

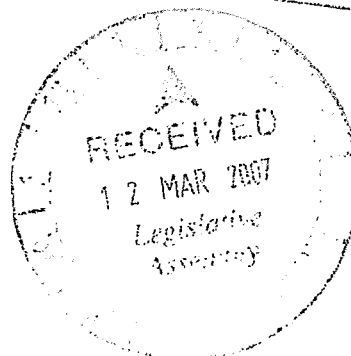
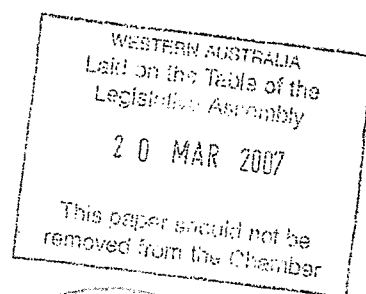
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**AUDIT CONSIDERATIONS IN
THE PUBLIC ACCOUNTS COMMITTEE REPORT No. 4**

**LOCAL GOVERNMENT ACCOUNTABILITY
IN WESTERN AUSTRALIA**

**DEPARTMENT OF LOCAL GOVERNMENT AND REGIONAL
DEVELOPMENT REFERENCE GROUP REPORT**

December 2006



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1. Introduction

The Public Accounts Committee of the Western Australian Parliament established an Inquiry into Local Government Accountability in Western Australia on 17 August 2005.

Its Report No. 4, *Local Government Accountability in Western Australia* ("the Report") was presented to Parliament on 28 September 2006.

The Report included Recommendations concerning the role of the Auditor General in the audit of the local government sector in Western Australia.

The Minister for Local Government and Regional Development ("the Minister") requested that the Department of Local Government and Regional Development ("the Department/DLGRD") establish a Reference Group with representatives from the Department and local government stakeholder organisations to provide comment on the following Finding and Recommendations in the Report:

Finding 15

The model of Local Government audit used in Queensland appears to give the best outcomes for all stakeholders without major impact on local government autonomy.

Recommendation 2

The Public Accounts Committee strongly recommends that the Auditor General conduct the audit of the local government sector in Western Australia. The State Government should examine the benefits of involving the Auditor General in the audit of local government in line with the Queensland model.

Recommendation 3

The Public Accounts Committee recommends that the Auditor General should audit no more than 15 per cent of councils on a rotating basis, with the remainder to be tendered out to the private sector.

Recommendation 4

The parameters of audit for the Western Australian local government sector should be set by the State Auditor General to ensure consistency of reporting across the State.

The Reference Group was established with the Department as Chair and membership from the Department, WALGA, and the LGMA.

Following the establishment of the Reference Group, it was agreed that the Group consider Recommendations 1, 5, and 6 to the extent that they impact on Recommendations 2, 3, and 4.

Recommendation 1

The Department of Local Government and Regional Development should, in conjunction with key stakeholder groups, conduct a review of the Compliance Audit Return to address concerns about its complexity and relevance.

Recommendation 5

The Auditor General should ensure there is an annual, comprehensive comparative report of each Local Government in Western Australia to facilitate transparency and provide an accurate assessment of the performance of individual local governments.

Recommendation 6

In recognition of the problems of financial sustainability in local government, the State Government should ensure the overall compliance burden on individual local governments does not unduly increase. The overall cost impost should be recognised by the State.

It was agreed that Recommendation 5 is relevant in relation to reporting and Recommendation 6 to the extent that it relates to the issue of any additional cost impost on local government. Recommendation 1 and the Compliance Audit Return is addressed separately below.

2. Executive Summary

The Reference Group is of the opinion that:

- There are beneficial aspects of the Queensland model that could be adopted to the advantage of the Western Australian local government auditing model;

-
- It is not necessary to adopt the Queensland model wholesale in order to achieve those benefits;
 - It is not necessary to divide responsibility for local governments' financial, compliance and probity health between the OAG and the Department in order to achieve the benefits inherent in the Queensland model;
 - It is possible to keep the strengths of the present Western Australian model (the lower cost of audit and the advantages of the Compliance Audit Report) while achieving the Queensland audit model benefits;
 - It is possible to obtain the benefit of the OAG's public sector audit skills and experience by having it manage and appoint the preferred auditors for local governments and provide an independent assessment of the activity of auditors each year to the Department; and
 - Adequate resources will need to be made available to the Department to ensure the successful implementation of an improved Western Australian audit model.

It is the view of the Reference Group that the model proposed in the Concluding Discussion and charted in Figure 1 on page 20 would achieve all of the benefits and solutions of the Queensland model at a significantly lower cost.

3. Reference Group Membership

Tim Fowler (Chair)	DLGRD: Director Capacity Building
Quentin Harrington	DLGRD: Director Governance and Statutory Support
Malcolm Jenkinson	LGMA: City of Melville; Manager, Neighbourhood Amenity
Michael Kent	LGMA: City of South Perth; Director, Financial Services & IT
Wayne Scheggia	WALGA: Director, Policy
Tony Brown	WALGA: Manager, Governance Policy

Secretariat:

Jenni Law	DLGRD: Manager, Local Government Support and Development
Paul Graham	DLGRD: Research Officer, Policy

4. Background

Prior to the Public Accounts Committee investigation into local government auditing, the legislation had recently changed. Those changes had just been implemented and the impact of those adjustments were not capable of ascertainment at the time the Report was prepared.

It is appropriate to set those out here briefly.

Audit Committee

The introduction of Audit Committees by the 2005 amendments to the *Local Government Act 1995* is mentioned in the Report, which states that "it is too soon to establish the effectiveness of the audit committees" but nonetheless finds (Finding 5) that "...audit committees will facilitate greater elected representative participation in the financial affairs of councils."

Audit Committees were established to provide independent oversight and guidance in relation to the financial systems of a local government, and to ensure increased elected representative participation. Among other things, Audit Committees may provide guidance and assistance as to matters to be audited and the scope of the audit.

Feedback from local governments (and Reference Group members from WALGA and LGMA) suggests that Audit Committees have been well received and are playing an anchoring role in local government audit procedures.

Guidelines to assist Audit Committees were issued in March 2006 (Local Government Operational Guidelines No. 6 – Audit Committees in Local Government, Their Appointment, Function and Responsibilities).

Introduction of a compulsory half-yearly budget review

Another amendment introduced by the 2005 amendments, under the *Local Government Act 1995*, was the requirement for local governments to review their budgets half-way through the financial year and to report the results to council.

Although the larger local governments already undertook budget reviews at this frequency or better, many of the smaller local governments did not review performance against the budget until year-end. Compulsory mid-year budget review

improves best practice financial management, enabling problems to be identified and checked at an earlier stage.

Local governments are required to provide a copy of the mid-year budget review to the Department within 30 days for monitoring purposes. The intention is to enable the Department to ensure that local governments have the financial assets to meet their current liabilities, are operating from a balanced financial position, and take corrective action to address significant budget variances within the financial year.

Guidance on Opening Balances

Standardisation of the way in which opening and closing balances are treated in the accounts (Local Government Operational Guidelines No. 8 – Opening and Closing Funds used in the Annual Budget was released in June 2006) has been achieved across local government.

This guideline was prepared and released by the Department due to some local governments having found themselves in difficulties over miscalculation of the amount of rates required to be raised, arising from the manner in which the opening balances in the rate setting statement of the budget were calculated.

This guideline is considered by the members of the Reference Group to have been of significant assistance to local government budget management.

Guidance on Financial Ratios

The Department is also developing a further guideline on the preparation of financial ratios on which local governments are required to report.

The guideline, which it is expected will be released in February 2007, is aimed at explaining the purpose of each of those ratios, achieving standardisation of the input data to provide consistency and to facilitate comparative analysis.

Amendment of the Compliance Audit Returns

As noted in the Report at page 23, the Department had informed the Committee of its intention to review the Compliance Audit Return (CAR) program. The Report endorsed that and recommended (Recommendation 1) that the review be undertaken in conjunction with key stakeholders.

The Department subsequently undertook extensive consultation directly with local governments through a series of state-wide seminars which were part of the review of the CAR.

The CAR has been revised accordingly and is now being distributed to local governments. Refinements include an electronic format which will assist in ease of completion, and which allows automatic uploading of all of the captured information into the Department's database. This facilitates close monitoring of trends at individual council and sector-wide levels and will be used to produce sector-wide reports and to inform feedback.

5. Finding 15

The model of Local Government audit used in Queensland appears to give the best outcomes for all stakeholders without major impact on local government autonomy.

As this Finding is the basis of the relevant Recommendations, it is appropriate to briefly set out the components of the Queensland model in a little more detail than appears in the Report.

Factual investigation

Framework

The primary source of the Queensland Auditor General's ("QAG") audit authority is the *Financial Administration and Audit Act 1977 (Qld)* ("the Act").

The QAG is required by section 73 to undertake a "**finance and compliance audit**" of all public sector entities (which includes local governments, by Schedule 3 of the Act) each financial year.

The results of those audits must be reported to Parliament, by section 99 of the Act, and may be presented as a composite report of two or more entities (section 101).

The QAG is also empowered by section 80 (but not required) to conduct "**performance management systems auditing**". This involves a scrutiny of the effectiveness of the systems in place for monitoring effectiveness and efficiency in the local government. It does not directly focus on effectiveness and efficiency, but on the systems in place for monitoring. It does not review or comment on policy.

The audits are to be conducted as the QAG "considers appropriate", taking into account the character of the relevant internal control system (including internal

audit), and recognised standards and practice (section 79). The audit standards are to be in accordance with an Auditing Standard which the QAG presents to Parliament (section 97).

The current Auditing Standard, dated 25 September 2003, which advocates a risk-based auditing approach, primarily requires audits to be undertaken in accordance with the accounting standards issued by the Australian Accounting Standards Board from time to time.

The Auditing Standard also sets out the scope of the finance and compliance audit, and of performance management systems auditing.

Section 95 entitles the QAG to charge local government for an audit, recoverable as a debt, and calculated in accordance with a "basic rates of fees" determined by the QAG with the Treasurer's approval.

Contract Auditors

Section 82 of the Act allows the QAG to appoint an "appropriately qualified individual" to be a contract auditor, whether generally or in relation to a particular audit, on terms specified by contract.

The Queensland Audit Office ("the QAO"), in undertaking the work of the QAG, relies heavily on the use of contract auditors, managed in accordance with a detailed *Policy on Contracting Out of Audits*, 28 July 2004, setting out the procedures and risk management in place for the contract auditor system.

In the past three financial years, contract auditors have undertaken between 85% and 90% of the local government sector audits (110 of 125 councils and 15 of 15 joint local councils).

Suitable auditors are included in a Contract Auditors Register from which appropriate individuals are matched with local government audits and asked to quote on the work.

Criteria for appointment to the Register include adequate levels of audit experience, a CPA or ICAA qualification and membership, and satisfying the QAO that their firm has adequate quality assurance procedures in place.

Where the work is estimated to exceed \$40,000, three auditors on the Register are invited to quote for the contract. Where the estimate exceeds \$100,000, the contract is put out to tender.

By an understanding between the QAO and the contract auditors on the Register, contract auditors charge hourly rates similar to those charged by QAO auditors; that is, in the range of \$100 to \$130 per hour. This is well below commercial rates.

When contract auditors undertake the audit, the QAO charges the audited local government an additional 10% uplift (as a rule of thumb), to cover QAO staff costs in managing the contract auditors.

The contract auditors' fees, along with the fees of the QAO staff, are recovered from the audited entity in accordance with section 95 of the Act.

Audit contracts are generally on the basis of three years with an option to renew (at the instance of the QAG) for a further two years. It is policy that an auditor should not be engaged on a particular audit for more than five years.

In the past, contract auditors have been matched with individual local governments. The QAG is presently developing a new approach whereby local governments in particular areas are grouped in batches of varying size, complexity and risk considerations. The aim is to attract interest from audit firms of differing size and capacity, and streamline contact between auditors and the QAO.

Contract auditors are contractually required to have adequate internal quality systems in place, which are to include appropriate internal staffing supervision.

The QAO maintains a system of pre-certification and post-certification reviews of audits undertaken by contract auditors.

Pre-certification reviews are undertaken where significant issues in relation to council operations had been identified in councils' financial statements. 15 such reviews were undertaken in the 2004/2005 financial year (of the 117 audits undertaken by contract auditors during that period, or 13%).

Post certification reviews are undertaken on a sample basis, to quality check the work of the auditor. Again, 15 such reviews were undertaken in the 2004/2005 financial year (of the 117 audits undertaken by contract auditors during that period, or 13%).

The stated aim is to undertake a post certification review of a contract auditor's work at least once in each contract cycle (that is, once every five years at worst), although the 2004/2005 rate of 13% falls short of the average rate required to achieve that target.

The result of the review results in a grading from 1 to 6, which is taken into account when awarding contracts, and in assessing whether the auditor is appropriate to remain on the Register.

Audit Scope

The Queensland Audit Office, *Accounting Standards*, September 2003, prepared in accordance with section 97 of the *Financial Administration and Audit Act 1977 (Qld)*, sets out the scope of Financial and Compliance Audits.

The audits are undertaken with a view to ensuring that annual reports are prepared in accordance with the accounting standards issued by the Australian Accounting Standards Board from time to time.

The scope of **Financial and Compliance Audits** includes:

- Attestation of financial data, including an opinion as to whether the financial reports fairly represent the financial position and the result of financial operations;
- Examination of financial systems and transactions including an evaluation of compliance with applicable legislation;
- Determination of the probity of persons charged with the administration of public funds, and the propriety of administrative decisions taken; and
- Observations or suggestions which the QAG considers should be brought to the attention of management or Parliament.

The scope of the discretionary **Performance Management Systems Auditing** includes determining whether local government has systems in place to assess the:

- Economy of activities;
- Efficiency of resource utilisation;
- Effectiveness and quality of service delivery;
- The appropriateness of the indicators developed by the local government used to measure programme performance; and
- Observations or suggestions which the QAG considers should be reported on.

The audits are undertaken in accordance with the accounting standards issued by the Australian Accounting Standards Board from time to time, with the specified exclusion of AUS 806 – "Performance Auditing" and AUS 808 – "Planning Performance Auditing".

The focus is not on effectiveness and efficiency *per se*, but on the systems in place for monitoring effectiveness and efficiency. It does not review or comment on policy. It is undertaken on a selection of bodies representative of the sector, rather than each body within the sector.

The QAG's *Report No. 1 for 2006 - Results of Local Government Audits for 2004-05* indicates that a first Performance Management Systems Audit of local government is being considered, but that the audit approach had not yet been finalised. As at the

date of this report, the first Performance Management Systems Audit of local government has yet to be commenced.

Appendix B to that report sets out “details of the likely audit approach” and includes evaluation of:

- Performance management frameworks;
- Performance measurement systems; and
- Performance reporting.

Where a Performance Management Systems Audit of a public sector is undertaken, the QAO absorbs the cost of that undertaking from its own budget and does not pass the expense on to the audited sector.

Reporting

The QAG reports annually to the Legislative Assembly with a combined summary of the audits of all local government, in accordance with sections 99 and 101 of the *Financial Administration and Audit Act 1977 (Qld)*.

The report presents a cross-sector analysis, giving a summary of issues that the AOG considers relevant to the sector, and sets out aggregated financial statistics.

The report also publishes tables showing:

- Those local governments which did comply with the Local Government Finance Standards by preparing and certifying proposed financial statements by 15 September (ie singled out for praise);
- Those local governments which by the date of the Report had still not finalised their financial statements (ie named and shamed); and
- Summarises in tabular form all qualified audit opinions by Local Government as well as the local government’s responses.

Separate from the QAG’s role, the Queensland Department of Local Government, Planning, Sport and Recreation, in conjunction with local government, publishes an annual report entitled “*Queensland local government comparative information*”.

This is a voluntary exercise which, at present, has about 90% local government participation. It spans a range of performance indicators and demographic information sets.

Each section begins with a description and explanation of the indicator and what it means, before listing the results for each participating local government.

It is not organised in a "league table" format, but rather groups local governments by type and then lists them alphabetically within type.

Comparison of Some Aspects of the Queensland and Western Australian Models

In relation to the **scope of the audit**, the minimum work required of an auditor in Western Australia is that required to consider whether accounts are properly kept and that the financial reports represent the accounts and operations fairly.

Compliance, management practice and financial trend information need only be reported to the extent revealed by that work. A basic financial audit is unlikely to reveal and, accordingly, unlikely to report on any such issues.

In Queensland, those matters are within the initial scope of the work. In addition, the Queensland system incorporates a limited probity audit.

The **audit standard** in Western Australia is identical to that in Queensland – in both systems the standards are those set by the professional accounting bodies.

There is significant difference in **reporting on the audit** between the two systems. In Western Australia, the Department's Compliance section monitors the provision of the audit reports and follows up significant issues raised in the Audit Report or Management Letter, but the report goes no further than that.

The **costs of audit** in the Queensland model are significantly higher than in Western Australia, due to the extended scope of the minimum audit. Annexure A to this Report lists a sample of Queensland local governments and the cost of audit for the 2004/2005 financial year, alongside comparable Western Australian local governments and their cost of audit in the same period. It will be noted that the comparable Queensland local government cost of audit is usually a multiple (in most cases, several multiples) of the Western Australian equivalent. That is despite the fact that the QAO has managed to keep the contract auditors' hourly rates well below market rates.

It is acknowledged that the CAR is costed internally in Western Australia, while in Queensland that cost is external and contributes to the high cost of audit. Nevertheless, the Reference Group considers that the amount of work undertaken internally in preparing for a compliance audit would be similar to that undertaken in completing the CAR.

Discussion

The Report identifies the Queensland model as an advantageous one, preferable to the Western Australian system.

In reaching this conclusion, the Report considered that the following advantages are inherent in the Queensland model:

- The QAG's Annual Audit Report provides a "comprehensive snapshot of the local government sector" and a useful analysis of trends, areas of risk and matters for consideration in the sector.
- The publication in the QAG's Annual Audit Report of all qualified audit report matters, as well as any other matters considered significant, along with responses to those where provided, is "a clear disincentive to receiving an adverse report".
- Having the QAG oversee and/or conduct local government audits results in the provision of reliable, consistent information that is accessible to Parliament and members of the public.

Views

This Reference Group agrees that the following are strengths of the Queensland model.

Managing Auditors Centrally

A centrally managed and supervised list of competent auditors has several advantages for local government, including ensuring that only appropriately competent auditors are retained, in collectively negotiating audit fees, and in centrally managing the contracts and the outputs of the audits.

One important benefit in centrally managing contracts is to allow consistency in audit management reporting standards to be achieved.

Another benefit is that central management of the auditors reduces local governments' administrative burden.

Enlarged Audit Scope

The wider scope of the audit in the Queensland system is considered significantly more beneficial than the minimum scope required in Western Australia, since the former includes scrutiny of financial systems rather than simply confirming that the financial information presented is accurate.

There are, however, substantial cost implications in expanding the scope of the audit. Many of the smaller local governments would find the increased fees difficult to accommodate.

Sector Analysis and Comparative Report

For the reasons given by the Committee in the Report, the Reference Group agrees that there are significant benefits in an over-arching sector-wide strategic analysis of local government, and in publishing and tabling such a report in Parliament.

Similarly, the Reference Group considered that a detailed comparative report including every local government would be of advantage in noting trends and identifying problems to enable the Department to step in and provide appropriate assistance where required.

Performance Management Systems Auditing

The Reference Group considered that the Queensland Performance Management Systems Auditing concept has real potential for value in ensuring that local governments have effective systems in place to pick up on problems at the earliest stages.

The Reference Group notes, however, that a Performance Management Systems Audit of local government in Queensland has yet to be undertaken and, accordingly, it is difficult to unequivocally support a system that has yet to be implemented and proven.

6. Recommendation 2

The Public Accounts Committee strongly recommends that the Auditor General conduct the audit of the local government sector in Western Australia. The State Government should examine the benefits of involving the Auditor General in the audit of local government in line with the Queensland model.

Discussion

The benefits inherent in the Queensland model, as assessed by this Reference Group and commented on above, do not appear to necessarily be dependant on the Auditor General's administration of the model.

- The scope of the audit is a high order strategic determination, which does not require day to day amendment or administration. There does not appear to be a need to have the scope set by the Auditor General specifically.
- Audit standards are by and large determined by the professional bodies, not by the Queensland Auditor General.
- 85% to 90% of the actual audits are undertaken by private audit firms. It is not clear what advantage is obtained by reserving any of the audit to the Queensland Auditor General as opposed to private audit firms.
- The main role of the Queensland Audit Office in relation to local government audits appears to be in the central management of contract auditors and in reviewing the audits, rather than in conducting audits. The Reference Group agreed that it is largely immaterial which body is responsible for managing such a system, but members agreed that it is the Department's role to oversee the efficiency and effectiveness of local governments, while the OAG is better suited to overseeing the auditors.
- The sector-wide "snapshot" analysis of local government builds on the individual audits. There appears to be no over-riding reason why that exercise should or should not be undertaken by the Auditor General or the Department (or even a private audit firm). In any event, it is not necessary for the Office of the Auditor General to conduct a local government audit to enable it to undertake the sector-wide "snapshot" analysis.
- As regards the comparative report, it is noted that the exercise is not undertaken by the Auditor General in Queensland, but by the Department of Local Government.

- Performance Management Systems Auditing of local government in Queensland has not in fact been undertaken.

Views

There may well be benefit to the Western Australian local government sector in adopting aspects of the Queensland model, but, adequately and appropriately resourced, there does not appear to be any significant reason for the Office of the Auditor General to assume all of those responsibilities rather than the Department.

The Reference Group members in particular felt strongly that since it is the responsibility of the Department to ensure the efficiency and effectiveness of Local Government, it makes sense to seat expanded audit management duties within the Department.

The Reference Group believes that where the OAG can best add value is in the provision of quality control; the central management and review of the work of contract auditors.

7. Recommendation 3

The Public Accounts Committee recommends that the Auditor General should audit no more than 15 per cent of councils on a rotating basis, with the remainder to be tendered out to the private sector.

Discussion

The Reference Group did not see any significant benefit in the Auditor General undertaking infrequent audits of local governments in the manner recommended. It is difficult to see any advantage in the Auditor General as opposed to a private audit firm conducting the audit.

Views

The Reference Group felt that there may well be a more useful role for the Auditor General in undertaking a programme of reviewing the audits undertaken by private audit firms. In the Queensland system, the intention is that reviews should take

place at least once during the course of each audit contract (that is, once every 3 - 5 years). It is considered that it would be a better use of resources for the OAG not to undertake actual audits but to increase the number of audit reviews.

8. Recommendation 4

The parameters of audit for the Western Australian local government sector should be set by the State Auditor General to ensure consistency of reporting across the State.

Discussion

Consistency of reporting is considered essential by this Reference Group to achieve the greatest benefit from the audit.

Views

It is considered that consistency of reporting would be achieved through implementation of central management of private audit firms undertaking local government audits, and central control of the audit parameters.

The Reference Group remains of the view, however, that there does not necessarily appear to be any advantage in the Auditor General in particular, rather than the Department, being tasked with the central management function or setting the parameters of audit.

As discussed above, the Reference Group considered that there is benefit in an annual comprehensive comparative report of local governments.

It is appropriate to distinguish between the sector-wide "snapshot" audit report, undertaken by the Auditor General in Queensland, and the detailed comparative report, which is prepared by the Queensland Department of Local Government.

Both report types are considered of real value to the sector, and both depend on the availability of comparable data obtained through standardised procedures.

There does not necessarily appear to be any advantage in the Auditor General in particular being tasked with responsibility for ensuring production of annual, comprehensive comparative reports.

9. Concluding Discussion

Overview

In considering the relevant recommendations of the Public Accounts Committee Report, the over-riding issue has been to determine how to obtain the best possible outcomes within the Western Australian local government environment.

There are enviable strengths in the Queensland model. In particular:

- Central management of auditors;
- The enlarged scope of the audit;
- Sector analysis and comparative reporting; and
- The concept of Performance Management Systems Auditing.

Compliance and Probity Aspects of the Audit

The benefits obtained from the enlarged scope of the audit come at a substantially increased cost of audit in Queensland, reflecting the extent of the work required to be undertaken by auditors to achieve a more thorough audit encompassing compliance and probity aspects.

In Western Australia, compliance and probity audits are self-assessed. That has the advantage of incurring an internal cost benefit, rather than an audit fee cost, as well as ensuring local government participation and appreciation of the issues.

The Report notes that local governments advised the Committee that the Compliance Audit Report (CAR) is regarded as a good checklist. The Report goes on to identify areas where the CAR approach could be strengthened for compliance and probity auditing – its effectiveness relies on the honesty of the respondents, and there is concern as to lack of relevant or timely feedback.

The Report summarises its views on page 24 as follows:

The Committee believes the CAR has potential for reducing or deterring poor accountability by reminding council management and staff about their key compliance responsibilities. However, the Committee notes the CAR is a self-assessment tool and does not provide the sort of

performance evaluation that an independent audit organisation may provide.

Although individual local governments have suggested the CAR is too complex and ineffective, on the whole, most view the CAR as more of a benefit than a burden and would prefer it to be streamlined, rather than abolished altogether.

It has been noted in the Background to this Report, above, that the CAR has recently undergone revision following consultation with local government. A key revision is the new electronic format making the system easier for local governments and feeding the submitted return data directly into the Department's database. That, coupled with a recent increase in resources and staffing, is expected to facilitate meaningful and timely analysis, both cross-sector and for the individual local governments.

An Audit Model for Western Australia Drawing on the Queensland Model

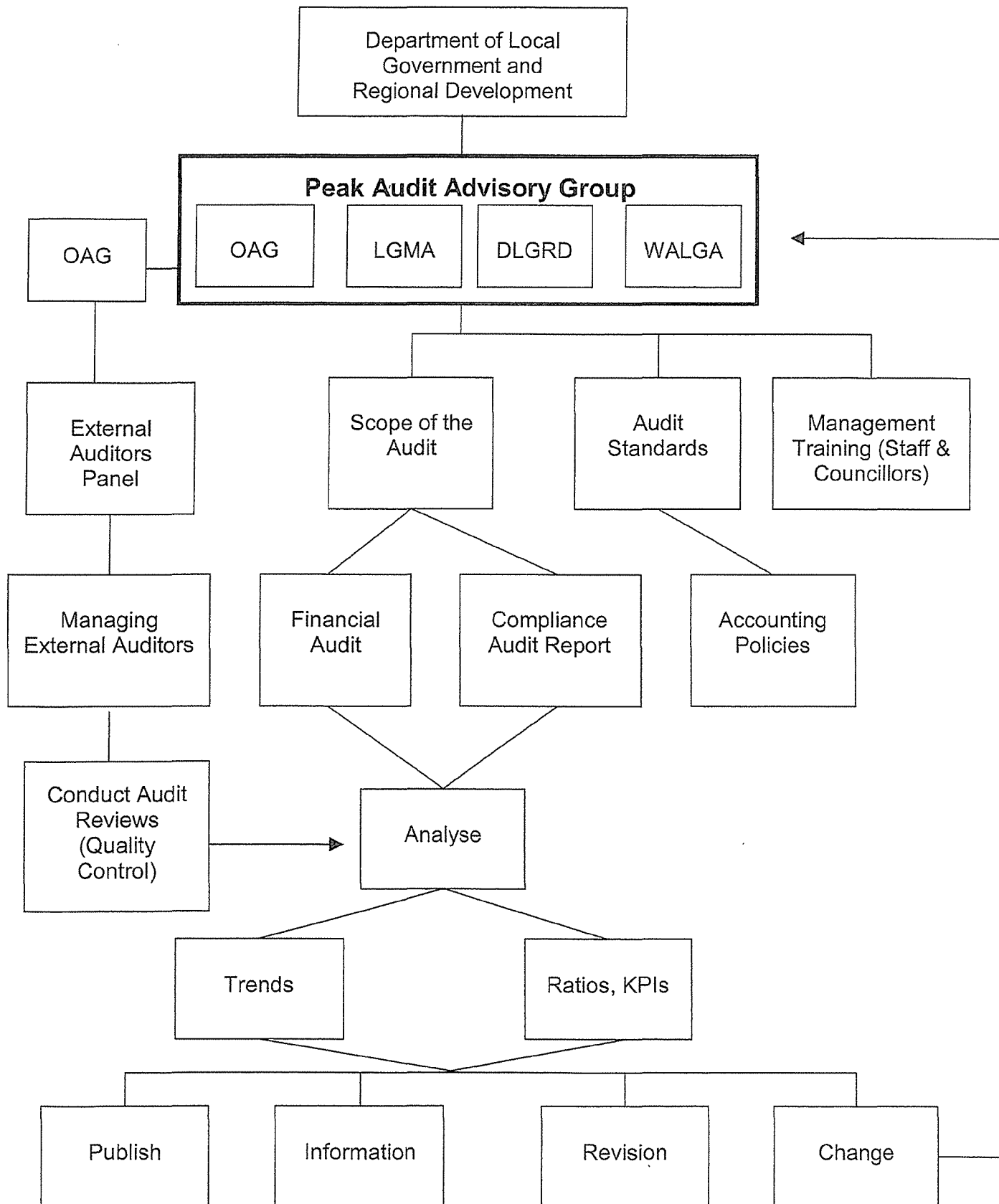
While the OAG has relevant public sector audit expertise, for the reasons set out under the heading Recommendation 2, above, there is no over-riding necessity for the OAG to assume responsibility for the audit of local government in Western Australia to achieve the benefits inherent in the Queensland system.

As the body responsible for ensuring the effectiveness and efficiency of local government, there is good reason for the Department to oversee local government financial, compliance and probity auditing.

The Reference Group considers it possible to incorporate all of the strengths of the Queensland system in a more collaborative and less costly Western Australian model. It is considered that this could be achieved without imposing new burdens on local governments.

The possible structure of a method to achieve this is set out in the following chart (Figure 1):

Suggested Structure Chart FIGURE 1



Peak Audit Advisory Group

A peak Advisory Group, comprised of representatives from the Department, the OAG, WALGA, and the LGMA, would advise and guide the Department in relation to local government audit, and the OAG in relation to management of external auditors.

The OAG would bring its experience and skills in public sector auditing to the Group, while WALGA and the LGMA would provide sector-wide representation and on the ground experience.

The Advisory Group's responsibilities would include the development of appropriate accounting policies, ensuring the availability and adequacy of training for local government staff and councillors, and in fostering standardisation of financial and audit practices to facilitate comparability.

Parameters of Audit

Through this Advisory Group, the Department would determine the scope of the audit, the audit standards to be employed, and identify and ensure that there are effective systems involving the officers and the council.

External Auditors Panel

An external auditors panel could be established to centrally manage contract auditors. That panel would be akin to a "preferred provider" panel, with all the strengths of the Queensland contract auditor model. The panel could be managed by the Department, appropriately resourced, or by the OAG directly.

The OAG could undertake a spread of audits of the work of the contract auditors. It is not envisaged that the OAG would undertake any audits of local government directly, but would rather use those resources to achieve a greater degree of scrutiny of the audits undertaken by contract auditors.

While this would be a matter for the Advisory Group to determine, it is suggested that contract auditors be appointed for no more than two terms of three years to a particular local government.

Financial and Compliance Auditing

While the Advisory Group would formulate the scope of the audit, it is envisaged that the scope would not be increased to the extent of compliance and probity auditing as in the Queensland system.

There is perceived to be real benefit in increasing the scope to look at the underlying performance of financial systems in place.

That would result in a marginally increased cost of audit, but not to the massive extent incurred in Queensland, and could be offset by savings obtained through a centralised management of contract auditors.

It is proposed that the effectiveness of the Compliance Auditing Return self-assessment approach be continued.

Analysis and Reporting

The combined effect of the peak Advisory Group recommending a uniform audit scope and standards, and the central management of contract auditors, will ensure that audit reports provide information in a consistent and standardised manner to facilitate cross-sector analysis.

The OAG would report to the Department summarising the audit activity for the year on matters relating to the professionalism of auditors and the management of the audit function.

That OAG report, along with the information obtained by the Department from an analysis of the individual local governments' audit reports and CARs, would form the basis of annual reporting to be prepared by the Department. The annual report could include a cross sector analysis of revealed trends and risks, along with detailed comparative information. It is envisaged such an annual report may be similar to a consolidated version of the Queensland Auditor General's report to Parliament and the Queensland Department of Local Government's comparative report.

The timing for completion of the CAR is presently deliberately staggered in relation to the audit cycle so as not to overwhelm local governments. Accordingly, some months would pass between completion of the audit and the delivery of the annual report following the CAR returns. That period would allow comments on the effectiveness of follow up action taken as a result of any qualified audit reports obtained by local governments.

The report could be tabled in Parliament by the Minister for Local Government, to ensure transparency and public scrutiny should the Government consider that this is necessary.

Appropriate resources will need to be available to the Department to enable it to undertake the monitoring and reporting responsibilities proposed.

The financial, trend, sustainability and performance information revealed by the reports would be used by the Advisory Group to recommend appropriate remedial steps, revision of the model and suggestions for changes as appropriate.

Concluding Advice

The Reference Group is of the opinion that:

- There are beneficial aspects of the Queensland model that could be adopted to the advantage of the Western Australian local government auditing model;
- It is not necessary to adopt the Queensland model wholesale in order to achieve those benefits;
- It is not necessary to divide responsibility for local governments' financial, compliance and probity health between the OAG and the Department in order to achieve the benefits inherent in the Queensland model;
- It is possible to keep the strengths of the present Western Australian model (the lower cost of audit and the advantages of the CAR) while achieving the Queensland audit model benefits;
- It is possible to obtain the benefit of the OAG's public sector audit skills and experience by having it manage and appoint the preferred auditors for local governments and provide an independent assessment of the activity of auditors each year to the Department.
- Adequate resources will need to be made available to the Department to ensure the successful implementation of an improved Western Australian audit model.

It is the view of the Reference Group that the model proposed above and charted in Figure 1 on page 20 would achieve all of the benefits and solutions of the Queensland model at a significantly lower cost.

22 December 2006

Queensland Local Government Cost of Audit 04/05 – ANNEXURE A

Type	Qld Example	Audit Fees 2004/2005	Operating Revenue		WA Local Government <i>with comparable Operating Revenue</i>	Audit Fees 2004/2005
Capital City	Brisbane City Council	\$672k	\$1.45b		None	---
Urban Developed Very Large	Logan City Council	\$131k	\$154.8m		Wanneroo (\$142m)	\$24.5k
Urban Developed Large	Toowoomba City Council	\$60k	\$91m		Perth (\$89m)	\$24k
Urban Developed Medium	Redcliffe City Council	\$104k (but 03/04 \$43k)	\$47m		Cockburn (\$47.5m)	\$10.7k
Urban Regional Very Large	Maroochy Shire Council	\$115k	\$170m		None	---
Urban Regional Large	Cairns City Council	\$120k	\$153.6m		Wanneroo (\$142m)	\$24.5k
Urban Regional Medium	Bundaberg City Council	\$32.6k (but 03/04 \$66k)	\$43m		Bayswater (\$36.7m)	\$12.3k
Urban Regional Small	Dalby Town Council	\$37.8k	\$13m		East Pilbara (\$13.4m)	\$15.7k
Urban Fringe Medium	Cooloola Shire Council	\$26.4k	\$38.6m		Bayswater (\$36.7m)	\$12.3k
Urban Fringe Small	Burnett Shire Council	\$36.6k	\$22.3m		Victoria Park (\$23.6m)	\$8.7k
Rural Agricultural Very Large	Banana Shire Council	\$23k	\$23m		Esperance (\$21m)	\$13.5k

Type	Qld Example	Audit Fees 2004/2005	Operating Revenue		WA Local Government <i>with comparable Operating Revenue</i>	Audit Fees 2004/2005
Rural Agricultural Large	Balonne Shire Council	\$36k	\$9.3m		Gingin (\$8.6m)	\$5.7k
Rural Agricultural Medium	Clifton Shire Council	\$28k	\$5.1m		Kojonup (\$5.3m)	\$9.4k
Rural Agricultural Small	Warroo Shire Council	\$24k	\$6.2m		Brookton (\$5.4m)	\$8.5k
Rural Remote Large	Murweh Shire Council	\$24k	\$12.7m		Ashburton (\$12.1m)	\$13.5k
Rural Remote Medium	Paroo Shire Council	\$25k	\$4m		Ngaanyatjarraku (\$4.6m)	\$6.6k
Rural Remote Small	Aramac Shire Council	\$18.3k	\$6.5m		Shark Bay (\$7.2m)	\$7k