achieving comparability and consistency in valuing specialised public sector infrastructure assets continues to represent a significant challenge for councils, given the differences in the methodologies adopted by valuers and the subjective nature of the key inputs and assumptions applied in the valuation process.

While councils can engage professional valuers to help in valuing their assets, councils have ultimate responsibility for the valuations. This requires councils to have an appropriate understanding of the scope of work performed by valuers, including any limitations, the methodology adopted by the valuers and the key assumptions and inputs used in applying the valuation methodology.

The impact of natural disasters only adds to this complexity and presents real financial risks in terms of access to federal and state assistance. The need to spend money to meet deadlines imposed under grant agreements does not always sit well with the need to demonstrate compliance with all grant conditions. Both circumstances create risks that councils will be left to fund part or all of the replacement of their infrastructure affected by natural disasters.

2.4.1 Valuation of infrastructure assets

Infrastructure assets, including roads, bridges, sewerage and water assets, represent a significant balance in the financial statements of all Queensland councils. These assets are reported at their estimated fair value in accordance with Australian Accounting Standard AASB 116 *Property, Plant and Equipment.*

For the 2011–12 financial year, the independent auditor's reports for the following councils included qualified opinions or emphasis of matter paragraphs as a result of issues associated with infrastructure assets:

- Burdekin Shire Council
- Cloncurry Shire Council
- Gympie Regional Council
- Lockyer Valley Regional Council
- Moreton Bay Regional Council
- Pormpuraaw Aboriginal Shire Council.

In addition, the complexity of valuing infrastructure assets regularly affects the comparability of council financial statements and the time and cost of preparing and auditing these statements; notably, 15 of the 24 councils (63 per cent) obtained Ministerial extensions for their 2011–12 annual reports on the basis of asset valuation-related issues.

Impact of movements in fair value on audited financial statements

To remain current, the reported values of infrastructure assets are subject to regular revaluations. These vary from the application of appropriate cost and price indices to a full valuation by professional valuers.

The difficulty in estimating the fair value of infrastructure assets has meant that the reported values are often subject to significant annual adjustments. The 68 councils audited to date reported infrastructure assets with a total estimated fair value of $ 63.6 billion as at 30 June 2012.

The net revaluation increment for these infrastructure assets during 2011–12 was $1.6 billion (2010-11: $0.97 billion). This net increment for 2011–12 comprised:

- 49 councils who reported increments totalling $3.0 billion during 2011–12 which represents an average of 9.57 per cent of the reported fair value of these assets as at 30 June 2012
- 11 councils who reported decrements totalling $1.4 billion during 2011–12 which represents an average of 6.15 per cent of the reported fair value of these assets as at 30 June 2012
- eight councils who reported no movement in the fair value of their assets during 2011–12.

Of the 49 councils reporting an increase in fair value, 14 councils reported valuation increments that were over 10 per cent of the reported fair values as at 30 June 2012. In one instance, the valuation increment represented over 48 per cent of the reported fair value of infrastructure assets as at 30 June 2012.

Of the 11 councils reporting a decrease in fair value, four councils reported valuation decrements that were over 10 per cent of the reported fair values as at 30 June 2012. In one instance, the valuation decrement represented over 28 per cent of the reported fair value of infrastructure assets as at 30 June 2012.

While these adjustments may arise from changes in prevailing economic conditions or other external factors such as recent natural disasters, they can also arise from changes in the methodology adopted in estimating the fair value of the assets.

Using depreciated replacement cost to estimate the value of infrastructure assets

As there is no active market for assets of this nature, councils estimate their fair value by using a depreciated replacement cost (DRC) approach. While AASB 116 permits the use of this approach, it provides limited guidance as to how such an approach is to be applied in practice.

Determining DRC can be a complex, costly and time consuming process and involves the use of a range of inputs and assumptions, many of which are subjective in nature. Key inputs and assumptions commonly associated with a DRC valuation include, but are not limited to the:

- nature and dimensions of the asset's component parts—such as the length and width of road pavements or the diameter of drainage pipes
- unit rates used for estimating the current replacement cost of each asset component—labour and materials
- total and remaining estimated useful life of the asset component—taking into account potential for obsolescence
- estimated residual value at the end of the asset's useful life—either scrap value or recondition and re-use
- present condition of the asset—its physical attributes and functionality and how these change over time
- depreciation method—which needs to reflect the pattern in which the service potential of the asset is consumed over its useful life.

Challenges faced by councils in the use of these inputs and assumptions include:

- conducting regular reviews to ensure they remain current and are accurately reflected in the estimated fair value of the asset
- ensuring there is adequate evidence available to support the assumptions and inputs.

Most issues identified in auditing the fair value of infrastructure assets arise from a lack of evidence to support the completeness and accuracy of the underlying asset component data and to support the key inputs and assumptions used to calculate the DRC.

Reliance on the work of professional valuers

Given the complexity involved, the majority of councils engage professional valuers every three to five years to provide valuations. While the use of professional valuers enhances the robustness of the valuation process, responsibility for acceptance of the values ultimately rests with the councils.

Accepting responsibility for the values reported in the annual financial statements requires councils to:

- understand the process used by valuers
- interpret the results of the valuation process
- evaluate and challenge the key assumptions and inputs used by the valuers
- identify and understand the reason for significant movements in the asset values
- ensure there is adequate support for the valuation process and the values provided
- include adequate disclosure in the financial statements of all key assumptions and inputs used to determine the asset values.

Councils also must maintain sufficient and appropriate evidence to support their asset values. At present, councils rely heavily on the valuation reports provided by the professional valuers as support for the valuation process and the resultant asset values; however, these reports do not provide a sufficient level of disclosure to allow the councils, and the auditors, to understand fully the valuation approach adopted by the valuer.

Areas where disclosures in valuers' reports and the valuation methodologies they adopt are often found to be deficient during an audit include:

- the extent of the investigations undertaken by the valuer in relation to the physical inspection of assets and verification of information supplied by the councils
- the sources of the data provided to, or relied upon, by the valuer and the procedures completed to ensure the data was complete and accurate
- identification of all key assumptions and inputs used in the valuation process.

These differences in valuation methodologies affect adversely the ability to achieve comparability in the reported values of infrastructure assets including:

- comparability between councils
- comparability between financial years for the same council where a change in valuer has occurred.

The lack of clear disclosure in valuers' reports also:

- reduces the ability of councils to understand the valuation process and the results of the valuation
- results in additional effort required to obtain sufficient appropriate evidence to enable the council to assess the valuation process adequately
- results in delays in the preparation and audit of the councils' financial statements.

Key assumptions and inputs used in the valuation process need to be disclosed in the financial statements if councils are to comply with accounting standard requirements. Deficiencies in the level of detailed information provided to the councils in the valuers' reports also affect adversely their ability to comply with these disclosure requirements.

Examples of better practice in valuers' reports are provided in International Valuation Standard IVS 103 *Reporting*. When professional valuers are engaged, councils should require that reports provided are consistent with the requirements of IVS 103.

In some jurisdictions, such as Victoria, the responsible departments have worked with the Office of the Valuer-General to prepare additional guidance to be applied in developing methodologies for determining the fair value of local government assets. While the application of the methodologies still needs to reflect the individual circumstances of each council, the benefit of this approach is that it ensures greater consistency and comparability in the results of the valuation process. Such an approach may also assist in reducing the time and cost associated with council asset valuations.

There would be benefit in councils using the skills and experience available in the Office of the Valuer-General in engaging professional valuers. This assistance could include:

- developing requests for proposals to engage valuers
- reviewing proposals received by valuers
- selecting valuers.

This assistance could be extended to establishing a panel of pre-approved valuers and model requests for proposals to engage valuers.

Impact of recent natural disasters on asset valuations

The recent natural disasters in Queensland are likely again to have a significant impact on the valuation of infrastructure assets for the affected councils in the 2012–13 financial year.

Challenges previously identified in accounting for the impacts of the 2011 natural disasters included:

- assessing the condition of the assets affected by the natural disasters to determine whether any assets, or significant parts of the assets, were lost or severely damaged and needed to be written off
- assessing the condition of the asset as at the reporting date to ensure this is accurately reflected in the value of the asset disclosed in the financial statements
- ensuring there is adequate disclosure in the financial statements to provide users of the financial statements with meaningful information to enable them to fully assess the impact of the natural disasters.

These same challenges will need to be addressed by councils in preparing their 2012–13 financial statements.

2.4.2 Natural Disaster Relief and Recovery Arrangements (NDRRA)

To facilitate recovery after major natural disasters, the Australian Government provides financial assistance to the state government through the Natural Disaster Relief and Recovery Arrangements (NDRRA). The Australian Government reimburses up to 75 per cent of eligible costs incurred by the state. These costs relate primarily to the restoration of state and local government roads and other public infrastructure.

As at 30 June 2012, the state's funding program under NDRRA was estimated at $12.1 billion with works due for completion by 30 June 2014. Of this, $4.9 billion relates to restoration works being undertaken by Queensland councils. The estimated costs of the recent natural disaster events are still being determined but are expected to have a significant impact on the funding program.

The coordination of the delivery of the state's NDRRA relief measures is now the responsibility of the Queensland Reconstruction Authority (QRA). Prior to the establishment of QRA, the former Department of Community Safety, through Emergency Management Queensland (EMQ), was responsible overall, but the former Department of Local Government and Planning was responsible for processing claims for financial assistance from councils.

The table at Figure 2E details the estimated program of reconstruction works against the year in which the natural disaster event occurred, the value of the works program delivered by councils as at 30 June 2012 and the value of works still to be completed.

Figure 2E
Estimated NDRRA reconstruction works by disaster event year

	2010 and prior ($ bil.)	2011 ($ bil.)	2012 ($ bil.)	2013 ($ bil.)
Total program estimate*	$3.0	$7.3	$1.8	$12.1
Total program estimate relating to local councils*	$1.3	$3.0	$0.6	$4.9
Total value of works program delivered relating to local councils as at 30 June 2012*	$0.9	$0.9	$0.03	$1.8
Total value of works program to be completed by local councils *	$0.4	$2.1	$0.6	$3.1

* Unaudited budget figures supplied by QRA

Source: QAO

The value of works to be completed by councils by 30 June 2014 is $3.1 billion, being 63 per cent of the total council works program. Failure to complete the works by 30 June 2014 may reduce the contribution from the Australian Government.

Establishing eligibility of NDRRA claims by councils

Prior to the establishment of the QRA, the acquittal of NDRRA payments followed established custom and practice based on the interpretation and understanding of the payment conditions at the time. This included reliance on certificates by engineers and councils regarding eligible expenditure.

With a significant increase in the quantum of expenditure required, the introduction of the National Partnerships Agreement for Disaster Reconstruction and Recovery for the 2010–11 flooding and Cyclone Yasi and the establishment of QRA in February 2011, the interpretation of the NDRRA Determinations 2007 and 2011 came under closer scrutiny by both the Australian Government and the state.

As a result, it became apparent that there had been inconsistent interpretation of the Determinations by local governments and that the effectiveness of their systems of control over such expenditure varied significantly. In particular the 'sign offs' by engineers—while evidence that work had been undertaken and that the associated expenditure was reasonable for the work undertaken— did not substantiate that the conditions attached to the assistance provided had been met fully, in terms of all eligibility criteria as understood subsequent to this scrutiny and clarification of requirements.

Standards of evidence that had been applied previously were reviewed and, at this point, we reassessed our audit approach to the level of evidence needed to support claims, including the outstanding claims dating back to 2009–10.

From an audit perspective, the auditing standards require a qualified audit opinion where the auditor is unable to substantiate a material component of a financial amount that is the subject of the opinion. In the situation described here, a qualified audit opinion was issued because it was not possible to assess reliably the condition of assets pre-flood damage—a prerequisite to being able to establish the validity of restoration claims.

As a result, a qualified opinion was issued on the state's acquittals to the Australian Government regarding the 2009–10, 2010–11 and 2011–12 claims for financial assistance under NDRRA, although it is recognised that not all expenditure for the periods in question would be ineligible.

The qualification primarily related to the eligibility of $0.93 billion of council claims (36 per cent of the total state expenditure of $2.6 billion) that lacked the necessary documentation to allow a reliable assessment in line with the NDRRA Determinations.

During the 2011–12 audit of the Whitsunday Regional Council, concerns were raised by QRA and the council in relation to the eligibility of certain costs claimed by the council on the restoration of roads. Concerns specifically related to work performed outside the original approved scope and roads being restored to a better condition than the pre-disaster standard. Subsequently the council, with QRA's assistance, has identified an exposure of approximately $18.0 million for expenditure incurred in restoring assets to a better standard than is eligible under the NDRRA.

Due to the significance of this issue, the council has experienced a considerable strain on both its staff and financial resources. This, in turn, has been the main factor in the council being unable to finalise its 2011–12 financial statements.

Issues were also identified by QRA at the Burke Shire Council relating to the administration of the Council's NDRRA program. Key findings by QRA were breakdowns in procurement processes, inadequate program management, recording of project costs not readily identifiable to relevant jobs and possible ineligible expenses claimed relating to on-costs and assets not built to pre-existing standards. This also was the primary reason for the council being unable to finalise its 2010–11 financial statements in a timely manner.

QRA have now been made solely responsible for administering claims for all past and current events. The QRA has established robust systems to address previous deficiencies including initiatives such as a value for money strategy; on site inspections at councils; progress payments; scheduled reviews of projects at the 50 per cent and 100 per cent stage; 10 per cent retention of costs until final confirmation of project deliverables; and review of actual costs to council ledgers.

Through these pre- and post-payment approval processes, QRA has now established a clear understanding with local governments and a greater certainty about compliance requirements with the Determinations. This is evidenced by our ability to determine the eligibility of expenditure on claims processed through QRA.

Future risks for councils

Prior to the 2013 natural disaster events, $3.1 billion of capital works needed to be completed by councils before 30 June 2014 (63 per cent of total program). Councils not affected by the recent events are still required to meet this deadline. Affected councils now have until 30 June 2015 to complete repairs of assets recently damaged that would be eligible for funding under NDRRA.

Councils need to ensure they have in place effective procurement processes, robust program management practices, systems that capture all project costs accurately and staff skills to manage large capital works programs. This will be a major challenge for councils inexperienced in managing large capital works projects in a short time frame. Where activities are outsourced, councils need to monitor closely the management of these projects.

For 2013 events, the state and federal governments have agreed on a framework for consideration of betterment proposals. The betterment provisions allow states to restore or replace essential public assets to a more disaster-resilient standard than the pre-disaster standard. To be considered, councils are required to demonstrate the cost effectiveness of the proposal and ensure the increased disaster resilience will mitigate the impact of future disasters.

2.4.3 Demerger of Southern SEQ Distributor-Retailer Authority (trading as Allconnex Water)

The establishment and dissolution of Allconnex Water within a two-year period has cost $53.4 million and resulted in a similar number of employees and net assets being transferred back to the councils involved.

Figure 2F
Summary of transfers and associated costs

	Asset Transfers ($ bil.)	Employee Transfers	Costs ($ mil.)
Establishment	$4.1	812	$27.9
Demerger	$4.4	764	$25.5
Total			**$53.4**

Source: QAO

Allconnex Water was established in November 2009 from the amalgamation of water businesses of city councils of the Gold Coast, Redland and Logan as part of south-east Queensland (SEQ) water reform under the *South-East Queensland Water (Distribution and Retail Restructuring) Act 2009*.

The amalgamation involved the transfer of 812 employees and $4.1 billion of assets and resulted in initial establishment costs of $16 million.

Allconnex Water became fully operational on 1 July 2010 and recorded a profit before tax for 2010-11 of $325,000. This included a $30.7 million impairment loss associated with the revaluation of the transferred assets. This result was affected by a further $11.9 million in establishment costs, and $32.4 million in costs incurred under service level agreements with the participating councils. In 2011–12, Allconnex Water made a before-tax profit of $108.5 million. This included $23.6 million in costs incurred under service level agreements with the participating councils.

On 7 April 2011, the then-Premier of Queensland announced that councils in south-east Queensland could 'opt out' of their distributor-retailer business. In August 2012, Gold Coast City Council resolved to withdraw from Allconnex Water, after which the other participants, Redland City Council and Logan City Council confirmed their decisions to withdraw.

Following amendment to the *South-East Queensland Water (Distribution and Retail Restructuring) Act 2009,* all Allconnex Water's assets and liabilities were transferred back to the participating councils on 1 July 2012. Allconnex Water was subsequently abolished on 30 September 2012 and 48 fewer employees were transferred back to the councils, together with their assets, valued then at $4.4 billion.

Allconnex Water incurred $11.9 million in demerger costs, which included terminated capital projects totalling $7.1 million. Under the terms of the demerger, Gold Coast City Council was responsible for all dissolution costs.

Since the transfer of assets from Allconnex Water on 1 July 2012, Gold Coast City Council incurred an additional $11.6 million to date and budgeted for an additional $2.0 million in withdrawal costs to 30 June 2013, the deadline for claims to be submitted.

2.5 Recommendations

It is recommended:

1. **The Department of Local Government, Community Recovery and Resilience works with the Office of the Valuer-General and councils to develop an agreed methodology for valuation of infrastructure assets and an agreed approach for engagement of professional valuers.**
2. **Councils affected by recent natural disasters implement the systems, processes and controls to:**
   - **demonstrate their funding claims relate only to eligible costs**
   - **identify and assess the cost-effectiveness of replacing assets to a more disaster-resilient standard**
   - **lodge their funding submissions with QRA in a timely manner**
   - **schedule and complete all approved works by the deadlines imposed under NDRRA.**

3 Timeliness and quality of financial statements

In brief

Background

The usefulness of council financial reports depended on the quality of the information contained in them and the time taken to produce them.

Conclusions

- Ongoing financial information provided to councillors during the year may not have been of acceptable quality for financial decision making.
- Local government was the least timely, and therefore the least accountable, of the three tiers of government.

Key findings

- Adjustments totalling $2.6 billion were made to management certified statements for 51 of 68 audited councils.
- The 68 councils audited to date had $6.8 billion of adjustments in the prior period.
- Reduced adjustments were attributed to engaging and finalising valuation processes earlier which allowed enhanced, quality review procedures.
- Ten of the 68 councils audited to date were unable to complete their 2011–12 asset valuations in a timely manner.
- One council provided for audit, statements signed by management that did not consolidate a significant controlled entity. This highlighted the need for all councils to exercise the influence they have over their controlled and associated entities in financial reporting timetables.
- There were 24 councils (33 per cent) with audit opinions issued after the 30 November deadline. Only nine councils (12 per cent) would have achieved the new 31 October reporting deadline introduced in 2012–13.
- Only 55 of the 68 councils audited to date have made their annual reports available on their respective websites.
- There were 24 councils granted annual report extensions from the Minister for 2011–12. Eleven of these 24 councils also requested an extension last year.

Recommendations

It is recommended:

3. **All councils with 2011-12 audit opinions issued after 31 October 2012 implement changes to their financial reporting processes that address the major reasons for the delay.**
4. **The Department of Local Government, Community Recovery and Resilience determines and publishes criteria for granting ministerial extensions to reporting deadlines in ‘extraordinary circumstances'.**

3.1 Background

The *Local Government Act 2009* requires each council to establish financial management systems that identify and manage financial risks, including risks to reliable and timely reporting. The performance of financial management systems requires regular review.

Effective financial systems are able to routinely produce timely and reliable financial information for management, councillors and users of council services. An efficient system will integrate internal management reporting with external accountability reporting as far as possible.

3.2 Conclusions

The volume and extent of significant changes required to financial statements prior to certification by audit signifies that quality assurance processes, including councils' assessments of the reasonableness of reported information, still have room for significant improvement. In this regard several small and Indigenous councils with limited resources provide lessons in better practice, as they produce good-quality, management certified financial statements consistently.

Local government continues to be the least timely, and therefore the least accountable, of the three tiers of government. In this regard, Queensland councils also perform poorly in comparison to councils other states and territories, particularly Victoria and Tasmania, where the Auditor-General has a similar mandate.

The usefulness and relevance of council annual reports is significantly reduced where these reports are not available to the community soon after the end of the financial year. The time delays in councils providing audit with financial statements indicate also that ongoing financial information provided to councillors during the year is not comprehensive enough to identify new and emerging financial risks, nor is it sufficiently precise for informed, high-quality financial decision making.

A majority of councils can only meet the new 31 October reporting deadline for 2012–13 if they change the way they approach their financial reporting process, particularly in the timing of their annual asset valuations and the presentation of a complete, quality set of financial statements for audit. Changing financial reporting systems and turnover of key staff are not excuses for continued untimely reporting—councils need implementation plans and succession strategies in place to cover such eventualities.

3.3 Quality of draft financial statements

The frequency and size of errors in the draft financial statements are a direct measure of accuracy. All errors identified during the audit process are raised with the council; where errors are material, adjustments are requested.

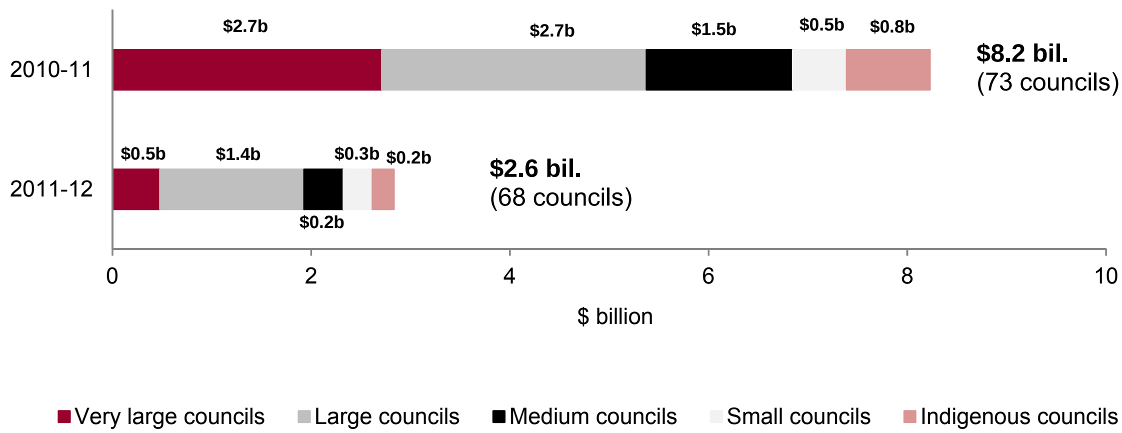
Before audit review, the draft financial statements should be subject to quality checks by the council to be assured that they are materially complete, are in accordance with management's understanding of the council's operations for the year, comply with accounting requirements and are ready for audit.

Ideally, each council prepares one set of financial statements, and no adjustments are made or required after they are provided for audit. This ideal was not achieved for the 2011–12 financial statements of 52 of 68 councils audited to date.

While a significant number of councils made adjustments to the financial statements provided to audit, there was a decrease in the dollar value of audit adjustments to management certified financial statements.

Adjustments initiated by management or arising from audit examination, totalled $2.6 billion in 2011-12 (68 councils audited to date), compared to $8.2 billion in 2010–11 (73 councils). Large councils accounted for 54 per cent (33 per cent in 2010–11) of the significant adjustments. Figure 3A compares the extent of financial statement adjustments with the prior year by council categorisation.

Figure 3A
Financial statement adjustments by council type ($ billions)



Source: QAO

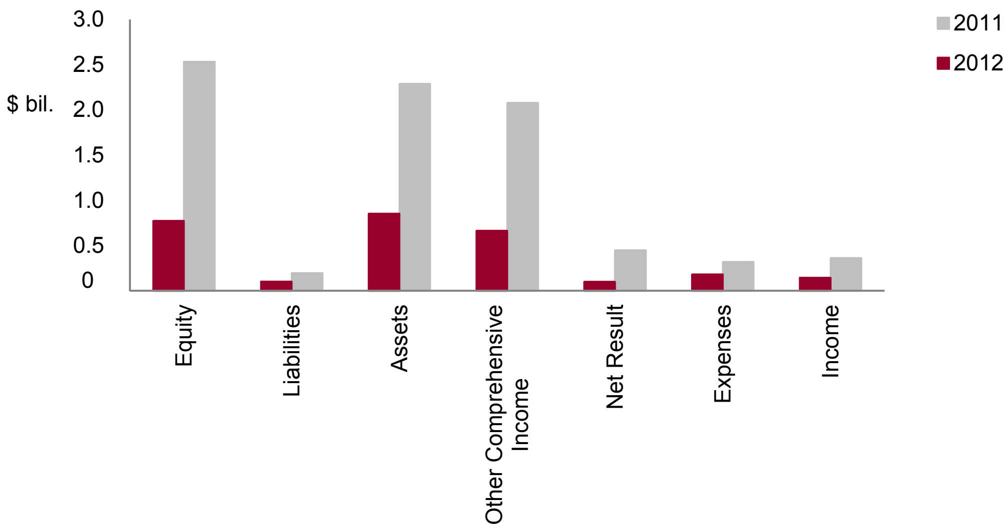
Of the $8.2 billion in total adjustments in the prior year, $6.8 billion related to the 68 councils audited to date. These 68 councils have reduced their financial statement adjustments by $4.2 billion (62 per cent).

This significant reduction was attributable to earlier engagement and finalisation of valuation processes which, in turn, allowed for the enhanced quality review procedures to be undertaken over the draft financial statements prior to providing them for audit.

However, 21 of the councils audited to date did not implement an independent quality review of their draft financial statements, by a person not involved in their preparation, prior to management certification. These councils accounted for $0.51 billion in adjustments (19 per cent).

Figure 3B compares the adjustments with the prior year for all key financial statement components.

Figure 3B
Adjustments by financial statement component ($ billions)



Source: QAO

Of the total adjustments of $2.6 billion, $1.0 billion related to Fraser Coast Regional Council. These adjustments reflected the council's non-consolidation of Wide Bay Water Corporation into the management signed statements provided to audit. This highlighted the need for all councils to exercise the influence they have over their controlled and associated entities to ensure the required financial information is provided to the council in time for the council to meet its financial statement timetable.

Adjustments related to asset valuations resulted in a $0.59 billion change to other comprehensive income, a $0.78 billion change to asset balances and a $0.77 billion change in equity. The following ten councils did not complete their asset valuation process on a timely basis:

- Aurukun Shire Council
- Barcaldine Regional Council
- Burke Shire Council
- Flinders Shire Council
- Isaac Regional Council
- Mackay Regional Council
- McKinlay Shire Council
- Napranum Aboriginal Shire Council
- South Burnett Regional Council
- Tablelands Regional Council.

Accordingly, significant movements occurred between the values in the draft financial statements of these councils as certified by council management and the audited financial statements. This issue was also identified in the prior year's report to Parliament on local governments.

In addition to changes in the reported figures, significant changes were required to the financial statement notes so that the disclosures fully and accurately reflected the councils' policies; appropriately described the processes for the valuation of infrastructure assets; and met the Australian accounting standards disclosure requirements.

Quality assurance checks should ensure that:

- the financial statements agree with the supporting notes
- notes to the financial statements adequately explain the council's policies and provide the level of disclosure required by Australian accounting standards
- only notes relevant to the operations of the council are reported
- revaluations of non-current assets have been included
- information on movements in non-current assets reconcile to prior year financial statements and underlying asset registers.

3.4 Timeliness of financial statements

3.4.1 Councils

The protracted time taken by many councils to provide financial statements for audit and produce their annual reports—a persistent theme of past reports to Parliament—has continued in 2011–12.

The legislative time frame for councils to finalise their 2011–12 audited financial statements was 30 November, which was five months after the balance date of 30 June. Figure 3C shows 49 of the 73 councils' (67 per cent) financial statements were certified by management and audit within this legislated time frame, two more councils than in 2010–11.

Figure 3C
Audit opinions issued by the 30 November annual reporting deadline

	2011–12	2010–11	2009–10
Number finalised	49	47	65
Per cent	67	64	89

Source: QAO

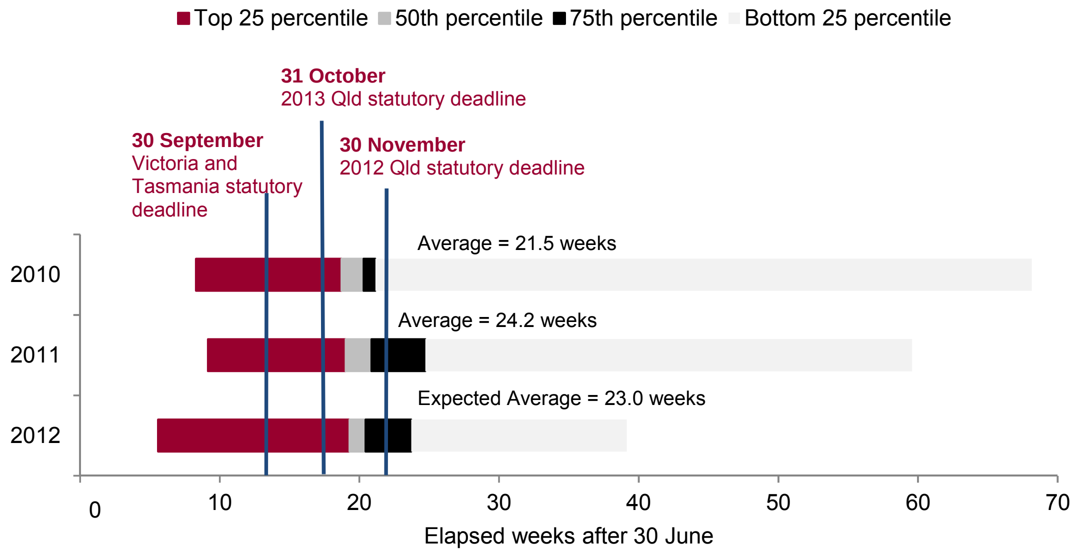
While this is a slight improvement on the prior year, when compared to other Queensland Government sectors and local governments in other states, it is a poor result.

The significant deterioration in timeliness between 2009–10 and 2010–11 resulting, either directly or indirectly, from the recent series of natural disasters that have affected most Queensland local government areas, was not addressed during 2011–12.

Many of the obstacles to timely reporting presented by disaster situations can and have been overcome by some councils with appropriate contingency planning and change management processes. That all have not been able to return to more acceptable time frames is a pointer to a lack of internal resilience and capacity within these councils.

Figure 3D shows the average time to finalise council financial statements over the past three years. This year, the average time was estimated to be 23.0 weeks compared with 24.2 weeks in 2010-11 and 21.5 weeks in 2009–10. From a best result in 2009–10, the average time has worsened over the past three years, with the average time being more than five months to finalise financial statements when the legislative requirement had been only five months.

Figure 3D
Average time to finalise council financial reports



Note: For unfinalised 2012 audits, the estimated audit opinion date was based on the Ministerial extension date and QAO expectation.

Source: QAO

Under the new *Local Government Regulation 2012*, councils will be required to finalise their audited financial statements by 31 October instead of 30 November. In 2011–12, only nine councils' audit opinions were issued before 31 October 2012. To achieve this earlier reporting deadline, the majority of councils would need to significantly improve their planning and reporting processes, particularly the:

- timing of annual asset valuations
- presentation of a complete, quality set of financial statements for audit
- implementation and change management strategies when changing financial systems
- the introduction of early hard closes
- succession planning and training strategies for staff in key positions.

Figure 3E shows the number and size of councils that would have met the new time frame for reporting had it been introduced this year—88 per cent of councils would not have been able to meet this time frame.

Figure 3E
Councils which would have met 31 October time frame had it been introduced in 2011–12

	Very large	Large	Medium	Small	Indigenous	Total
Number	3	2	3	0	1	**9**
Percentage of category	25	13	23	0	6	**12**

Source: QAO

Timeliness by council size

While the timeliness of the very large and large councils improved this year, the timeliness of medium, small and Indigenous councils worsened from 2011 to 2012 as shown in Figure 3F.

Figure 3F
Audit opinions issued by 30 November annual reporting deadline

	Very large	Large	Medium	Small	Indigenous	Total
Number of councils	12	16	13	16	16	73
2010–11	11 (92%)	6 (38%)	8 (62%)	13 (81%)	9 (56%)	47 (64%)
2011–12	12 (100%)	12 (75%)	6 (46%)	12 (75%)	7 (44%)	49 (67%)
Variance	**+1 (+8%)**	**+6 (+37%)**	**-2 (-16%)**	**-1 (-6%)**	**-2 (-12%)**	**+2 (+3%)**

Source: QAO

This was primarily a result of having limited finance staff and insufficient succession planning or change management processes to complete financial reporting tasks as well as other finance-related tasks associated with the delivery of restoration works under the Natural Disaster Relief and Recovery Arrangements (NDRRA).

Interstate comparisons

The legislative deadline for councils in Victoria and Tasmania to finalise their audited financial statements was 30 September: 99 per cent of councils in Victoria and 86 per cent of councils in Tasmania met these deadlines for 2011–12. Only four Queensland councils (5 per cent) achieved this time frame.

3.4.2 Other local government entities

Audit opinions for the financial statements of ten other local government entities remain unissued at the date of this report.

Figure 3G shows the timeliness of the 2011–12 audited financial statements of other local government entities, compared to the 2009–10 and 2010–11 financial statements.

Figure 3G
Financial statement timeliness of other local government entities

Number of months after the end of financial year audited statements were finalised	2011–12 Number	2011–12 %	2010–11 Number	2010–11 %	2009–10 Number	2009–10 %
Less than 3 months	23	30	21	27	6	8
3 to 5 months	28	36	24	31	47	64
5 months or more	26	34	33	42	21	28
Total	**77**	**100**	**78**	**100**	**74**	**100**

Source: QAO

In 2011–12, there was an improvement of eight per cent in the number of financial statements finalised within five months from 2010–11. The number of entities finalised within three months also improved by three per cent compared with the prior year.

3.4.3 Timeliness of council annual reports

There were 22 councils that did not adopt and make public their 2010–11 annual reports, including the audited financial statements, until after 15 January 2012. Of these, four councils (Cherbourg Aboriginal Shire Council, Northern Peninsula Area Regional Council, Woorabinda Aboriginal Shire Council and Yarrabah Aboriginal Shire Council) had not adopted their 2010–11 reports by 28 February 2013.

Under the *Local Government (Finance, Plans and Reporting) Regulation 2010*, the Minister could approve an extension of the 30 November deadline for councils to adopt their annual reports, including their audited financial statements.

The new *Local Government Regulation 2012* allows ministerial extensions of the date for completion of the audited financial statements where the Minister considers there to be extraordinary circumstances that make it impractical for the local government to comply. The new Regulation also retains the option for the Minister to grant an extension to the date by which a council's annual report must be adopted.

Figure 3H details the 24 councils (33 per cent) that requested an annual report extension from the Minister for 2011–12. This was 11 per cent less than the 32 extensions provided last year. Eleven of the 24 councils (46 per cent) also requested an extension last year. All council requests for annual report extensions were granted in 2011–12.

As shown in Figure 3H, 15 of the 24 councils (63 per cent) received extensions because of asset valuation issues, mainly to conduct detailed assessments of the condition of assets affected by past natural disasters. Four councils (17 per cent) had issues implementing a new finance system and a further five councils (21 per cent) had issues with turnover or availability of key staff.

The recent amendments to the local government legislation require councils to adopt their 2012–13 annual reports, including the audited financial statements, within one month of the audit opinion date. The adopted annual report is then required to be made available on the council's website within two weeks of adoption.

Figure 3H
Annual report extensions 2011–12

Council	Reason for extension	Date extension granted to	Date audit opinion signed	2010–11 extension
Pormpuraaw Aboriginal Shire Council	Asset valuation issues	19.12.2012	10.12.2012	Yes
Western Downs Regional Council	Asset valuation issues	19.12.2012	18.12.2012	Yes
Aurukun Shire Council	Asset valuation issues	20.12.2012	12.12.2012	No
Quilpie Shire Council	Implementation of new finance system	22.12.2012	18.01.2013	No
Cook Shire Council	Financial statement issues	31.12.2012	14.12.2012	Yes
Palm Island Aboriginal Shire Council	Asset valuation issues	31.12.2012	06.12.2012	Yes
Torres Shire Council	Asset valuation issues, implementation of new finance system	31.12.2012	12.12.2012	No
Paroo Shire Council	Asset valuation issues	30.01.2013	31.01.2013	Yes
Woorabinda Aboriginal Shire Council	Financial statement issues	30.01.2013	26.02.2013	No
Banana Shire Council	Asset valuation issues, inexperienced finance staff	30.01.2013	14.12.2012	Yes
Gympie Shire Council	Asset valuation issues	30.01.2013	13.12.2012	No
Isaac Regional Council	Asset valuation issues	30.01.2013	11.12.2012	Yes
Maranoa Regional Council	Implementation of new finance system	30.01.2013	Not completed	No

Council	Reason for extension	Date extension granted to	Date audit opinion signed	2010–11 extension
Northern Peninsula Area Regional Council	Availability of key personnel, timing of council meeting to adopt report	30.01.2013	14.12.2012	No
Balonne Shire Council	Asset valuation issues	28.02.2013	14.02.2013	Yes
Burdekin Shire Council	Asset valuation issues	28.02.2013	14.02.2013	Yes
Cherbourg Aboriginal Shire Council	Asset valuation issues	28.02.2013	Not completed	No
Cloncurry Shire Council	Asset valuation issues	30.01.2013	14.02.2013	No
Hinchinbrook Shire Council	Asset valuation issues	30.01.2013	25.01.2013	Yes
Carpentaria Shire Council	Availability of key personnel, timing of council meeting to adopt report	22.03.2013	Not completed	Yes
Whitsunday Regional Council	Natural Disaster Relief and Recovery Arrangements Scheme, staff changes, going concern	29.03.2013	Not completed	No
Mapoon Aboriginal Shire Council	Financial statement issues	31.03.2013	09.01.2013	No
Kowanyama Aboriginal Shire Council	Availability of key personnel, relocation of finance area from Cairns to council	31.03.2013	Not completed	No
Wujal Wujal Aboriginal Shire Council	Asset valuation issues, implementation of new finance system	31.03.2013	Not completed	No

Source: QAO

It is acknowledged that many Indigenous councils have only recently established their own websites. However, only 55 councils of the 68 completed to date had made their annual reports available on their respective websites. By not publishing this primary accountability document on their websites in a timely manner, community members are being denied access to information that allows them to critically assess the performance of their council.

3.5 Recommendations

It is recommended:

3. **All councils with 2011–12 audit opinions issued after 31 October 2012 implement changes to their financial reporting processes that address the major reasons for the delay.**

4 **The Department of Local Government, Community Recovery and Resilience determines and publishes criteria for granting ministerial extensions to reporting deadlines in 'extraordinary circumstances'.**

4 Internal control frameworks

In brief

Background

Internal controls include the systems, policies and activities established by councils to ensure the effectiveness and efficiency of their operations, reliability of financial reporting, and compliance with applicable legislation. As part of the financial audit, we assess key internal controls over the reliability of financial reporting, with any weaknesses identified raised with management for their corrective action.

Conclusions

- The number and nature of audit issues reported indicated systemic problems relating to a lack of control consciousness and weakened governance.
- Council monitoring of controlled entities could be enhanced to ensure councils are deriving the desired outcomes from these business decisions.

Key findings

- There were 506 significant control weaknesses reported to date across the sector for 2011–12.
- There were 77 entities (62 councils and 15 related entities) identified with significant control activity weaknesses.
- Torres Strait Island Regional Council and Northern Peninsula Area Regional Council accounted for 11 per cent of the sector's significant control weaknesses.
- Burdekin Shire Council has a particularly poor internal control framework and had little regard to legislative requirements or audit recommendations related to internal controls.
- Eight councils did not have fully-developed plans for business continuity and disaster recovery.
- Six councils did not have an up to date risk management policy or risk register.
- Ten councils did not have an internal audit function during 2011–12 and seven councils spent $5 000 or less on internal audit services during 2011-12.

Recommendations

It is recommended that:

5. **Those councils without an internal audit function take immediate action to comply with this legislative requirement.**
6. **Those councils spending $5 000 or less on internal audit services annually assess the effectiveness of these services.**

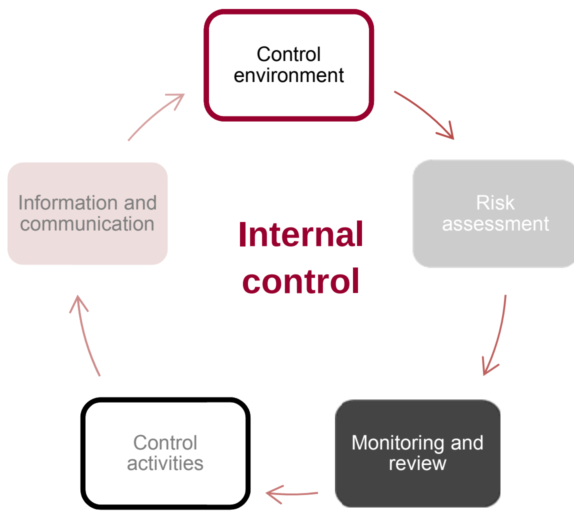
4.1 Background

Under the *Local Government Act 2009* and its Regulations, councils are required to have an effective system of internal control.

Each council is responsible for developing measures for managing risks to which their operations were exposed. These measures included maintaining an adequate system of internal control to ensure that financial records and other information are complete and accurate, assets are safeguarded, and errors and other irregularities are prevented or detected.

Figure 4A sets out the five main components of an effective internal control framework.

Figure 4A
Internal Control Framework



Source: QAO

In the diagram:

- control environment—management's actions, attitudes, policies and values that influence day to day operations
- risk assessment—consideration of relevant risks to achieving the organisation's objectives, forming a basis for risk management
- control activities—policies and procedures that help ensure management directives are carried out
- monitoring and review—assessment of the internal controls to ensure they are in use throughout the period, effective and meet the changing needs of the organisation
- information and communication—systems that support the capture and exchange of relevant information in a form and time frame that enable people to carry out their responsibilities.

4.2 Conclusions

While there was a significant reduction across the sector in the number of control activity weaknesses we raised, the number and nature of audit issues reported this year indicated that systemic problems remained underpinned by a lack of control consciousness and weak governance within councils and their related local government entities.

A serious concern is that 19 councils had non-existent, immature or ineffective internal audit functions during 2011–12. In these councils, internal audit was not being used as intended to monitor the effectiveness of internal control. Maintaining effective internal control is a key accountability obligation of the chief executive to the council.

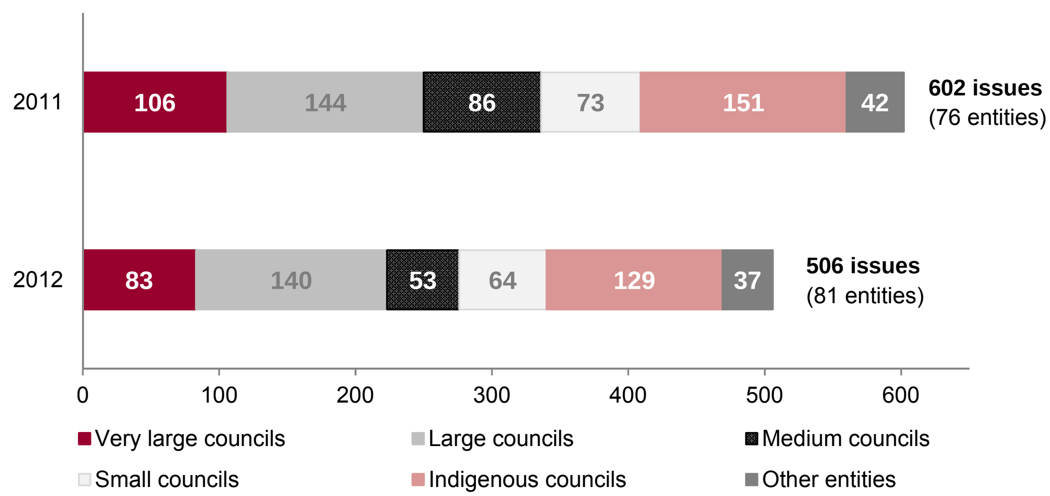
Burdekin Shire Council is singled out as it had a particularly weak internal control framework, and it paid little regard to legislative control requirements or audit recommendations related to internal controls.

4.3 Internal control frameworks

Internal controls include the systems, policies and activities established by councils to ensure the effectiveness and efficiency of their operations, reliability of financial reporting and compliance with applicable legislation. As part of the financial audit an assessment was made of key internal controls over the reliability of financial reporting, and any weaknesses identified were raised with management for corrective action.

Across the sector, we reported 506 control weaknesses to management during 2011-12 as illustrated in Figure 4B.

Figure 4B
Significant control weaknesses reported by category



Source: QAO

These 506 issues (2010-11: 602 issues) were analysed against the components of the internal control framework. Eighty-one per cent (2010-11: 87 per cent) of the control issues identified related to weaknesses in control activities.

Torres Strait Island Regional Council and Northern Peninsula Area Regional Council accounted for 54 (11 per cent) of the significant control weaknesses identified across the sector.

Torres Strait Island Regional Council's prolonged internal control issues were a catalyst for the Acting Director-General, Department of Local Government, Community Recovery and Resilience's appointment of a financial controller to the council under section 118 of the *Local Government Act 2009* in November 2012.

An emphasis of matter paragraph was included in Northern Peninsula Area Regional Council's audit report to highlight that the council had used grant monies to meet operational needs which cast doubt on the council's ability to continue as a going concern.

4.3.1 Control environment

Planning and accountability documents outline the goals, strategies and policies for implementing an organisation's vision, managing finances, ensuring information system security and achieving sustainable management of infrastructure. Effective policies and plans allow management to reinforce relevant legislative requirements and organisational priorities and are a cornerstone in establishing a good control environment.

Having documented and approved policies and plans for the recovery of information systems and continuity of all critical business functions in disaster situations is particularly important.

Despite the significant impact natural disasters have had on Queensland local governments in recent years, the following eight councils continued to have inadequate, incomplete or undocumented plans for business continuity and disaster recovery:

- Burdekin Shire Council
- Burke Shire Council
- Cook Shire Council
- Lockyer Valley Regional Council
- Maranoa Regional Council
- Mount Isa City Council
- Scenic Rim Regional Council
- Tablelands Regional Council.

Of these, Lockyer Valley Regional Council and Scenic Rim Regional Council were severely affected by the recent rainfall and flooding associated with ex-Tropical Cyclone Oswald.

4.3.2 Risk management

Risk management is the process of establishing and maintaining an effective method to identify, analyse and mitigate risks relevant to achieving business objectives and/or preparing reliable financial statements. Risk management policies and risk registers identify councils' major risk exposures and the control measures adopted to mitigate those risks.

Six councils did not have an up to date risk management policy or risk register:

- Boulia Shire Council
- Burdekin Shire Council
- Cook Shire Council
- Mapoon Aboriginal Shire Council
- Northern Peninsula Area Regional Council
- Western Downs Regional Council.

Failure to appropriately identify and document significant and emerging business risks considerably diminishes these councils' effectiveness at managing risks to their financial position and their ability to deal with unexpected events. We reported the same finding for each of these councils in 2010-11.

4.3.3 Control activities

Control activities are the specific procedures established to protect assets, ensure reliable accounting records, promote efficiency and encourage adherence to the organisation's policies. Effective controls provide early warning of weaknesses or susceptibility to error; support for timely reporting; and early identification of irregularities.

We continued to identify most control activity weaknesses in large and Indigenous councils. These councils account for 53 per cent (2010-11: 49 per cent) of the significant audit issues raised across the sector.

Figure 4C shows the number of significant control activity weaknesses reported by category.

Figure 4C
Significant control activity weaknesses by category

Category	Number of entities		Number of issues	
	2011–12	2010–11	2011–12	2010–11
Councils				
Indigenous	12	15	102	125
Small	12	12	48	62
Medium	10	11	41	67
Large	16	15	115	134
Very large	12	12	74	99
Other				
Local government entities	15	9	30	37
Total	**77**	**74**	**410**	**524**

Source: QAO

Progress on addressing issues identified in prior years that remained unresolved was followed up during 2011–12. Approximately 25 per cent of the issues identified in 2010–11 remained unresolved in 2011–12 and were raised again with the councils. Torres Strait Island Regional Council showed the least improvement with approximately 43 per cent of audit issues raised again in 2011–12.

Sixty-two councils and 15 related local government entities had significant weaknesses in control activities associated with their accounting and supporting systems and processes. These weaknesses reflected a business or financial risk that we recommended the relevant entities correct as a matter of priority.

The major issues were:

- shortcomings in controls over the valuation of non-current assets, including incomplete asset registers, a lack of understanding of the valuation methodology adopted, untimely capitalisation of work in progress and insufficient documentation to support management's review of the key assumptions used and reasonableness of valuation outcomes
- weaknesses in information system and user access controls, including inadequate change management controls which increased the risk of unauthorised or inappropriate access to core financial systems and data
- non-compliance with procurement and tendering policies which affected achieving value for money and increased the risk of fraud
- inadequate monitoring and review of reports, reconciliations and processes across non-current assets, expenditure and payables, employee expenses and benefits and general ledger journals which increased the likelihood of unauthorised or inappropriate transactions
- inadequate segregation of key duties across expenditure and payables, employee expenses and benefits and revenue and receivables which increased the risk of inappropriate activities such as fraudulent payments or misappropriation
- failure to manage excessive leave balances of staff which created possible workplace health and safety issues and large leave liabilities
- breakdowns in controls over corporate card processes, including review and authorisation of transactions incurred and non-compliance with internal council policies, which increased the risk of inappropriate transactions been incurred.

4.3.4 Monitoring and review over control activities

Monitoring and review activities evaluate whether the components of the system of internal control are in place and operating effectively, with a view to detecting and remediating any control deficiencies. An internal audit function and an audit committee are two key monitoring and review activities.

An effective internal audit function provides assurance to a council that appropriate internal controls exist and are operating effectively; risks are being managed; and operations are being run economically.

An effective audit committee provides a forum to promote communication with internal and external audit; oversights internal audit activity; and ensures the integrity of financial reporting. Without an audit committee, there is no independent monitoring of remedies to internal audit issues raised.

Internal audit function

Since 1 July 2010, all councils have been legislatively required to establish an internal audit function. As at 30 June 2012, the following 10 councils did not have an internal audit function:

- Barcaldine Regional Council
- Boulia Shire Council
- Bulloo Shire Council
- Burdekin Shire Council
- Burke Shire Council
- Diamantina Shire Council
- North Burnett Regional Council
- Torres Strait Island Regional Council
- Winton Shire Council
- Woorabinda Aboriginal Shire Council.

All of these councils advised that they would establish an internal audit function during 2012–13. To date, only two councils—Boulia Shire Council and Torres Strait Island Regional Council—have done so.

A further two councils – Hinchinbrook Shire Council and Goondiwindi Regional Council – established internal audit functions during 2011-12 which were still maturing at 30 June 2012. We will commence assessing the effectiveness of these functions in 2012-13.

While the amount of money spent on internal audit during a particular year is not necessarily an indicator of its effectiveness, benchmarking the amount spent within each council category highlighted councils well outside the average for that category.

Figure 4D shows the average amount spent on internal audit services by council category and the range of amounts spent within the category.

Figure 4D
Average dollars spent on internal audit for 2011–12 by council category

Category	Average spend ($000)	Range of spend ($)
Very large	440	64 000 to 1.8 mil.
Large	69	20 000 to 138 000
Medium	16	800 to 68 000
Small	6	2 500 to 10 000
Indigenous	25	6 000 to 56 000
Total	**127**	**800 to 1.8 mil.**

Source: QAO

Seven councils across the medium and small categories spent $5 000 or less on internal audit services during 2011–12, compared to average spends of $16 000 and $6 000 respectively.

Five of these councils used the internal audit services provided by the Local Government Association of Queensland Limited. These services are provided at a low cost as part of a council's membership of the Association.

An effective internal audit for even small and medium sized councils is unlikely to be achieved for $5 000 or less.

Audit committees

Since 1 July 2010, the local government legislation has required all councils within remuneration category 3 and higher, as determined by the Local Government Remuneration and Discipline Tribunal (i.e. all councils other than small, Indigenous, and some medium councils) to establish an audit committee. Burdekin Shire Council was the only council required to establish an audit committee that failed to do so. The council advised that an audit committee would be established during 2012–13.

While not required to do so, Torres Strait Island Regional Council established an audit committee. This was a positive step which, in conjunction with the department's appointment of a financial controller, should enable the council to achieve greater accountability and transparency in future.

Monitoring of controlled entities

Councils directly control 63 entities and there are a further 41 jointly controlled or related local government entities across the sector (refer Appendix B and Appendix C). The level of oversight of these entities varies significantly across the sector. As councils are responsible for the activities of their controlled entities, they have an obligation to ensure these entities are being managed effectively, achieving their objectives and providing positive outcomes to the community. Where this is not the case, councils need to reassess whether these entities remain the most appropriate vehicles for delivering these services.

In 2009–10, we reported that City of Brisbane Arts and Environment Limited, a controlled entity of Brisbane City Council and trustee of the Brisbane Arts Trust and the Brisbane Environment Trust failed to comply with the trust deeds for these entities, in that monies were inappropriately transferred from the trusts to the trustee. Weaknesses in board reporting and record keeping were also identified.

The 2010–11 and 2011–12 audits of City of Brisbane Arts and Environment Limited and the associated trusts were not performed as all the accounting records could not be located. While there were limited, low-value transactions during these periods and these entities had ceased trading, we were not able to determine whether all transactions were appropriate.

Previous Auditor-General reports to Parliament had reported on the financial difficulties being experienced by Poruma Island Pty Ltd, a controlled entity of Torres Strait Island Regional Council, and Edward River Crocodile Farm Pty Ltd, a controlled entity of Pormpuraaw Aboriginal Shire Council. These companies were both in voluntary administration and, therefore, did not prepare financial statements for 2011–12 (refer to Appendix C). At the date of this report, these companies were yet to be formally deregistered by the Australian Securities and Investment Commission.

4.4 Recommendations

It is recommended:

5. **Those councils without an internal audit function take immediate action to comply with this legislative requirement.**
6. **Those councils spending $5 000 or less on internal audit services annually assess the effectiveness of these services.**

5 Financial sustainability

In brief

Background

To be sustainable, councils need to adopt longer-term planning processes that manage future financial risk, while maintaining an appropriate level of services to their communities.

This section details our assessment of council's financial sustainability from an analysis of the following financial sustainability measures:

- operating surplus ratio—capacity to meet operating expenditure from operating revenue
- net financial liabilities ratio—capacity of the council to repay long-term liabilities, especially borrowings
- capital replacement ratio—comparison of the rate of capital spending on property, plant and equipment to the rate of depreciation.

Conclusions

Except for Indigenous councils, the overall financial sustainability risk for councils in 2011–12 was rated as low.

Key findings

- Sixteen councils, including 11 of the 14 Indigenous councils, were at higher risk of becoming unsustainable if the results from the previous three years continued.
- The department proposed to review and reissue its financial sustainability guidelines and include detailed guidance on the calculation of the three sustainability measures, including comments on the calculation and assumptions used in the nine-year financial sustainability forecasts.
- Twenty of the 55 councils which published their 2011–12 annual reports on their respective website did not disclose all three financial sustainability measures.

Recommendations

It is recommended:

7. **The Department of Local Government, Community Recovery and Resilience revises and reissues the financial sustainability guidelines so that councils are provided detailed guidance (including examples) on the calculation of the three sustainability measures well in advance of councils having to present them for audit in 2012–13.**

8. **The Department of Local Government, Community Recovery and Resilience works with Queensland Treasury Corporation to actively assist councils in refining the assumptions used in their long-term forecasts to heighten council awareness of the impact today's budgetary decisions have on a council's long-term financial sustainability.**

5.1 Background

To be sustainable, councils need to adopt longer-term planning processes that manage future financial risk, while maintaining an appropriate level of services to their communities.

Business risks that affect liquidity, key infrastructure assets and debt financing require evaluation within a sustainability strategy. By measuring sustainability using financial indicators, councils could highlight the strengths and weaknesses of their current strategy.

The implementation of the new *Local Government Regulation 2012*, effective from 14 December 2012, halved the number of financial sustainability measures reported by councils annually. Council annual reports are required to include the following three measures:

- operating surplus ratio
- net financial liabilities ratio
- asset sustainability ratio.

We have used a capital replacement ratio in this report in lieu of the asset sustainability ratio, as there was insufficient information contained in the audited financial statements for the calculation of that measure in 2011–12. Appendix E details the financial sustainability measures used and the 2011–12 results for each council.

Our assessment of the three measures was based on actual results for the last three years, and did not take into account councils' long-term forecasts or credit assessments undertaken by Queensland Treasury Corporation (QTC). QTC's assessments are forward-looking and apply other credit metrics overlaid with qualitative characteristics.

5.2 Conclusions

Meaningful assessments of financial sustainability could not be made over periods of less than three years. Our overall financial sustainability relative risk assessment used the financial data reported for the past three years, starting with 2009–10 which was the first 12-month financial year for all amalgamating councils (mainly regional councils) under the former *Local Government Reform Implementation Regulation 2008*. Our future assessments will mature from this baseline position.

The risk rating assigned did not mean that councils were presently unsustainable. It was based on actual experience over the past three years and on the premise that if this actual experience continued, the risk of the councils becoming unsustainable increased.

The 16 councils rated this year as at higher risk of becoming unsustainable consistently incurred operating losses over the last three years. Operating surpluses are required over the long-term so that councils can self-fund their asset acquisitions and repay debt.

While the local government legislation required all councils to include financial sustainability measures in their annual reports, 20 of the 55 councils to publish their 2011–12 annual reports on their respective website did not disclose all three financial sustainability measures. Non-disclosure or incorrect disclosure of financial sustainability measures in council annual reports could mislead users about a council's sustainability.

5.3 Results for each measure

The three financial sustainability measures were calculated using information from the 68 financial statements (consolidated where applicable) completed to date and were compared to the targets identified by the Department of Local Government, Community Recovery and Resilience, as contained in the department-issued *Financial Management (Sustainability) Guideline 2011*. We understand that the department would review and reissue an amended guideline during 2012-13.

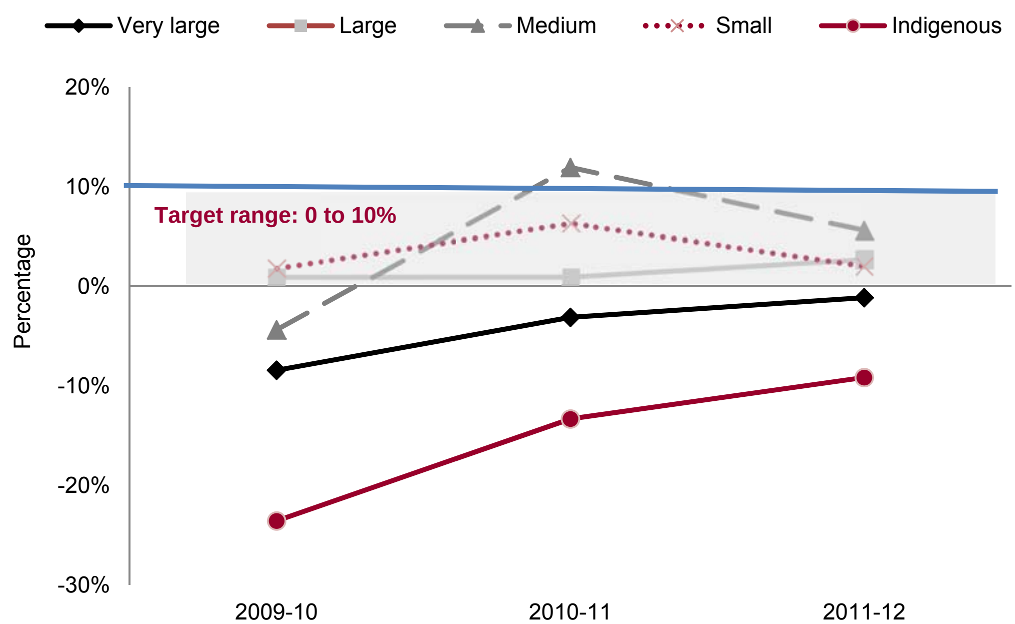
Appendix E (Figure E4) details the individual financial sustainability ratios for the councils audited to date.

5.3.1 Operating surplus ratio

This ratio indicated the extent to which operating revenues raised covered operating expenses. The department's target range for councils was an operating surplus (that is, positive) ratio of between 0 and 10 per cent.

Figure 5A compares the movement in the average operating surplus ratio over the past three financial years by council category: based on the 68 councils audited to date.

Figure 5A
Operating surplus ratio (average by council category)



Source: QAO

For 2011–12, 34 councils out of 68 completed to date (50 per cent) spent more than they earned and 18 of these councils also reported operating deficits in 2010–11. These councils were predominately very large and Indigenous councils.

A further 14 councils exceeded the department's target of greater than 10 per cent of total operating revenue. Six of these also exceeded the target in 2010–11. Exceeding this target is positive in the short-term, but should be at the expense of maintaining appropriate service levels and effective infrastructure for the local community.

To rate a councils' overall financial sustainability (refer Appendix E, Figure E4) we used the average operating result for the last three years. This provides a more informed indicator of actual trends, rather than looking at the 2011–12 actual results in isolation.

The overall financial sustainability of the following 16 councils was rated as being at higher risk based on their average operating surplus ratios:

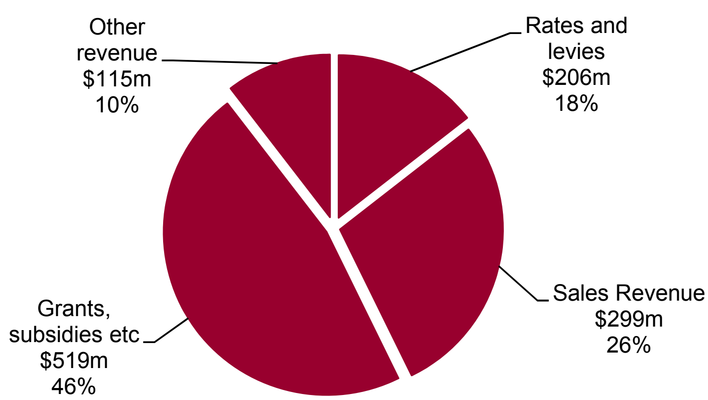
- Cook Shire Council
- Cherbourg Aboriginal Shire Council
- Doomadgee Aboriginal Shire Council
- Gold Coast City Council
- Lockhart River Aboriginal Shire Council
- Mapoon Aboriginal Shire Council
- Mornington Shire Council
- Northern Peninsula Area Regional Council
- Palm Island Aboriginal Shire Council
- Paroo Shire Council
- Pormpuraaw Aboriginal Shire Council
- Redland City Council
- Torres Strait Island Regional Council
- Western Downs Regional Council
- Woorabinda Aboriginal Shire Council
- Yarrabah Aboriginal Shire Council.

With the exception of Western Downs Regional Council and Paroo Shire Council, these councils also incurred substantial operating deficits for 2011–12, with minimal improvement (if any) from 2010–11. Western Downs Regional Council and Paroo Shire Council achieved an operating surplus in 2011–12.

These results were further considered in conjunction with the composition of council operating revenues. A council's operating revenue base includes grants, subsidies, contributions and donations received from external bodies.

Figure 5B depicts the amalgamated 2011-12 operating revenue composition for medium, small and Indigenous councils.

Figure 5B
Operating revenue composition – Medium, Small and Indigenous



Source: QAO

As shown in Figure 5B, medium, small and Indigenous councils relied heavily on grant funding provided by the federal and state governments.

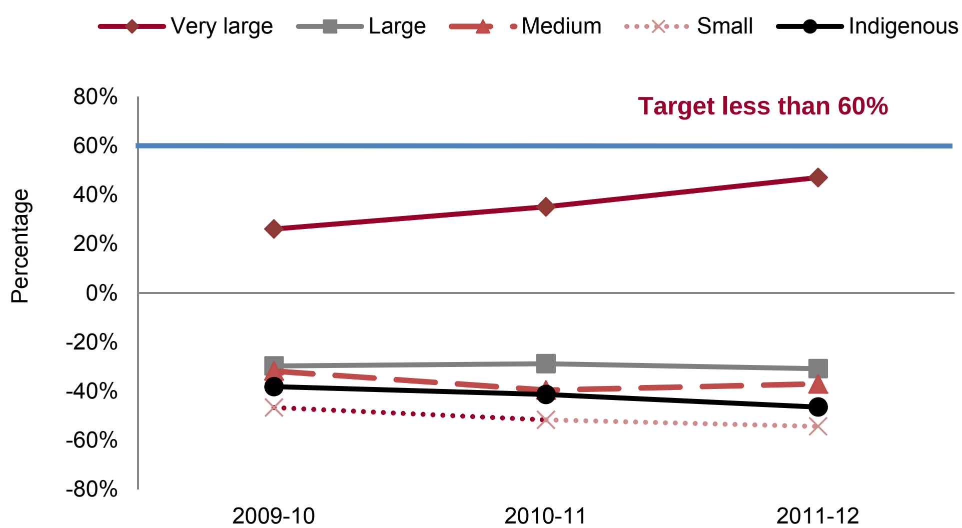
In addition to operational grant funding, medium and small councils also relied on significant sales revenue generated from the rectification work they undertook on state roads. The revenue derived from this source is disproportionately high in times of natural disaster, so the significance of recent natural disasters in Queensland may have masked the sustainability positions of these councils.

5.3.2 Net financial liabilities ratio

The net financial liabilities ratio indicates the extent to which a council's operating revenues can service its net liabilities (usually loans and leases) while maintaining its assets and level of community services. The department's target range for councils is a net financial liabilities ratio of not greater than 60 per cent. If net financial liabilities are greater than 60 per cent of operating revenue, councils have limited capacity to increase loan borrowings and may experience stress in servicing their debt.

Figure 5C compares the movement in average net financial liabilities ratio over the past three years by council categorisation: based on the 68 councils audited to date.

Figure 5C
Net financial liabilities ratio (average by council category)



Source: QAO

For 2011–12, the following four very large councils had net financial liabilities that exceeded the 60 per cent target:

- Brisbane City Council
- Ipswich City Council
- Rockhampton Regional Council
- Townsville City Council.

The high debt levels these councils are carrying—$3.577 billion (out of a total debt of $7.532 billion for the sector)—directly relate to the large capital projects they are currently undertaking.

Indebtedness

An indebtedness ratio can be used to further analyse a council's ability to cover its non-current liabilities. This ratio compares non-current liabilities (mainly comprised of borrowings) to own-sourced revenue which excludes grants, subsidies, contributions and donations. It is calculated as total non-current liabilities divided by own-sourced revenue. The higher the percentage, the less able a council is to cover long-term debts from self-generated revenues.

While an indebtedness ratio is not required by the *Local Government Regulation 2012*, its application in 2011–12 revealed that ten of 12 very large councils and six of 16 large councils had an indebtedness ratio more than 60 per cent.

We further analysed the indebtedness of these councils by comparing their annual interest payments on their state government debt to their own-sourced revenue. The higher the percentage, the less own-source revenue a council has to meet community needs.

On average, large and very large councils annually spend 3.3 per cent of their own-sourced revenues on interest payments. Ipswich City Council spent $20.2 million (9.7 per cent) of its own-sourced revenue servicing its state government debt in 2011–12. While we acknowledge that Ipswich City Council's water and waste water services are provided by an associated water entity, on average, very large councils subject to the same water reform processes spend 4.8 per cent of their own-sourced revenues on interest payments servicing state government debt.

5.3.3 Asset sustainability ratio

Asset sustainability approximates the extent to which a council is replacing its assets as these assets reach the end of their useful lives. The ratio indicates the extent of spending on existing assets through renewing, restoring and replacement compared with depreciation. Ratios higher than 1:1 (i.e.100 per cent) indicate that spending is higher than the depreciation rate.

The department's target range for councils is a ratio greater than 0.90. A value less than 0.90 may be indicative of a declining asset base and/or an inadequate asset management plan. However, a low percentage may also indicate the asset base is relatively new, such as those resulting from rectifying extensive natural disaster damage which does not require replacement or renewal.

The department-issued *Financial Management (Sustainability) Guideline 2011* requires the calculation to be based on that portion of capital expenditure that relates to asset renewal expenditure on existing assets, excluding expenditure incurred on the construction or acquisition of new assets. This amount was not disclosed separately in the audited financial statements. Instead, many councils sourced this renewal information from their unaudited asset management plans. Consequently we have not used the asset sustainability ratio to assess councils' sustainability in 2011–12.

Under the repealed local government legislation, long-term asset management plans were compulsory for all councils from 1 July 2010. However, councils were given an extension until 30 November 2011 to have their original plans finalised. The department's *Report on the 2011 Annual Return on the Status of Asset Management* stated that, of the 55 councils that responded to a survey issued on 25 October 2011, only 12 councils had finalised an asset management plan. The extent of finalised asset management plans as at 30 June 2012, as well as their robustness and maturity has not been subsequently determined by the department.

As the focus of local government legislation in force continues to move towards long-term sustainability, the department has an obligation to ensure all councils understand why long-term asset management plans are required, as well as ensuing they have the capability to update them appropriately.

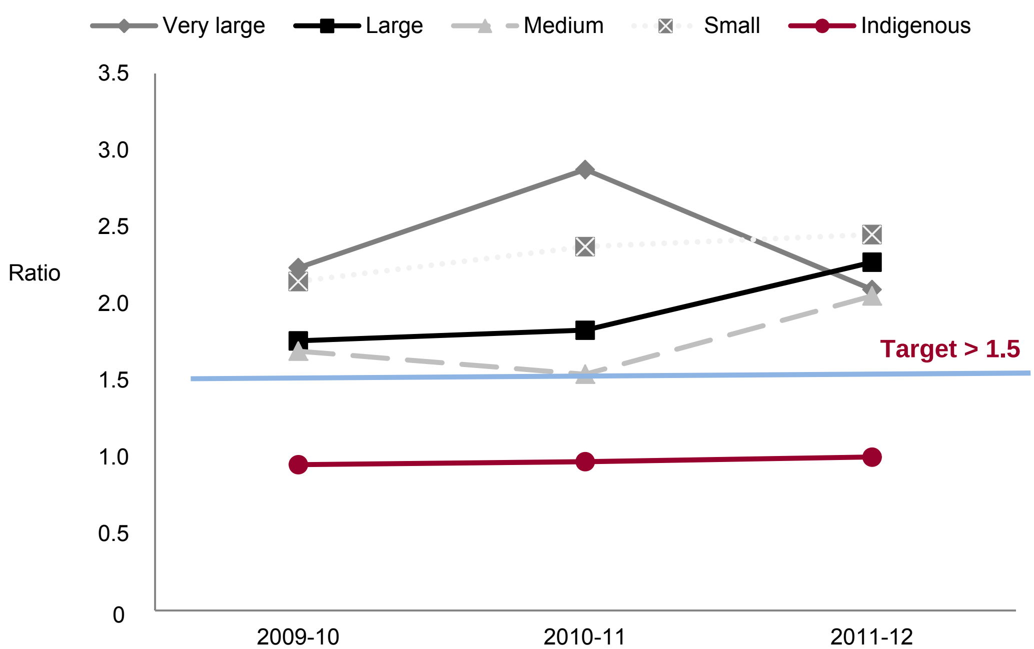
Capital replacement ratio

As the asset sustainability ratio cannot be calculated from the audited financial statements, we have used a capital replacement ratio in its place. The capital replacement ratio is a long-term sustainability ratio that compares the annual net expenditure on property, plant and equipment (predominately infrastructure) to annual depreciation expense.

Our target range for this ratio is more than 1.5 which means that councils should be generating at least 1.5 times their annual depreciation expense to be able to service their annual net expenditure on property, plant and equipment and be sustainable over the long-term. We consider 1.5 to be acceptable as a council's capital expenditure on assets is broader than its application to only renewals on existing assets. This ratio is also used by the Victorian Auditor-General's Office in its Parliamentary reporting on local government and our target range is consistent with theirs.

Figure 5D compares the movement in the average capital replacement ratio over the past three years: based on the 68 councils audited to date.

Figure 5D
Capital replacement ratio (average by council category)



Source: QAO

The extent of capital expenditure that Indigenous councils incurred directly did not fund the replacement of community infrastructure assets. The Indigenous Council Task Force 2009 noted asset management as one of the five most pressing issues confronting Indigenous councils.

The issue of depreciation of assets has very significant implications for Indigenous councils' capacity to maintain adequate services to their communities. In recognition of Indigenous councils' limited financial resources, the requisite infrastructure for roads, water, sewerage and community facilities is provided by the federal and state governments under special infrastructure programs. Without federal and state governments' grant funding or significant changes to their current operational strategies, Indigenous councils would not be able to meet ongoing asset maintenance requirements.

There were 24 councils with a 2011–12 ratio of less than 1.5 (considered as moderate risk). This included nine Indigenous councils, of the 14 audited to date, with a ratio of less than 0.9 (considered as higher risk). This meant that these Indigenous councils did not have adequate asset management plans to ensure community assets were appropriately replaced when they reached the end of their useful lives.

Asset renewal funding ratio

While not included in the new Local Government Regulation, we understand the department is liaising with Queensland Treasury Corporation and the department's South Australian counterpart regarding the possible future inclusion of an asset renewal funding ratio. This sustainability measure would be similar to the asset renewal funding ratio in the department's *Financial Management (Sustainability) Guideline 2011* and would be calculated using information contained in councils' long-term asset management plans.

Subject to the robustness and maturity of the underlying long-term asset management plans, we consider the inclusion of an asset renewal funding ratio would further strengthen the ability of a council to manage its infrastructure capital over the long term.

5.4 Annual report disclosures

Councils' 2011–12 annual reports were required to include unaudited financial sustainability measures.

Figure 5E shows the extent of 2011–12 annual reports that disclosed the three financial sustainability measures (operating surplus ratio, net financial liabilities ratio and asset sustainability ratio) required by both the new and repealed local government legislation. Only 55 of the 68 councils audited to date published their annual report on their respective website.

Figure 5E
Disclosure of financial sustainability measures

Sustainability measures disclosed	Number of councils
All three measures disclosed for actual results	35
Fewer than the required three measures disclosed for actual results	20

Source: QAO

Of the 20 councils with fewer than the required three measures disclosed for actual results:

- nine councils reported on measures other than the three measures, or disclosed a required measure as not available due to incomplete asset management plans
- 11 councils did not disclose any financial sustainability measures.

For the 35 councils that disclosed all three unaudited measures ratios in their annual report, 25 councils disclosed ratios that varied from those we calculated (disclosed in Appendix E). Such differences arose from councils interpreting the department-issued guidelines inconsistently or processing adjustments that reported a better result.

This demonstrates a lack of commitment and understanding of the financial sustainability measures. More rigour is needed in the calculation of these measures to ensure consistency of council calculations and to enable effective comparisons by the department and other users of the annual report.

5.5 Action proposed by the department

The Department of Local Government, Community Recovery and Resilience regulates legislative compliance by councils. This responsibility includes ensuring councils' annual reports comply with financial sustainability and long-term planning disclosure requirements.

To ensure it is adequately discharging its regulatory responsibilities, the department needs to evaluate the sustainability of local governments through various activities, including adherence to the financial sustainability guidelines.

In line with recommendations reported in *Report No. 2 for 2012 Results of audits: Local government financial statements for 2010–11*, the department proposed to review and reissue its financial sustainability guidelines to:

- align with the reduced number of financial sustainability measures contained in the new *Local Government Regulation 2012* to identify the additional audit requirement for the current financial year sustainability statement and for inclusion in the annual report
- include terminology and ratio calculations that aligned with nationally-agreed measures through discussions with Queensland Treasury Corporation and the department's South Australian counterpart
- include worked examples for greater guidance and assistance, particularly with the department-issued Tropical illustrative financial statements; council financial statements will need to include disclosure of asset renewal expenditure on existing assets for the calculation of the asset sustainability ratio
- include comments on the implications of having a measure outside the department's indicative targets (both above and below)
- include comments on calculation of the nine-year financial sustainability forecasts as required under the new *Local Government Regulation 2012*, including the need to back test key assumptions and complete annual sensitivity analysis.

5.6 Recommendations

It is recommended:

7. **The Department of Local Government, Community Recovery and Resilience revises and reissues the financial sustainability guidelines so that councils are provided detailed guidance (including examples) on the calculation of the three sustainability measures well in advance of councils having to present them for audit in 2012–13.**
8. **The Department of Local Government, Community Recovery and Resilience works with Queensland Treasury Corporation to actively assist councils in refining the assumptions used in their long-term forecasts to heighten council awareness of the impact today's budgetary decisions have on a council's long-term financial sustainability.**

Appendices

Appendix A—Comments

Auditor-General Act 2009 (Section 64)—Comments received

Introduction

In accordance with section 64 of the *Auditor-General Act 2009* a copy of this report was provided to the Department of Local Government, Community Recovery and Resilience, the Queensland Reconstruction Authority and all councils named in the report with a request for comment.

Responsibility for the accuracy, fairness and balance of the comments rests with the head of these agencies.

Responses to recommendations

Response to recommendations provided by the Director-General, Department of Local Government, Community Recovery and Resilience on 28 March 2013.

RECEIVED
03 APR 2013
QUEENSLAND AUDIT OFFICE

Queensland Government

Department of
Local Government, Community Recovery and Resilience

Our ref: MBN13/275

28 MAR 2013

Mr Andrew Greaves
Auditor-General
Queensland Audit Office
PO Box 15396
CITY EAST QLD 4002

Dear ~~Mr Greaves~~ Andrew

Thank you for the opportunity to comment on your draft 'Report 10: 2012-13' (Report) which will soon be tabled in Parliament. I found your Report informative and agree with many of your recommendations and observations.

In respect of your specific recommendations for the Department of Local Government, Community Recovery and Resilience (the Department), I provide the following comments:

Recommendation 1: *The Department of Local Government, Community Recovery and Resilience work with the Office of the Valuer-General and councils to develop an agreed methodology for valuation of infrastructure assets and an agreed approach for engagement of professional valuers.*

I agree that the valuation of infrastructure assets remains a significant, complex and costly financial reporting issue for local governments. I am concerned, however, about the potential resourcing impacts on the Department and the Office of the Valuer-General. As a first step, therefore, I am proposing that the Department meet with the Office of the Valuer-General to discuss your recommendation and scope the project to identify what this means for our respective agencies.

Recommendation 2: *Councils affected by recent natural disasters implement the systems, processes controls needed to:*

- *Demonstrate their funding claims relate only to eligible costs*
- *Identify and assess the cost-effectiveness of replacing assets to a more disaster resilient standard*
- *Lodge their funding submission with the Queensland Reconstruction Authority in a timely manner*
- *Schedule and complete all approved works by the deadlines imposed under the Natural Disaster Relief and Recovery Arrangements.*

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Responses to recommendations

Response to recommendations provided by the Director-General, Department of Local Government, Community Recovery and Resilience on 28 March 2013.

While this is primarily an issue to be addressed by councils, the Department fully supports the recommendation and will communicate that support to councils.

Recommendation 3: *All councils that had their 2011-12 audit opinions issued after 31 October 2012 implement changes to their financial reporting processes that address the major reasons for the delay.*

While this recommendation is directed at councils, the Department has issued two Bulletins summarising the new requirements for general purpose financial statements and the Annual Report and emphasising the need to complete processes by the earlier date. The upcoming Tropical Workshops for local government finance officers, in which the Queensland Audit Office is participating, will include a component on this issue as well as the other matters raised in your Report.

Recommendation 4: *The Department of Local Government, Community Recovery and Resilience should determine and publish criteria for granting Ministerial extensions to reporting deadlines in 'extraordinary circumstances'.*

I acknowledge the merit of this recommendation. I believe local governments would benefit from having 12 months to adjust to the new reporting timelines before introducing "extraordinary circumstances" assessment criteria.

Recommendation 5: *Those councils without an internal audit function should take immediate action to comply with this legislative requirement.*

The Department will write to each of the councils named in your Report to instruct them to institute an internal audit function unless they have already done so.

Recommendation 6: *Those councils spending less than $5,000 on internal audit services annually should assess the effectiveness of these services.*

The Department supports local governments having an effective internal audit function in line with the requirements of the *Local Government Act 2009*, and agrees that councils need to assess the effectiveness of their service, regardless of cost.

Recommendation 7: *The Department of Local Government, Community Recovery and Resilience revises and reissues the financial sustainability guidelines so that councils are provided detailed guidance (including examples) on the calculation of the three sustainability measures well in advance of councils having to present them for audit in 2012-13..*

The Department is well advanced in updating and refining the Financial Management Sustainability Guidelines (Guidelines). The Guidelines were originally issued in 2009 and were reviewed and reissued in 2011. The aim is to further clarify the definitions and align the measures to meet the requirements of the *Local Government Regulation 2012*. The Department will consult with Queensland Audit Office and Queensland Treasury Corporation prior to finalising the Guidelines. Information will be provided to councils to explain the implications and applications of these Guidelines during the upcoming Tropical Workshops for finance officers.

Page 2 of 3

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Responses to recommendations

Response to recommendations provided by the Director-General, Department of Local Government, Community Recovery and Resilience on 28 March 2013.

Recommendation 8: *The Department of Local Government, Community Recovery and Resilience work with the Queensland Treasury Corporation to actively assist councils in refining the assumptions used in their long-term forecasts to heighten council awareness of the impact today's budgetary decisions have on a council's long-term financial sustainability.*

The Department currently works with Queensland Treasury Corporation to assist councils who submit long-term forecasts in support of borrowing applications for capital works. As part of the capacity to repay assessment, the Department analyses each council's long-term financial forecast and works with the council to refine assumptions, when assessing the borrowing application.

I look forward to receiving your final Report in due course.

If you require any further information, please contact Bill Gilmore, Director, Finance and Funding Services on (07) 322 76941 or bill.gilmore@dlgcrr.qld.gov.au, who will be pleased to assist you.

Yours sincerely

Craig Evans
Director-General
Department of Local Government,
Community Recovery and Resilience

Page 3 of 3

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Comments received

Response provided by the Chief Executive Officer, Fraser Coast Regional Council on 2 April 2013.

Fraser Coast
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2 April 2013

Mr Andrew Greaves
Auditor-General
Queensland Audit Office
PO Box 15396
CITY EAST QLD 4002

Dear Sir

RE: Results of audit: Local government financial statements for 2011-12

I refer to your correspondence dated 8 March 2013 (your ref. 10651) in relation to the above matter and wish to provide comment on the proposed report. I have listed below comments on several items detailed in your draft report to Parliament on our local government financial statements for 2011-12.

Consolidation of Wide Bay Water Corporation (WBWC) statements not included in management signed statements:

Consolidation of WBWC statements requires considerable work or re-work in the removal (or reversal) of a number of transactions that cannot be shown in Queensland local government financial statements including deferred tax assets and liabilities, deferred subsidies and income tax equivalents. Some of the final calculations (including final dividends) are incomplete or not known until after the 15 September deadline to present management signed statements to audit.

In addition, a number of prior period adjustments required by WBWC were identified during their audit, requiring further adjustments to their property, plant and equipment (PPE).

Notwithstanding that the consolidation of WBWC statements could occur prior to the deadline using preliminary results (or management accounts), we believe that the number of adjustments required would be significantly greater and require considerably more resourcing and audit work than would be required by consolidating once WBWC's numbers are final, which may further delay the finalising of the audit. Furthermore, as we did not have final figures from WBWC available at the time of signing (13 September 2012), adjustments of $4,463,863 related solely to WBWC were required to the Council only accounts.

Comments received

Response provided by the Chief Executive Officer, Fraser Coast Regional Council on 2 April 2013.

This issue was discussed with Council's contract Auditors and Council's Audit Committee pre-audit and confirmation that Council were not submitting management signed consolidated statements to the auditors for the reasons stated above.

Additionally given previous years experiences with Audit issues surrounding amendments and changes as a result of consolidation prior to final audited figures from WBWC which resulted in additional costs to Council it was agreed that consolidation would only occur when the final audited figures of WBWC had been received.

Timeliness of financial statements

Although not specifically mentioned in your report, the unqualified audit opinion of Fraser Coast Regional Council's (FCRC's) financial statements was issued on 1 November 2012, or one day later than the current deadline required in the *Local Government Regulation 2012*. Even though improvements can always be made to our current planning and reporting processes to enable earlier completion, part of the reason why some Councils struggle to meet the current deadlines is that sometimes the contract auditors are not available to conduct the audit earlier, making it difficult for the audits to be completed much earlier than they are.

In FCRC's case, our contract auditors are required to complete the audit of WBWC (which is a significant entity in its own right) before FCRC, meaning they cannot substantially complete the FCRC audit until after the WBWC audit is completed. This ultimately affects the timing of the issue of the audit opinion.

Should you wish to discuss this matter further or require further information, please do not hesitate to contact Council's Financial Planning & Reporting Manager, Mr Peter Dart on the telephone number listed below.

Yours faithfully

Desmond

Lisa Desmond
Chief Executive Officer

Contact Officer:	**Peter Dart**
Phone:	**4190 5840**
Reference:	**Docs# 2333496**

Comments received

Response provided by the Chief Executive Officer, Gold Coast City Council on 2 April 2013.

Date: 2 April 2013
Contact: John Blair
Location: Waterside West
Telephone: (07) 5581 6397
Your reference: 10651
Our reference: FN342/341/12(P1) 39809761

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04 APR 2013
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Mr Andrew Greaves
Auditor-General
Queensland Audit Office
PO Box 15396
CITY EAST QLD 4002

Dear Mr Greaves

Results Of Audit: Local Government Financial Statements For 2011-12

Thank you for providing the Council of the City of Gold Coast with the opportunity to respond to the draft Auditor-General's report to Parliament 'Results of Audit: Local Government Financial Statements for 2011-12'.

It is requested that the full statement below be included in the report to Parliament to provide some context.

Statement from Council:

"Council's financial sustainability has been assessed as 'higher risk' purely on the basis of one financial sustainability ratio, being the Operating Surplus ratio. Council does not agree that it should be categorised as 'higher risk' based on such an assessment. This report to Parliament provides no context around this assessment and, in our opinion, needs to refer to other information, including key reasons for the recent trend in terms of Council's operating position.

The financial assessment undertaken by the QAO is based on the result of one ratio calculated at a given point in time. The measure does not seek to understand the reasons for the result or provide any flexibility to adjust the calculation for legitimate reasons. When viewed in isolation it gives a false impression of the real situation.

A more reliable and complete review of Council's financial position was recently conducted by Queensland Treasury Corporation (QTC). The review provided an analysis of both historical results and the future forecast. While QTC also expressed concern over the historical operating deficits, Council was issued with a moderate rating, meaning it has adequate capacity to meet financial commitments in the short to medium-term and acceptable capacity in the long-term.

Council is concerned that the ratio does not take into account the following:

- In recent years, Council contributed more than $170m towards State owned infrastructure constructed on the Gold Coast, including the Gold Coast Rapid Transit project, Metricon Stadium and Skilled Park. Because the infrastructure is State owned the contribution of $170 million had to be treated as an operating cost, resulting in a negative impact on the Operating Surplus Ratio. In contrast, Council receives contributions from developers for infrastructure but this is excluded from the Operating Surplus Ratio calculation.

Gold Coast City Council

Comments received

Response provided by the Chief Executive Officer, Gold Coast City Council on 2 April 2013.

To put the issue of Council's contribution to State owned infrastructure into context, if Council had not made these contributions the average Operating Surplus ratio for the past three years would have changed from the actual ratio of -13.7% to -8.39%. This would have put Council in the 'medium risk' range, not 'higher risk'.

- For accounting purposes, depreciation of $160 million was included as an operating cost in the Operating Surplus Ratio calculation for 2011-12, yet Council's asset management plans indicate that only $50 million (excluding Gold Coast Water) was required for asset renewal and replacement costs. Council is a growth Council and the community infrastructure is relatively new. Although Council is giving priority to maintaining and renewing its existing assets in accordance with its asset management plans, it would not be financially responsible for Council to reduce its operating costs by reallocating funding from new infrastructure to renewal and replacement simply to match depreciation, which is purely an accounting entry. Council is of the view that it has an appropriate balance between maintaining existing community assets and the needs of a growing community. Council's approach is consistent with the Department of Infrastructure and Planning 'A Guide to Asset Accounting in Local Governments - 2010' which states in part "in the past, concepts such as 'funding depreciation' were used to establish a link between capital expenditure and required levels of funding. These old concepts are no longer sufficient to address the issues being faced, with the new approach emphasising long-term asset management plans and long-term financial forecasts" and "These asset management plans and the associated forward forecasts of expenditure requirements provide a more accurate indication of the local Government's ongoing funding needs.

It should be noted that Council's Audit Advisory Committee, which includes three highly qualified external members, recently expressed its concern that a financial risk assessment based on one financial ratio without any contextual background does not represent a true reflection of Council's financial position.

Council has in place sophisticated long-term financial planning and modelling that is constantly reviewed to manage current and future financial risk, and make the appropriate adjustments for ever changing internal and external environments. Despite challenges such as a downturn in development as a result of the current economic climate, cost-shifting from other levels of government, and a looming (and significant) Commonwealth Games contribution, Council has been able to minimise projected rate increases, reduce projected borrowings and decrease future debt service payments and expenditure to ensure ongoing financial sustainability."

Again, Council appreciates the opportunity to respond to the report and I trust that you understand Council's view that it is not accurately classified as a 'higher risk' council, for the cogent reasons outlined.

Yours sincerely

Dale Dickson
CHIEF EXECUTIVE OFFICER

Auditor-General response

Response provided by the Auditor-General to the previous letter from the Gold Coast City Council.

QAO
Queensland Audit Office

Your ref:
Our ref: 2013-4164
Ms Karen Johnson – 3149 6017

4 April 2013

Mr D Dickson
Chief Executive Officer
Gold Coast City Council
PO Box 5042
GOLD COAST MC QLD 9729

Dear Mr Dickson

Results of Audit: Local Government Financial Statements for 2011-12

Thank you for the response to my proposed report to Parliament. I note the comments made and will include your response in the report.

You have challenged our assessment of Gold Coast City Council as relatively "higher risk" and provided the recent Queensland Treasury Corporation (QTC) rating of "moderate" as support. Your comments omitted that QTC rated your council as "moderate with a negative outlook". The QTC rating definition of "moderate with a negative outlook' would indicate that your council was assessed as having adequate capacity to meet its short and/or long term financial commitments but as a result of future events there is the potential for deterioration in that capacity. Based on this definition and the significant future challenges you note the council will face, I consider that the QTC rating "with a negative outlook" further supports our assessment of "higher risk".

For completeness, a copy of this letter will be included in the Appendix to my report to Parliament after your response.

Yours sincerely

Andrew Greaves
Auditor-General

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Comments received

Response provided by the Chief Executive Officer, Queensland Reconstruction Authority on 28 March 2013.

Queensland Reconstruction Authority

For reply please quote: *QldRA/CFO/CJC – QRAIN/13/1658*
Your reference: 10651

28 MAR 2013

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02 APR 2013
QUEENSLAND AUDIT OFFICE

Mr Andrew Greaves
Auditor-General
Queensland Audit Office
PO Box 15396
CITY EAST QLD 4002

Andrew
Dear Mr ~~Greaves~~

Thank you for your letter of 8 March 2013 concerning your draft report to Parliament relating to 'Results of Audit: Local Government financial statements for 2011-12. Thank you also for the opportunity to review the draft report and provide a response on behalf of the Queensland Reconstruction Authority ('Authority').

I note the comments in the draft report relating to the qualified audit opinion issued on the State's Natural Disaster Relief and Recovery Arrangements (NDRRA) acquittal to the Commonwealth.

Should you wish to discuss this matter, please do not hesitate to contact Frankie Carroll, Chief Financial Officer.

Yours sincerely

Graeme Newton
Chief Executive Officer

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Appendix B—Status of financial statements

Figure B1
Status of 2011–12 financial statement audits

Audit	Date statements signed	Date opinion issued	Opinion	Ministerial extension issued to date	Timeliness (since 30 June)		
					<3 mths	3-5 mths	>5 mths
Councils and controlled entities							
Aurukun Shire Council	05.12.2012	12.12.2012	U	20.12.2012			✓
Balonne Shire Council	14.02.2013	14.02.2013	U	28.02.2013			✓
Banana Shire Council	14.12.2012	14.12.2012	U	31.01.2013			✓
Barcaldine Regional Council	21.11.2012	21.11.2012	U	No		✓	
Barcoo Shire Council	27.11.2012	27.11.2012	U	No		✓	
Blackall–Tambo Regional Council	30.11.2012	30.11.2012	U	No		✓	
Boulia Shire Council	09.11.2012	09.11.2012	U	No		✓	
Brisbane City Council	23.08.2012	24.08.2012	U	No	✓		
• Brisbane Green Heart CitySmart Pty Ltd	20.09.2012	21.09.2012	U	N/A	✓		
• Brisbane Marketing Pty Ltd	26.09.2012	27.09.2012	U	N/A	✓		
• Brisbane Powerhouse Pty Ltd	27.09.2012	28.09.2012	U	N/A	✓		
• City of Brisbane Investment Corporation Pty Ltd	21.08.2012	28.08.2012	U	N/A	✓		
• Nuffield Pty Ltd	29.08.2012	31.08.2012	U	N/A	✓		
• TradeCoast Land Pty Ltd	15.10.2012	16.10.2012	U	N/A		✓	

Audit	Date statements signed	Date opinion issued	Opinion	Ministerial extension issued to date	Timeliness (since 30 June)		
					<3 mths	3-5 mths	>5 mths
Bulloo Shire Council	14.11.2012	14.11.2012	U	No		✓	
Bundaberg Regional Council	26.10.2012	31.10.2012	U	No		✓	
Burdekin Shire Council	02.04.2013	04.04.2013	Q	31.12.2012 28.02.2013			✓
• Burdekin Cultural Complex Board Inc.^	16.07.2012	27.07.2012	E*	N/A	✓		
Burke Shire Council	21.11.2012	21.11.2012	U	No		✓	
Cairns Regional Council	26.09.2012	26.09.2012	U	No		✓	
• Cairns Regional Gallery Limited	08.10.2012	08.10.2012	U	N/A		✓	
Carpentaria Shire Council	Not completed	Not completed		20.02.2013			
Cassowary Coast Regional Council	21.11.2012	21.11.2012	U	No		✓	
Central Highlands Regional Council	08.11.2012	09.11.2012	U	No		✓	
Charters Towers Regional Council	05.11.2012	05.11.2012	U	No		✓	
Cherbourg Aboriginal Shire Council	20.03.2013	04.04.2013	E	28.02.2013			✓
Cloncurry Shire Council	27.02.2013	13.03.2013	Q	21.12.2012 30.01.2013			✓
Cook Shire Council	13.12.2012	14.12.2012	U	31.12.2012			✓
Croydon Shire Council	12.11.2012	12.11.2012	U	No		✓	

Audit	Date statements signed	Date opinion issued	Opinion	Ministerial extension issued to date	Timeliness (since 30 June)		
					<3 mths	3-5 mths	>5 mths
Diamantina Shire Council	19.11.2012	19.11.2012	U	No		✓	
Doomadgee Aboriginal Shire Council	15.11.2012	15.11.2012	U	No		✓	
Etheridge Shire Council	12.11.2012	12.11.2012	U	No		✓	
Flinders Shire Council	15.11.2012	19.11.2012	U	No		✓	
Fraser Coast Regional Council	01.11.2012	01.11.2012	U	No		✓	
• The Brolga Theatre Board Inc.	13.12.2012	21.12.2012	E	N/A			✓
• Wide Bay Water Corp.	31.10.2012	31.10.2012	U	N/A		✓	
• Widelinx Pty Ltd	23.11.2012	12.12.2012	E *	N/A			✓
Gladstone Regional Council	13.11.2012	16.11.2012	U	No		✓	
Gold Coast City Council	02.10.2012	20.11.2012	E	No		✓	
• Broadbeach Alliance Limited	11.09.2012	20.09.2012	U	N/A	✓		
• Connecting Southern Gold Coast Limited	23.08.2012	28.08.2012	U	N/A	✓		
• Gold Coast Arts Centre Pty Ltd	17.10.2012	29.10.2012	U	N/A		✓	
• Surfers Paradise Alliance Limited	20.09.2012	27.09.2012	U	N/A	✓		

Audit	Date statements signed	Date opinion issued	Opinion	Ministerial extension issued to date	Timeliness (since 30 June)		
					<3 mths	3-5 mths	>5 mths
Goondiwindi Regional Council	07.08.2012	24.09.2012	U	No	✓		
Gympie Regional Council	13.09.2012	13.12.2012	Q	31.01.2013			✓
Hinchinbrook Shire Council	23.01.2013	25.01.2013	U	31.12.2012 31.01.2013			✓
Hope Vale Aboriginal Shire Council	08.08.2012	08.08.2012	U	No	✓		
Ipswich City Council	15.11.2012	20.11.2012	U	No		✓	
• Ipswich Arts Foundation	13.11.2012	26.11.2012	U	N/A		✓	
• Ipswich Arts Foundation Trust	13.11.2012	26.11.2012	U	N/A		✓	
• Ipswich City Developments Pty Ltd	27.02.2013	01.03.2013	U	N/A			✓
• Ipswich City Enterprises Investments Pty Ltd	27.02.2013	01.03.2013	U	N/A			✓
• Ipswich City Enterprises Pty Ltd	27.02.2013	01.03.2013	U	N/A			✓
• Ipswich City Properties Pty Ltd	Not completed	Not completed		N/A			
• Ipswich Mayor's Carols by Candlelight Fund Inc.	29.12.2013	25.03.2013	QE *	N/A			✓
Isaac Regional Council	04.12.2012	11.12.2012	U	31.01.2013			✓
• Isaac Affordable Housing Fund Pty Ltd	04.12.2012	07.12.2012	U	N/A			✓
• Isaac Affordable Housing Trust	04.12.2012	07.12.2012	U	N/A			✓
• Moranbah Early Learning Centre Pty Ltd	04.12.2012	07.12.2012	U	N/A			✓

Audit	Date statements signed	Date opinion issued	Opinion	Ministerial extension issued to date	Timeliness (since 30 June)		
					<3 mths	3-5 mths	>5 mths
Kowanyama Aboriginal Shire Council	Not completed	Not completed		31.03.2013			
Lockhart River Aboriginal Shire Council	21.11.2012	21.11.2012	U	No		✓	
• Lockhart River Aerodrome Company Pty Ltd	19.11.2012	20.11.2012	U	N/A		✓	
Lockyer Valley Regional Council	29.11.2012	30.11.2012	Q	No		✓	
Logan City Council	28.09.2012	10.10.2012	E	No		✓	
Longreach Regional Council	13.09.2012	10.10.2012	U	No		✓	
Mackay Regional Council	27.11.2012	27.11.2012	U	No		✓	
Mapoon Aboriginal Shire Council	18.10.2012	09.01.2013	U	31.01.2013			✓
Maranoa Regional Council	Not completed	Not completed		31.01.2013			
McKinlay Shire Council	26.10.2012	16.11.2012	U			✓	
Moreton Bay Regional Council	07.11.2012	12.11.2012	E			✓	
Mornington Shire Council	29.11.2012	29.11.2012	U			✓	
Mount Isa City Council	16.11.2012	19.11.2012	U			✓	
• Outback @ Isa Pty Ltd	05.03.2013	05.04.2013	E	N/A			✓
• Rodeo Capital Pty Ltd	19.10.2012	26.10.2012	U	N/A		✓	

Audit	Date statements signed	Date opinion issued	Opinion	Ministerial extension issued to date	Timeliness (since 30 June) <3 mths	3-5 mths	>5 mths
Murweh Shire Council	22.10.2012	25.10.2012	U	No	✓		
Napranum Aboriginal Shire Council	19.11.2012	19.11.2012	U	No	✓		
North Burnett Regional Council	02.11.2012	02.11.2012	U	No	✓		
Northern Peninsula Area Regional Council	04.12.2012	14.12.2012	E	31.01.2013			✓
Palm Island Aboriginal Shire Council	06.12.2012	06.12.2012	U	31.12.2013			✓
• Palm Island Community Company Limited	11.10.2012	11.10.2012	U	N/A	✓		
Paroo Shire Council	30.01.2013	31.01.2013	U	19.12.2012 30.01.2013			✓
Pormpuraaw Aboriginal Shire Council	21.11.2012	10.12.2012	Q	19.12.2012	✓		
Quilpie Shire Council	18.01.2013	18.01.2013	U	22.12.2012			✓
Redland City Council	12.11.2012	26.11.2012	E	No	✓		
Richmond Shire Council	16.10.2012	16.11.2012	U	No	✓		
• The Kronosaurus Korner Board Inc.	15.10.2012	14.12.2012	E*	N/A			✓
Rockhampton Regional Council	06.11.2012	06.11.2012	U	No	✓		
• The Rockhampton Art Gallery Trust	16.10.2012	24.10.2012	Q E *	N/A	✓		

Audit	Date statements signed	Date opinion issued	Opinion	Ministerial extension issued to date	Timeliness (since 30 June)		
					<3 mths	3-5 mths	>5 mths
Scenic Rim Regional Council	13.09.2012	25.10.2012	U	No		✓	
Somerset Regional Council	22.11.2012	26.11.2012	U	No		✓	
South Burnett Regional Council	14.11.2012	14.11.2012	U	No		✓	
• Castra Retirement Home Limited	30.10.2012	31.10.2012	U	N/A		✓	
• Kingaroy Private Hospital Limited	25.10.2012	31.10.2012	U	N/A		✓	
Southern Downs Regional Council	12.11.2012	14.11.2012	U	No		✓	
• Warwick Tourism and Events Pty Ltd	27.11.2012	30.11.2012	U	N/A		✓	
Sunshine Coast Regional Council	11.09.2012	05.11.2012	U	No		✓	
• Noosa Biosphere Limited	26.11.2012	26.11.2012	E *	N/A		✓	
Tablelands Regional Council	12.11.2012	15.11.2012	U	No		✓	
Toowoomba Regional Council	16.11.2012	16.11.2012	U	No		✓	
• Empire Theatre Projects Pty Ltd	31.08.2012	03.09.2012	U	N/A	✓		
• Empire Theatres Foundation	03.09.2012	03.09.2012	U	N/A	✓		
• Empire Theatres Pty Ltd	03.09.2012	03.09.2012	U	N/A	✓		
• Jondaryan Woolshed Pty Ltd	10.12.2012	13.12.2012	U	N/A			✓

Audit	Date statements signed	Date opinion issued	Opinion	Ministerial extension issued to date	Timeliness (since 30 June)		
					<3 mths	3-5 mths	>5 mths
• Toowoomba and Surat Basin Enterprise Pty Ltd	Not completed	Not completed		N/A			
Torres Shire Council	10.12.2012	12.12.2012	U	31.12.2012			✓
Torres Strait Island Regional Council	15.11.2012	19.11.2012	Q	No	✓		
Townsville City Council	19.11.2012	20.11.2012	U	No	✓		
Western Downs Regional Council	14.12.2012	18.12.2012	U	19.12.2012			✓
• Western Downs Disaster Relief Fund	14.01.2013	04.03.2013	Q E	N/A			✓
• Western Downs Housing Fund Pty Ltd	Not completed	Not completed		N/A			
• Western Downs Housing Trust	Not completed	Not completed		N/A			
Whitsunday Regional Council	Not completed	Not completed		29.03.2013			
Winton Shire Council	15.11.2012	15.11.2012	U	No	✓		
• Waltzing Matilda Centre Ltd	22.10.2012	22.10.2012	U	N/A	✓		
Woorabinda Aboriginal Shire Council	19.02.2013	26.02.2013	U	30.01.2013			✓
• Woorabinda Pastoral Company Pty Ltd	13.02.2013	13.02.2013	Q E *	N/A			✓

Audit	Date statements signed	Date opinion issued	Opinion	Ministerial extension issued to date	Timeliness (since 30 June)		
					<3 mths	3-5 mths	>5 mths
Wujal Wujal Aboriginal Shire Council	Not completed	Not completed		31.03.2013			
Yarrabah Aboriginal Shire Council	12.11.2012	16.11.2012	U	No			✓
Joint local governments							
Esk–Gatton–Laidley Water Board	28.11.2012	10.12.2012	E	No			✓
Nogoa River Flood Plain Board	11.10.2012	18.10.2012	U	No		✓	
Jointly controlled entities							
Advance Cairns Limited	Not completed	Not completed		N/A			
Brisbane Festival Limited+	Not completed	Not completed		N/A			
Central Queensland Local Government Association Inc.	06.11.2012	09.11.2012	E*	N/A		✓	
Central Western Queensland Remote Area Planning & Development Board	09.11.2012	09.11.2012	U	N/A		✓	
Council of Mayors (SEQ) Pty Ltd	15.10.2012	17.10.2012	U	N/A		✓	
• SEQ Regional Recreational Facilities Pty Ltd	05.12.2012	12.12.2012	U	N/A			✓
Far North Queensland Regional Organisation of Councils	10.12.2012	09.01.2013	E*	N/A			✓
Gulf Savannah Development Inc.	13.09.2012	05.10.2012	E*	N/A		✓	
Local Government Association of Queensland Ltd	28.09.2012	02.10.2012	U	N/A		✓	
• DDS Unit Trust	21.09.2012	25.09.2012	U	N/A	✓		
• Govcloud Joint Venture	21.09.2012	25.09.2012	E*	N/A	✓		
• Local Buy Trading Trust	17.09.2012	25.09.2012	Q	N/A	✓		

Audit	Date statements signed	Date opinion issued	Opinion	Ministerial extension issued to date	Timeliness (since 30 June)		
					<3 mths	3-5 mths	>5 mths
• Local Partnerships Services Pty Ltd	21.09.2012	25.09.2012	E*	N/A	✓		
• Prevwood Pty Ltd	21.09.2012	25.09.2012	E*	N/A	✓		
• QPG Shared Services Support Centres Joint Venture	17.09.2012	24.09.2012	E*	N/A	✓		
• Resolute I.T. Pty Ltd	21.09.2012	25.09.2012	E*	N/A	✓		
Local Government Infrastructure Services Pty Ltd	10.09.2012	18.09.2012	U	N/A	✓		
Major Brisbane Festivals Pty Ltd+	Not completed	Not completed		N/A			
North Queensland Local Government Association+	Not completed	Not completed		N/A			
Queensland Local Government Mutual Liability Pool (LGM Queensland)	05.11.2012	07.11.2012	U	N/A		✓	
Queensland Local Government Workers Compensation Self-Insurance Scheme (trading as Local Government Workcare)	05.11.2012	07.11.2012	U	N/A		✓	
Services Queensland	17.09.2012	24.09.2012	E*	N/A	✓		
South West Queensland Local Government Association #	Not completed	Not completed		N/A			
Townsville Breakwater Entertainment Centre Joint Venture	Not completed	Not completed		N/A			

Audit	Date statements signed	Date opinion issued	Opinion	Ministerial extension issued to date	Timeliness (since 30 June)		
					<3 mths	3-5 mths	>5 mths
The Wide Bay Burnett Regional Organisation of Councils Inc.	18.12.2012	20.12.2012	E*	N/A			✓
Western Queensland Local Government Association	10.09.2012	12.11.2012	E*	N/A		✓	
Statutory body							
The Island Industries Board (trading as Islanders Board of Industry and Service (IBIS)**	19.03.2012	22.03.2012	U	N/A	✓		
Audited by arrangement							
Brisbane City Council Superannuation Plan	24.10.2012	29.10.2012	U	N/A		✓	
Brisbane Powerhouse Foundation	27.09.2012	28.09.2012	U	N/A	✓		
Local Government Superannuation Scheme	24.10.2012	30.10.2012	U	N/A		✓	
Queensland Local Government Superannuation Board (trading as LGsuper)	26.10.2012	30.10.2012	U	N/A		✓	

* An emphasis of matter paragraph was issued to alert users of the financial statements to the fact that special purpose financial statements had been prepared.

^ The financial year of Burdekin Cultural Complex Board Inc. was 1 May 2011 to 30 April 2012.

\+ The financial year of Brisbane Festival Limited, Major Brisbane Festivals Pty Ltd and North Queensland Local Government Association was 1 January 2012 to 31 December 2012.

\# The financial year of South West Queensland Local Government Association was 1 April 2011 to 31 March 2012.

** The financial year of The Island Industries Board was 1 February 2011 to 31 January 2012.

Opinion key:

U = unmodified

Q = qualified

A = adverse

E = unmodified with emphasis of matter

D = disclaimer.

Source: QAO

Appendix C—Local government entities for which audit opinions will not be issued

Figure C1
Local government entities for which audit opinions will not be issued for 2011–12

Entity	Parent entity	Reason
Controlled entities		
Brisbane Arts Trust	Brisbane City Council	Wound up
Brisbane Environment Trust	Brisbane City Council	Wound up
Brisbane Tolling Pty Ltd	Brisbane City Council	Dormant
City of Brisbane Arts and Environment Limited	Brisbane City Council	Dormant
City Super Pty Ltd	Brisbane City Council	Dormant
Museum of Brisbane Pty Ltd	Brisbane City Council	Dormant
Riverfestival Brisbane Pty Ltd	Brisbane City Council	Dormant
Citipac International Pty Ltd	Gold Coast City Council	Dormant
Gold Coast City Council Insurance Co Ltd	Gold Coast City Council	Overseas based entity
RM Williams Australian Bush Learning Centre Ltd	North Burnett Regional Council	Dormant
Edward River Crocodile Farm Pty Ltd	Pormpuraaw Aboriginal Shire Council	Under administration
Redheart Pty Ltd	Redland City Council	Dormant
Mayoress Regional Charity Foundation Ltd	Rockhampton Regional Council	Dormant
Southern Downs Flood Relief Fund	Southern Downs Regional Council	Wound up
Quad Park Corporation Pty Ltd	Sunshine Coast Regional Council	Non-reporting
Sunshine Coast Events Centre Pty Ltd	Sunshine Coast Regional Council	Non-reporting
Sunshine Coast Enterprises Pty Ltd	Sunshine Coast Regional Council	Wound up
Poruma Island Pty Ltd	Torres Strait Island Regional Council	Under administration
Jointly controlled entities		
Local Buy Pty Ltd	Local Government Association of Queensland Ltd	Dormant
Resolute Information Technology Pty Ltd	Local Government Association of Queensland Ltd	Dormant

Entity	Parent entity	Reason
Queensland Partnerships Group (LG Shared Services) Pty Ltd	Local Government Association of Queensland Ltd	Dormant
LG Disaster Recovery Services Pty Ltd	Local Government Association of Queensland Ltd	Dormant
GovCloud Pty Ltd	Local Government Association of Queensland Ltd	Dormant
LG Cloud Pty Ltd	Local Government Association of Queensland Ltd	Dormant
SEQ Distribution Entity (Interim) Pty Ltd	Council of Mayors (SEQ) Pty Ltd	Dormant
Urban Local Government Association of Queensland Inc.		Wound up
Western Sub Regional Organisation of Councils		Wound up

Source: QAO

Appendix D—Status of 2010–11 financial statements

Figure D1
Status of 2010–11 financial statement audits not previously reported

Entity	Date statements signed	Date opinion issued	Opinion
Councils			
Burke Shire Council	21.06.2012	20.08.2012	U
Central Highlands Regional Council	21.05.2012	21.05.2012	U
Cherbourg Aboriginal Shire Council	21.05.2012	04.07.2012	E
Kowanyama Aboriginal Shire Council	28.06.2012	29.06.2012	Q
Controlled entities			
The Kronosaurus Korner Board Inc.	10.02.2012	17.07.2012	E*
Western Downs Disaster Relief Fund	30.01.2012	14.01.2013	Q E
Jointly controlled entities			
North Queensland Local Government Association+	30.05.2012	30.05.2012	E*
South West Queensland Local Government Association#	25.09.2012	06.11.2012	E*
Townsville Breakwater Entertainment Centre Joint Venture	02.02.2012	04.07.2012	E*
Western Queensland Local Government Association	10.09.2012	12.11.2012	E*
Western Sub Regional Organisation of Councils	12.06.2012	04.07.2012	E

* An emphasis of matter paragraph was issued to alert users of the financial statements to the fact that special purpose financial statements had been prepared.

\+ The financial year of North Queensland Local Government Association was 1 January 2012 to 31 December 2012.

\# The financial year of South West Queensland Local Government Association was 1 April 2011 to 31 March 2012.

Opinion key:

U = unmodified

Q = qualified

A = adverse

E = unmodified with emphasis of matter

D = disclaimer.

Source: QAO

Appendix E—Financial sustainability measures

The ratios reflecting short-term and long-term sustainability are detailed in Figure E1.

Figure E1
Financial sustainability measures for councils

<table>
<tr><th>Measure</th><th>Formula</th><th>Description</th><th>Target range</th></tr>
<tr><td rowspan="2">Operating surplus ratio

Required per Local Government Regulation 2012</td><td>Net operating result divided by total operating revenue

Expressed as a percentage</td><td>Indicates the extent to which operational revenues raised cover operational expenses</td><td>Between 0% and 10%

(Per department-issued guidelines)</td></tr>
<tr><td colspan="3">A negative result indicates an operating deficit and the larger the negative percentage, the worse the result. Operating deficits cannot be sustained in the long-term. A positive percentage indicates that surplus revenue is available to support the funding of capital expenditure, or to be held in reserve to offset past or expected future operating deficits.

Councils that consistently achieve an operating surplus and expect that they can do so in the future, having regard to asset management and community service level needs, are considered financially sustainable.</td></tr>
<tr><td rowspan="2">Net financial liability ratio

Required per Local Government Regulation 2012</td><td>Total liabilities less current assets divided by total operating revenue

Expressed as a percentage</td><td>Indicates the extent to which its operating revenues (including grants and subsidies) can cover a council's net financial liabilities (usually loans and leases)</td><td>Not greater than 60%

(Per department-issued guidelines)</td></tr>
<tr><td colspan="3">If net financial liabilities are greater than 60 per cent of operating revenue, the council has limited capacity to increase loan borrowings and may experience stress in servicing current debt.</td></tr>
<tr><td rowspan="2">Capital replacement ratio

QAO ratio used in lieu of the asset sustainability ratio required by Local Government Regulation 2012</td><td>Capital expenditure per Statement of Cash Flows divided by depreciation expense.

Expressed as a ratio</td><td>Comparison of the rate of spending on assets with depreciation.</td><td>Greater than 1.5

(Consistent with the Victorian Auditor-General's Office)</td></tr>
<tr><td colspan="3">A value less than 1.5 may indicate a declining asset base and / or inadequate asset management plans. A low ratio may also indicate that the asset base is relatively new, such as resulting from rectifying extensive natural disaster damage, and does not require replacement or renewal.</td></tr>
</table>

The risk assessment criteria used for the financial sustainability measures are detailed in Figure E2.

Figure E2
Risk assessment criteria for financial sustainability measures

Relative risk rating Measure	Operating surplus ratio Required per Local Government Regulation 2012	Net financial liabilities ratio Required per Local Government Regulation 2012	Capital replacement ratio QAO ratio used in lieu of the asset sustainability ratio required by Local Government Regulation 2012
Higher	**Less than negative 10% (i.e. losses)**	**More than 80%**	**Less than 0.9**
	Insufficient revenue is being generated to fund operations and asset renewal	Potential long-term concern over ability to repay debt levels from operating revenue	Spending on capital works has not kept pace with consumption of assets.
Moderate	**Negative 10% to zero**	**60% to 80%**	**0.9 to 1.5**
	A risk of long-term reduction in cash reserves and in ability to fund asset renewals	Some concern over the ability to repay debt from operating revenue	May indicate spending on asset replacement or renewal is insufficient
Lower	**More than zero (i.e. surpluses)**	**Less than 60%**	**More than 1.5**
	Generating surpluses consistently	No concern over the ability to repay debt from operating revenue	Low risk of insufficient spending on asset replacement or renewal.

The overall financial sustainability risk assessment is calculated using the ratings determined for each measure as shown in Figure E3 and the assignment of the criteria is shown in Figure E4.

Figure E3
Overall financial sustainability relative risk assessment

Risk level	Detail of risk
Higher risk	Higher risk of sustainability issues arising in the short- to medium-term if currently experienced operating income and expenditure policies continue, as indicated by • average operating deficits (losses) of more than 10% of revenue.
Moderate risk	Moderate risk of sustainability issues over the longer-term if current debt financing and capital investment policies continue, as indicated by: • current net financial liabilities more than 80% of revenue or • average capital replacement ratio less than 0.9 or • realising two or more of the ratios per the moderate risk assessment (Figure E2).
Lower risk	Lower risk of financial sustainability concerns based on current income, expenditure, asset investment and debt financing policies.

Our assessment of financial sustainability risk factors does not take into account councils' long-term forecasts, nor is it a credit assessment, which is undertaken by Queensland Treasury Corporation.

Figure E4
Financial sustainability risk assessment: Results at the end of 2011–12

Council	Current operating surplus ratio (%)	Avg operating surplus ratio (%)	Trend	Net financial liabilities ratio (%)	Trend	Current capital replacement ratio	Avg capital replacement ratio	Trend	Relative risk assessment
Very large councils									
Brisbane City Council	3.65	-1.62	↑	92.90	↓	3.09	3.27	–	Moderate
Cairns Regional Council	-2.02	-1.90	–	10.01	↓	1.50	1.35	–	Moderate
Gold Coast City Council	-10.29	-13.70	↑	31.85	↓	1.05	1.36	–	Higher
Ipswich City Council	-6.65	-3.00	↓	173.70	↓	3.50	2.65	↑	Moderate
Logan City Council	2.34	-3.44	↑	-10.30	↑	1.04	1.44	–	Moderate
Mackay Regional Council	-8.07	-3.44	↓	34.10	–	1.87	2.10	–	Lower
Moreton Bay Regional Council	6.55	1.94	↑	42.34	↓	1.97	2.53	↓	Lower
Redland City Council	-4.90	-10.21	↑	28.05	↓	0.93	1.18	–	Higher
Rockhampton Regional Council	-1.34	-4.56	↑	60.56	–	1.90	2.02	–	Moderate
Sunshine Coast Regional Council	2.62	0.59	↑	11.07	↓	2.45	2.93	↓	Lower
Toowoomba Regional Council	5.04	0.75	↑	-3.24	↑	3.93	1.88	↑	Lower
Townsville City Council	-0.56	-3.33	↑	93.78	–	1.87	6.09	↓	Moderate
Very large average	**-1.14**	**-3.49**		**47.07**		**2.09**	**2.40**		
Very large—combined risk assessment		**Moderate**		**Lower**			**Lower**		**Lower**

Council	Current operating surplus ratio (%)	Avg operating surplus ratio (%)	Trend	Net financial liabilities ratio (%)	Trend	Current capital replacement ratio	Avg capital replacement ratio	Trend	Relative risk assessment
Large councils									
Bundaberg Regional Council	3.94	0.90	↑	-8.77	↑	1.64	1.50	–	Lower
Cassowary Regional Council	7.90	-2.13	↑	-34.20	↑	3.09	2.09	↑	Lower
Central Highlands Regional Council	-4.32	0.21	↓	-19.14	↓	1.53	1.69	–	Lower
Fraser Coast Regional Council	-0.40	-2.68	↑	11.89	↑	1.24	1.18	–	Moderate
Gladstone Regional Council	12.20	4.33	↑	28.66	↑	3.64	4.30	↓	Lower
Gympie Regional Council	6.07	5.64	–	-59.91	↓	2.59	2.35	–	Lower
Isaac Regional Council	29.89	26.95	↑	-80.15	–	3.82	2.50	↑	Lower
Lockyer Valley Regional Council	-15.76	-1.03	↓	9.47	↓	2.52	2.85	–	Lower
Mount Isa City Council	1.09	-0.91	↑	-4.87	↑	0.99	1.02	–	Moderate
Scenic Rim Regional Council	-1.15	-2.94	↑	-30.28	↑	1.84	1.78	–	Lower
Somerset Regional Council	-0.45	7.45	↓	-174.16	↑	5.08	2.58	↑	Lower
South Burnett Regional Council	-4.66	-1.71	↓	-56.64	–	1.60	1.58	–	Lower
Southern Downs Regional Council	-19.91	-8.74	↓	23.43	↓	0.94	1.04	–	Moderate
Tablelands Regional Council	8.96	10.73	–	-67.10	–	1.95	1.77	–	Lower
Western Downs Regional Council	12.60	-16.43	↑	-25.10	–	1.68	1.17	–	Higher
Whitsunday Regional Council	Financial statements not finalised								

Council	Current operating surplus ratio (%)	Avg operating surplus ratio (%)	Trend	Net financial liabilities ratio (%)	Trend	Current capital replacement ratio	Avg capital replacement ratio	Trend	Relative risk assessment
Large average	2.40	1.31		-32.46		2.28	1.96		
Large—combined risk assessment		**Lower**		**Lower**			**Lower**		**Lower**

Council	Current operating surplus ratio (%)	Avg operating surplus ratio (%)	Trend	Net financial liabilities ratio (%)	Trend	Current capital replacement ratio	Avg capital replacement ratio	Trend	Relative risk assessment
Medium councils									
Balonne Shire Council	28.33	27.25	–	-70.93	↑	2.03	1.89	–	Lower
Banana Shire Council	2.41	2.70	–	-5.00	↓	1.96	1.69	–	Lower
Barcaldine Regional Council	6.37	-9.96	↑	-41.41	–	1.24	1.24	–	Moderate
Burdekin Shire Council	5.94	4.11	↑	-2.56	↓	2.61	1.82	↑	Lower
Carpentaria Shire Council	Financial statements not finalised								
Charters Towers Regional Council	13.63	1.02	↑	-53.68	–	2.10	1.57	↑	Lower
Cloncurry Shire Council	1.48	15.19	↓	-31.39	↓	2.86	2.10	–	Lower
Goondiwindi Regional Council	6.45	2.14	↑	-41.27	↓	1.16	1.29	–	Lower
Hinchinbrook Shire Council	-2.11	-0.51	↓	-50.79	↑	5.27	3.08	↑	Lower
Longreach Regional Council	10.98	3.96	↑	-49.31	↑	1.44	1.64	–	Lower
Maranoa Regional Council	Financial statements not finalised								
Murweh Shire Council	-1.00	5.57	↓	-20.86	↑	1.98	1.66	–	Lower
North Burnett Regional Council	-6.05	-6.29	–	-26.84	–	1.08	1.25	–	Moderate
Medium average	**6.04**	**4.11**		**-35.82**		**2.16**	**1.75**		
Medium—combined risk assessment		**Lower**		**Lower**			**Lower**		**Lower**

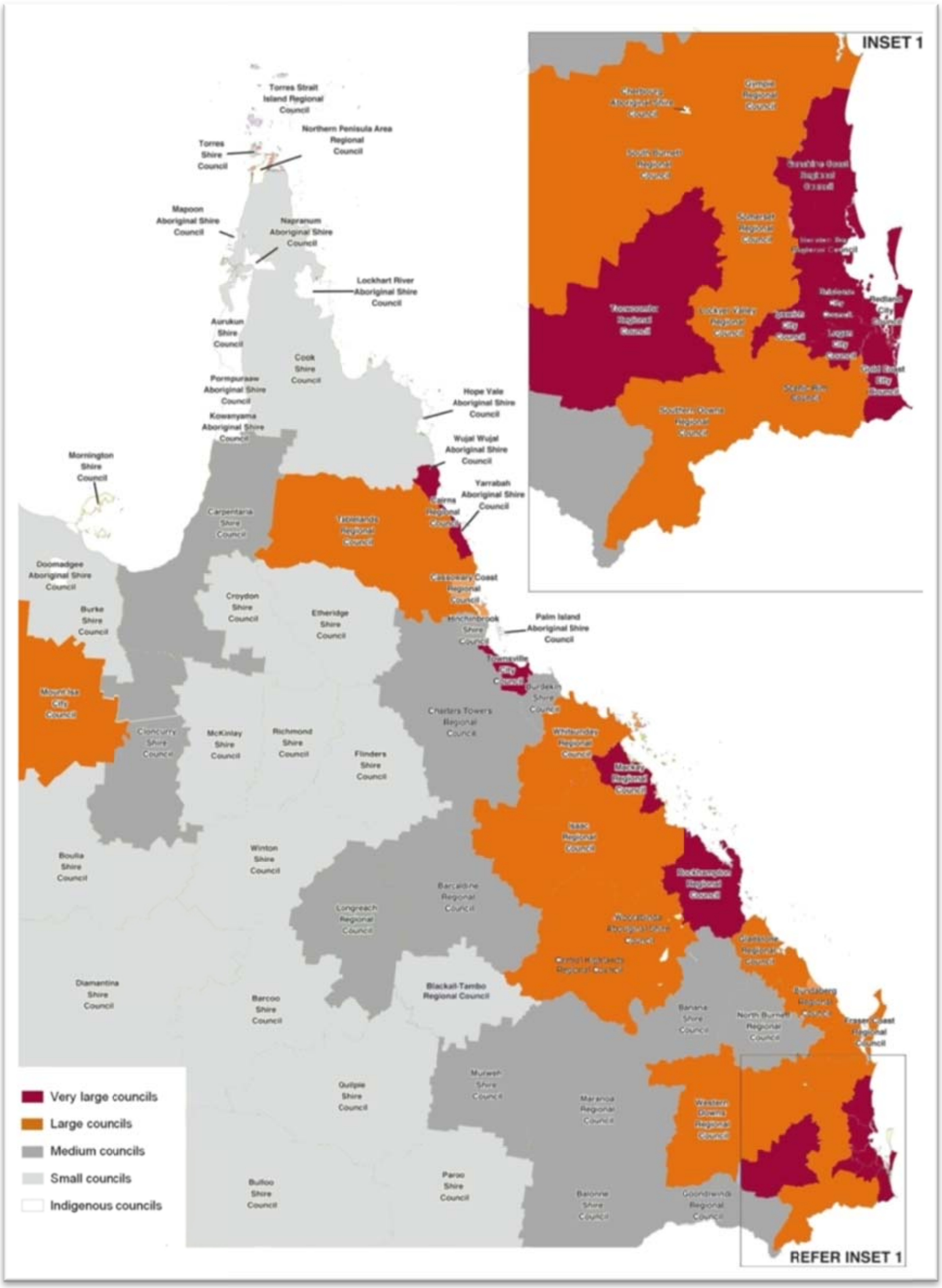
Council	Current operating surplus ratio (%)	Avg operating surplus ratio (%)	Trend	Net financial liabilities ratio (%)	Trend	Current capital replacement ratio	Avg capital replacement ratio	Trend	Relative risk assessment
Small councils									
Barcoo Shire Council	-3.10	10.54	↓	-64.54	↑	2.45	1.99	–	Lower
Blackall–Tambo Regional Council	-2.77	4.08	↓	-51.27	–	0.91	1.94	–	Lower
Boulia Shire Council	19.76	10.56	↑	-50.34	↑	1.96	2.88	–	Lower
Bulloo Shire Council	18.80	14.38	↑	-59.92	↓	7.88	5.26	↑	Lower
Burke Shire Council	-40.19	-5.24	↓	-86.50	↑	1.28	1.77	–	Lower
Cook Shire Council	-3.92	-11.89	↑	-15.56	–	1.12	1.39	–	Higher
Croydon Shire Council	4.33	9.61	↓	-71.81	↑	1.08	0.90	–	Lower
Diamantina Shire Council	-8.23	0.85	↓	-26.05	↓	2.42	2.44	–	Lower
Etheridge Shire Council	-2.30	-9.77	↑	-45.15	↓	1.56	2.46	–	Lower
Flinders Shire Council	19.62	5.33	↑	-59.12	↑	3.40	3.22	–	Lower
McKinlay Shire Council	10.76	12.27	–	-54.28	↑	2.98	3.18	–	Lower
Paroo Shire Council	3.55	-13.66	↑	-25.65	–	4.80	2.83	↑	Higher
Quilpie Shire Council	5.50	3.12	↑	-66.14	↓	1.98	1.51	–	Lower
Richmond Shire Council	1.55	7.86	↓	-21.40	–	1.55	1.47	–	Lower
Torres Shire Council	24.66	6.01	↑	-68.92	↑	2.20	2.40	–	Lower

Council	Current operating surplus ratio (%)	Avg operating surplus ratio (%)	Trend	Net financial liabilities ratio (%)	Trend	Current capital replacement ratio	Avg capital replacement ratio	Trend	Relative risk assessment
Winton Shire Council	-15.20	10.37	↓	-102.19	↑	1.64	1.51	–	Lower
Small average	**2.05**	**3.40**		**-54.30**		**2.45**	**2.32**		
Small—combined risk assessment		**Lower**		**Lower**			**Lower**		**Lower**

Council	Current operating surplus ratio (%)	Avg operating surplus ratio (%)	Trend	Net financial liabilities ratio (%)	Trend	Current capital replacement ratio	Avg capital replaceme nt ratio	Trend	Relative risk assessment
Indigenous councils									
Aurukun Shire Council	23.96	-7.00	↑	-110.20	↑	0.38	0.99	↓	Moderate
Cherbourg Aboriginal Shire Council	-10.16	-10.80	–	-23.49	↑	2.22	1.02	↑	Higher
Doomadgee Aboriginal Shire Council	-14.72	-25.25	↑	-77.31	–	0.19	0.61	↓	Higher
Hope Vale Aboriginal Shire Council	22.35	10.44	↑	-37.55	–	3.14	2.39	↑	Lower
Kowanyama Aboriginal Shire Council	Financial statements not finalised								
Lockhart River Aboriginal Shire Council	-15.16	-14.38	–	-25.20	↓	0.45	0.78	–	Higher
Mapoon Aboriginal Shire Council	-20.40	-18.82	–	-39.41	–	0.15	2.08	↓	Higher
Mornington Shire Council	-8.48	-13.03	↑	-97.80	↑	2.84	1.10	↑	Higher
Napranum Aboriginal Shire Council	19.75	-7.39	↑	-47.82	–	1.23	0.89	↑	Moderate
Northern Peninsula Area Regional Council	-39.00	-44.80	–	-26.03	↑	0.26	0.22	–	Higher
Palm Island Aboriginal Shire Council	-10.22	-19.03	↑	-21.77	–	0.34	0.15	–	Higher
Pormpuraaw Aboriginal Shire Council	-7.76	-17.01	↑	-39.18	–	1.71	1.30	↑	Higher
Torres Strait Island Regional Council	-35.00	-38.69	–	-9.17	–	0.17	0.42	–	Higher

Council	Current operating surplus ratio (%)	Avg operating surplus ratio (%)	Trend	Net financial liabilities ratio (%)	Trend	Current capital replacement ratio	Avg capital replaceme nt ratio	Trend	Relative risk assessment
Woorabinda Aboriginal Shire Council	-10.58	-10.37	–	-65.18	–	0.21	0.27	–	Higher
Wujal Wujal Aboriginal Shire Council	Financial statements not finalised								
Yarrabah Aboriginal Shire Council	-22.84	-33.62	↑	-29.68	↓	0.77	0.35	–	Higher
Indigenous average	**-9.16**	**-17.84**		**-46.41**		**1.00**	**0.90**		
Indigenous—combined risk assessment		**Higher**		**Lower**			**Moderate**		**Higher**

Appendix F—Queensland council areas by category



Source: Department of Local Government, Community Recovery and Resilience.

Auditor-General Reports to Parliament

Tabled in 2012–13

Report number	Title of report	Date tabled in Legislative Assembly
1	Racing Queensland Limited: Audit by arrangement	July 2012
2	Follow- up of 2010 audit recommendations	October 2012
3	Tourism industry growth and development	November 2012
4	Queensland Health - eHealth	November 2012
5	Results of audits: State entities 2011–12	November 2012
6	Implementing the National Partnership Agreement on Homelessness in Queensland	February 2013
7	Results of audit: Queensland state government financial statements 2011-12	March 2013
8	Online service delivery	March 2013
9	Fraud risk management	March 2013
10	Results of audits: Local government entities 2011–12	April 2013

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