LOCAL GOVERNMENT MINISTERIAL ORDERS 2014

SNAPSHOT

- In February 2014 Orders were gazetted requiring local government councils to establish audit panels, develop long-term financial and long-term asset management strategies, policies and plans and report certain financial sustainability indicators in the notes to annual financial statements.
- The Orders were unclear as to timeframes by when councils are expected to comply although the financial sustainability indicators must be included in the notes to annual financial statements at 30 June 2014.
- The Orders were clear as to the establishment of audit panels and the content of long-term financial and long-term asset management strategies, policies and plans and the financial sustainability indicators to be reported.
- Other than the Asset renewal funding ratio, we will audit reported financial sustainability indicators at 30 June 2014.
- In the case of the Asset renewal funding ratio, where reported, we will ensure these are in line with approved long-term financial and long-term asset management plans but we will not form an audit opinion on this ratio.
- We anticipate that where a council does not report the Asset renewal funding ratio, reasons will be provided along with details as to when compliance will be achieved.
- We anticipate that councils will set targets for each financial sustainability indicator and explain variations from target.
- We anticipate that information about financial sustainability indicators will include trend data over more than two financial periods.
- We will assess, not audit, compliance with the other Orders.
- Any findings will be reported to respective councils and to the Parliament.

OUR ROLE

We were consulted during the development of the Orders referred to in this Chapter. However, apart from work we must do as outlined in section 6 of this Chapter, we have no ongoing role. In particular, we play no regulatory function. This is a matter for the Local Government Division in the Department of Premier and Cabinet.

OBJECTIVE BEHIND INCLUSION OF THIS CHAPTER IN THIS REPORT

In February 2014, Orders were gazetted requiring local government councils to establish audit panels, develop long-term financial and asset management strategies, policies and plans and report certain financial sustainability indicators (referred to as management indicators) in annual financial statements. These Orders took effect immediately and councils are expected to comply, although, apart from the management indicator which are to be included in 30 June 2014 financial reports, the Orders contain no guidance as to when compliance is to be achieved.

Based on our previous reports we believe it likely that some councils will find it difficult to fully implement all of the new requirements in the short term and probably not by 30 June 2014. For example, our reporting about audit committees and existence of long-term financial and long-term asset management plans indicates some councils will need time to implement these Orders in full. We consider this a reasonable expectation in the circumstances.

The objective behind including this Chapter in this Report is to set out how we will assess council responses to these Orders in the financial year ending 30 June 2014 bearing in mind our above noted 'reasonable expectation', and to note our anticipation that all councils will report all of the management indicators which will then be subjected to audit.

However, we expect that by 30 June 2015 all councils will comply in full with all Orders.

BACKGROUND

Following consultation and building on the work of our Office, the *Local Government (Miscellaneous Amendments) Act 2013* (Amendment Act) received Royal Assent on 19 November 2013. Part 4 of the Amendment Act requires councils to:

- maintain long-term financial and asset management plans, financial and asset management strategies and an asset management policy
- maintain an audit panel
- report financial and asset management sustainability indicators in their financial statements, and
- provides a power for the Minister for Local Government to make Ministerial Orders outlining the detail and minimum requirements of the financial and asset management reforms detailed above.

Commencement of Part 4 of the Amendment Act was delayed to allow for the development of the Ministerial Orders which outline the detail and minimum requirements of the financial and asset management reforms.

Part 4 of the Amendment Act was proclaimed on 7 February 2014. Subsequently, the then Minister for Local Government made the following Ministerial Orders under Sections 70F, 84 (2A) and 85B of the *Local Government Act 1993*:

- the Local Government (Contents of Plans and Strategies) Order 2014
- the Local Government (Audit Panels) Order 2014 and
- the Local Government (Management Indicators) Order 2014.

These Orders were effective on the day of their gazettal which occurred on 19 February 2014.

PRIMARY FUNCTIONS OR PURPOSE

The primary purpose and or functions of each order are:

Audit Panels

Clause 4 of *Local Government (Audit Panels) Order 2014* notes the following matters that an audit panel is to consider as part of keeping relevant council's performance under review:

(a) whether the annual financial statements of the council accurately represent the state of affairs of the council;

(b) whether and how strategic plan, an annual plan, a long-term financial management plan or a long-term strategic asset management plan of a council are integrated and the processes by which, and assumptions under which, those plans were prepared;

(c) the accounting, internal control, anti-fraud, anti-corruption and risk management policies, systems and controls that the council has in relation to safeguarding its long-term financial position;

(d) whether the council is complying with the provisions of the Act and any other relevant legislation;

(e) whether the council has taken any action in relation to previous recommendations provided by the audit panel to the council and, if it has so taken action, what that action was and its effectiveness.

Contents of plans and strategies

This Order outlines required content and strategies of the following plans, which must be prepared under sections 70 and 70A to 70E of the Act:

(a) long-term financial management plan

(b) financial management strategy

(c) long-term strategic asset management plan

(d) asset management policy

(e) asset management strategy.

It also details those classes of assets that are referred to as major assets for purposes of section 70 of the Act.

Management Indicators (referred to by us as financial sustainability indicators)

Section 84 subsection (2A) authorises that the Minister, by order, may specify that annual financial statements of councils include:

(a) financial management indicators; and

(b) asset management indicators.

The Order requires inclusion of the following indicators in the notes to the annual financial statements of each council:

- asset consumption ratio
- asset renewal funding ratio
- asset sustainability ratio
- net financial liabilities
- net financial liabilities ratio
- underlying surplus or deficit
- underlying surplus ratio.

Appendix 1 to this Chapter provides a definition of each of these indicators.

WHAT COUNCILS WILL NEED TO DO

Audit panels

Two situations are evident:

1. Those councils that have already established audit committees will need, assuming they have not already done so, to ensure their charters, member appointment, meeting and annual work plan arrangements satisfy the new Order.

2. Those councils who currently have no audit committees in place, of which at 30 June 2013 there were a number, will need to take steps to appoint committees/panels in line with the Order.

Plans and strategies

Again, two situations are evident:

1. Those councils that have already developed the required strategies, policies and plans will, if they have not already done so, need to ensure these are integrated and approved by respective audit panels.
2. Those councils who currently have no strategies, policies and plans in place, will need to take steps to ensure these documents are in line with the Order.

Financial sustainability (management) indicators

Councils will need to calculate these ratios and include them in the notes to the annual financial statements signed by their general managers and presented for audit commencing 30 June 2014. Where, due to the possible lack of long-term asset management of financial management plans for example, councils are unable to calculate all ratios, we anticipate reasons for this will be provided along with steps as to actions being taken to address this.

WHAT WE WILL NEED TO DO

Auditing standard ASA 250 *Consideration of Laws and Regulations in relation to an Audit of a Financial Report* requires notes that the objectives of the auditor are (our emphasis by underlining):

(a) To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations <u>generally recognised to have a direct effect on</u> the determination of material amounts and disclosures in the financial report;

(b) To perform specified audit procedures to help identify instances of non-compliance with <u>other laws and regulations that may have a material effect on the financial report</u>; and

(c) To <u>respond appropriately</u> to non-compliance or suspected non-compliance with laws and regulations identified during the audit.

This standard defines non-compliance as (our emphasis by underlining):

> *acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.*

The three Orders will have the following impacts on our audits for the year ending 30 June 2014:

- audit panels – it is our expectation that by 30 June 2014 all councils will have established, or will have progressed establishment of, audit (or equivalent) panels with charters consistent with the Order. Where we find that this is not the case, we will report to the council and to Parliament accordingly. However, non-compliance will not impact our audit opinion on the financial statements.
- content of plans, policies and strategies – page 38 in Report of the Auditor-General No. 4 of 2012-13 *Auditor-General's Report on the Financial Statements of State Volume 3 Part I Local Government Authorities 2012-13* notes that at 30 June 2013 seven councils had not developed long-term asset management plans and four had not developed long-term financial management plans. However, and as indicated in that Report, developed plans had not been audited.[1]

[1] That report did not address the existence of asset management or financial management policies or strategies nor did it set out to.

It is not our intention to audit long-term asset management or financial management plan. These are 'forward looking' with our focus being on 'historical' financial information. However, our audits for the 2013-14 financial year will:

- inquire into the existence of these plans or progress towards their development
- establish whether they have been reviewed and reported on (reported to council) by audit panels (the Audit Panels Order makes this a requirement)
- inquire into the extent of reporting by management on compliance with, achievement of, these plans and evidence their regular review and update.

Our findings will be reported to councils and to Parliament. However, other than any potential impacts on the asset renewal funding ratio referred to below, non-compliance will not impact our audit opinion on the financial statements.

- Management indicators – our reports to Parliament regarding councils have for some time now included all of the indicators required by this Order and we anticipate, other than for the asset renewal funding ratio, that councils will report all of these indicators in the notes to their 2013-14 financial statements. We will then audit these indicators and form an opinion on them along with our opinion on the financial statements as a whole. Any non-compliance, which we expect will be rare, will be reported to respective councils and to Parliament. Where there is non-compliance, we will also assess the materiality thereof and any implications of our audit opinion.

  Asset renewal funding ratio – this is a 'forward looking' ratio requiring completion of long-term asset management and long-term financial management plans at least for the next ten years. As noted in the previous dot point, we will inquire into the existence of these plans, their adoption and so on. We will also ensure the mathematical accuracy of the plans but we will not attempt to form a view regarding other matters such as assumptions and judgements made, priorities chosen, systems implemented, etc. As a result, our audit report will include the following sentence:

  My audit is not designed to provide assurance on the accuracy and appropriateness of the budget information or the asset renewal funding ratio in Council's financial report.

  However, we will test the calculation of the ratio.

  The outcomes of our work will be reported to respective councils and to the Parliament. We anticipate instances where, due to lack of long-term asset management and long-term financial management plans some councils may not report the asset renewal funding ratio. Where we find this is the case, we:

  - anticipate that reasons for not calculating the ratio will be provided along with details as to when it will be included
  - will report to the council and to Parliament accordingly. However, non-compliance will not impact our audit opinion on the financial statements.

OUR EXPECTATIONS REGARDING THE MANAGEMENT INDICATORS

In the previous section we note our approach to auditing the financial sustainability indicators required to be reported annually. While not a requirement of the Management Indicators Order, we anticipate that, in order for alderman, councillors and general managers to be fully responsible for the governance and accountability of their respective councils, they set targets for each ratio and explain achievements both better and worse than target.

In addition, we anticipate that:

- targets be set in line with those established by the Institute of Public Works Engineers. Doing this ensures councils set similar targets which are based on those recommended by an independent body.
- councils include in their financial statements comparative performance over periods longer than two years.

OUR EXPECTATIONS REGARDING COMPLIANCE WITH ALL THREE ORDERS IN 2014-15 AND SUBSEQUENT YEARS

It is our expectation that by 30 June 2015 all councils will have complied with all three Orders in full.

APPENDIX I

Definitions

The Local Government (Management Indicators) Order 2014 defines the various indicators addressed by this Order as follows:

Asset consumption ratio, in relation to an asset class required to be included in the long-term strategic asset management plan of a council, means an amount that is the depreciated replacement cost of an asset divided by the current replacement cost of the asset;

Asset renewal funding ratio means an amount that is the current value of projected capital funding outlays for an asset identified in the long-term financial plan of a council divided by the value of projected capital expenditure funding for an asset identified in the long-term strategic asset management plan of a council;

Asset sustainability ratio means an amount that is the amount of capital expenditure by a council in a financial year on the replacement and renewal of existing council plant, equipment and infrastructure assets divided by the annual depreciation expense of the plant, equipment and assets for the financial year;

Net financial liabilities means an amount that is the amount of the liquid assets of a council for a financial year less the total liabilities of the council for the financial year;

Net financial liabilities ratio means an amount that is the amount of net financial liabilities of a council for a financial year divided by an amount that is the recurrent income (not including income received specifically for new or upgraded assets, physical resources received free of charge or other income of a capital nature) of a council for the financial year;

Underlying surplus or deficit means an amount that is the recurrent income (not including income received specifically for new or upgraded assets, physical resources received free of charge or other income of a capital nature) of a council for a financial year less the recurrent expenses of the council for the financial year;

Underlying surplus ratio means an amount that is the underlying surplus or deficit of a council for a financial year divided by the recurrent income (not including income received specifically for new or upgraded assets, physical resources received free of charge or other income of a capital nature) of a council for the financial year.

Further information about these ratios, the manner in which they are calculated and anticipated benchmarks can be found on pages 25 to 27 of Report of the Auditor-General No. 4 of 2012-13 *Auditor-General's Report on the Financial Statements of State entities Volume 3 Part I Local Government Authorities 2012-13.*