

6 December 2013

The Mayor
Oberon Council
PO Box 84
OBERON NSW 2787

Dear Mr Mayor

**INDEPENDENT AUDITOR'S REPORT ON THE CONDUCT OF THE AUDIT – Section 417 (3)
OBERON COUNCIL**

We advise having completed our audit of the financial statements of Oberon Council (Council) for the financial year ended 30 June 2013. Our audit resulted in the issuing of an unmodified audit report on both the general purpose and special purpose financial statements of Council, though we note in our reports that the financial statements were not completed by the statutory deadline or by the approved revised due date for submission of 29 November 2013.

In accordance with Section 417 of the Local Government Act 1993 we submit our report on the conduct of the audit of Oberon Council for the year ended 30 June 2013. Our audit reports on the general purpose financial statements of Council and the special purpose financial statements on Council's business units outline the legislative framework of our audit and should be referred to in order to establish the context in which our comments are made.

Council's Responsibility for the Financial Statements

The Council is responsible for the preparation and fair presentation of the financial statements in accordance with the Local Government Act 1993. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Council, as well as evaluating the overall presentation of the financial statements.

The following comments are provided in accordance with Section 415 (3) of the Local Government Act 1993 and Regulation 227 of the Local Government (General) Regulation to assist in the understanding of the financial statements and our reports.

Review of the Financial Statements

(a) Operating Result

As disclosed in Council's Income Statement the year's operations resulted in a surplus from continuing operations after capital amounts of \$2,554,000 (2012 – \$1,848,000). Some items of note in the operating statement include:

Revenue

- The operating surplus from continuing operations *before* capital amounts was \$1,850,000 (2012 - \$245,000 deficit).
- Rates and annual charges increased by \$100,000 to \$3,927,000 (2012 - \$3,827,000). This increase reflects the 3.6% increase in rate pegging offset by a decrease in annual charges.
- User charges fees fell from \$4,947,000 in 2012 to \$3,696,000 for 2013 (decrease of \$1,251,000).

The main contributor to this result was a decrease in the value of work conducted by Council for the RMS of \$1,082,000. The nature and timing of this work is purely at the discretion of the RMS and therefore out of Council's control.

- Total interest and investment revenue increased by \$1,022,000 from \$112,000 in 2012 to \$1,134,000 in 2013.

Actual interest earned on Council's investments in 2012-'13 was \$226,000 (2012 - \$216,000), which is comparable to the prior year and consistent with the size and nature of Council's investment portfolio.

The year ended 30 June 2013 included \$74,000 in interest from the delayed settlement of the sale of Council property in Albion Street, Oberon, which is scheduled for use as an Aged Care Facility.

Fair value adjustments to investments for 2013 included an upward movement of \$311,000 compared to a downward movement in 2012 of \$141,000 (total variance of \$452,000). In addition, Council received \$495,000 on redemption of previously written off CDO's.

- Other revenues for 2012-'13 totaled \$637,000 compared to \$291,000 in the previous year (increase of \$346,000). This result was primarily due to the receipt of \$382,000 by Council as a result of successful court proceedings in relation to a failed LGFS investment product. We note that this decision is now subject to appeal.
- Operating grants and contributions rose to \$5,337,000 in 2013, a \$1,054,000 increase on the prior year income of \$4,283,000.

Key contributors to this movement were:

- Receipts under the Financial Assistance Grant were \$520,000 less than 2012, primarily due to the timing of advance payments under this program.
- Council received \$966,000 in the 2012-13 financial year in natural disaster funding for a flood event which occurred in March 2012.
- Whilst total contributions received from the RMS were comparable with the previous year (2013 - \$1,849,000, 2012 - \$1,741,000), there was a change in the mix of these funds between capital and operating contributions due to the nature of the projects to which the contributions related. This saw an increase in operating contributions of \$564,000 and a decrease in capital contribution of \$456,000, compared to 2012.

This was a key factor in the decrease in capital grants and contributions of \$1,389,000, which moved from \$2,093,000 in 2012 to \$704,000 in 2013. Other factors in this movement included:

- Contributions received from Forests NSW for work on roads in State Forests were nil for 2013 compared to \$180,000 in 2012.
- Contributions for Community Infrastructure and Recreation and Culture (which related to works on Tennis Courts) totaled \$302,000 in 2012 compared to nil for 2013.

Expenditure

- Total employee costs decreased by \$101,000 or 2.12%.

Salaries and wages rose by \$123,000 or 2.90% which is slightly lower than the annual Award increase and reflects the staffing changes experienced by Council during 2012-'13.

Council had a number of long serving staff resign during the year, resulting in employee termination costs of \$142,000 (2012 - \$2,000). The departure of these staff also contributed to the decrease of \$157,000 in employee leave entitlements.

- Council spent \$2,913,000 on materials and contracts for the year, compared to \$3,492,000 in 2012 (decrease of \$579,000). This decrease was primarily due to a change in the mix of operating and capital works undertaken by Council and with the reduction in the level of work undertaken for the RMS on State Roads.

(b) Financial Position

The Balance Sheet discloses that for the year ended 30 June 2013 Council's net assets stood at \$184,208,000 (2012 - \$180,619,000) which represents an increase of \$3,589,000. This comprised the surplus from continuing operations after capital amounts of \$2,554,000, and an adjustment to Council's asset revaluation reserve of \$1,035,000 which arose from the revaluation of Council's buildings, other structures and operational land, combined with the indexation of Council's water and sewerage assets.

To assess the flexibility of Council's net current asset position it is necessary to review the level of restrictions placed against the use of Council's assets. The notes to the financial statements indicate clearly where restrictions exist and the effect of the restrictions is summarised on the below.

	2013 \$'000	2012 \$'000
Net current assets	6,524	5,640
Less: Amounts externally restricted for special purposes refer Notes 6; 7; & 8 of financial statements	(2,128)	(1,854)
Less: Council internally imposed restrictions (refer Note 6 of financial statements)	(3,700)	(1,918)
Less: Current real estate for resale not expected to be settled within 12 months	(150)	(717)
Add: Applicable current liabilities refer Note 10		
- Water	102	97
- Sewerage	1	5
- Other	108	-
- Current employee leave entitlements not expected to be paid within 12 months	737	831
Unrestricted net current asset surplus/(deficit)	1,494	2,084

Unrestricted net current assets comprise:-**Assets**

Cash	189	474
Receivables	994	1,490
Inventories	1,032	1,514
Other assets	214	188

Less: Current real estate for resale not expected to be settled within 12 months	<u>(150)</u>	<u>(717)</u>
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	2,279	2,949
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Less:

Liabilities

Payables	(397)	(362)
Provisions	(1,235)	(1,344)
Interest Bearing Liabilities	(101)	(92)

Add: Restricted liabilities per note 10	211	102
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Add: Current employee leave entitlements not expected to be paid within 12 months	<u>737</u>	<u>831</u>
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	<u>(785)</u>	<u>(865)</u>
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Unrestricted net current asset surplus/(deficit)	<u>1,494</u>	<u>2,084</u>
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The positive unrestricted net current asset position of Oberon Council has deteriorated since the prior year, and will need continued management to ensure it remains positive in the subsequent financial years.

It is important to note that, as in the last few years, this result is underpinned by high levels of receivables and inventories.

Liquidity

Note 6 to the accounts discloses total cash and investments (current and non-current) of \$6,725,000 (2012 - \$4,690,000). Of this amount \$2,836,000 (2012 - \$2,298,000) is subject to external restrictions requiring Council to commit those funds to the purposes for which they were provided and \$3,700,000 (2012- \$1,918,000) is subject to internal restrictions agreed upon by Council for designated purposes. These internal restrictions may be altered at the discretion of Council, consistent with their operational plan.

The unrestricted balance of \$189,000 (2012 - \$474,000) represents funds available to cover non-budgeted discretionary expenditure and short-term cash flow requirements.

(c) Performance Indicators

Note 13 to the Financial Statements provides a measure of Council's performance using a number of selected ratios as follows:

Unrestricted Current Ratio

The Unrestricted Current Ratio is a measure of Council's liquidity that demonstrates Council's ability to satisfy obligations out of short-term asset balances.

Council's ratio of 6.68:1 (2012 – 5.63:1) demonstrates a robust depth of liquidity.

It is also important to note that, as outlined above, Council's current assets include high levels of receivables and inventories. These assets will need to be converted into cash before Council is able to fully utilise the value of these assets in its day to day operations.

We stress the importance of considering this ratio in conjunction with other performance indicators and not in isolation. The fact that this ratio is based upon consolidated funds should also be kept in mind as the ratios for individual funds (i.e. General, Water, Sewer and Town Improvement) may vary significantly.

Debt Service Ratio

The cost of repaying debt is reflected in the debt service ratio, which expresses that cost as a percentage of revenue from continuing operations.

Whilst there is no definitive guide on what constitutes an acceptable ratio it is generally accepted that a ratio of up to 20% depending on the level of long-term development (infrastructure) plans, is considered tolerable. At 0.96% (2012 – 0.95%) Oberon Council's ratio is well below this industry benchmark and the Council has the capacity to fund further debt should the growth in the need for infrastructure dictate. However, any future borrowings should be entered into only if Council can continue to meet its debt service requirements out of recurrent revenue.

Rates and Annual Charges Coverage Ratio

The ability of Council to meet community expectations for the delivery of services and provision of facilities is directly influenced by the discretion it can exercise in the allocation of resources.

In relation to rates, a high level of dependency on rates income provides Council with a degree of flexibility in the nature and timing of how funds are spent.

Oberon Council's ratio of 25.30% (2012 – 25.21%) is consistent with the prior year.

Rates and Annual Charges Outstanding Ratio

The rates and annual charges outstanding percentage is a measure of management efficiency. Whilst prevailing economic conditions may influence Council's ability to collect revenue, the efficiency and application of collection procedures are still the largest determinant of this ratio.

Oberon Council's rates and annual charges outstanding percentage of 8.12% (2012 – 8.14%) has improved marginally since the prior year, but will require continued, concerted efforts in order to bring it back to a more acceptable level during the 2013-'14 financial year.

Building and Infrastructure Renewals Ratio

The purpose of this ratio is to assess the rate at which infrastructure assets are being renewed against the rate at which they are depreciating.

Because the distinction between replacements, renewals and repairs is not well defined, it is difficult to make meaningful analysis from this ratio. Council's ratio at 30 June 2013 was 135.90% compared to 125.62% in 2012 and 140.91% in 2011. The impact of increased depreciation expense over the last few years due to revaluations performed needs to be considered in assessing this ratio.

(d) Statement of Cash Flows

The Statement of Cash Flows reports a net increase in cash assets held of \$1,724,000 (2012- \$2,583,000 increase) as follows:

	2013 \$'000	2012 \$'000
Cash flow provided by / (used in)		
Operating activities	6,152	5,267
Investing activities	(4,333)	(2,597)
Financing activities	(95)	(87)
	<hr/>	<hr/>
Net increase / (decrease) in cash held	<u>1,724</u>	<u>2,583</u>

Cash flows from Operating Activities

The cashflows from operating activities were higher than the previous year. This was primarily due to a decrease in the cashflows for materials and contracts expenditure. This was the result of both lower expenditure in this category in 2013 than in 2012, as well as movements in creditor balances, which impacted the timing of cashflows.

Cash flows from Investing Activities

The net cash flow used in investing activities totalled \$4,333,000. Purchases of infrastructure, property, plant and equipment totalled \$5,185,000. The major cash outflows related to capital work on a number of roads throughout the Shire totaling \$2,717,000 plus an additional \$889,000 on bulk earthworks. As in prior years, one of the major roads on which works were undertaken during the year was Abercrombie Road. Plant and equipment additions for the year totalled \$991,000 which related primarily to the turnover of Council's motor vehicle fleet and purchases of heavy machinery.

These outflows were offset by the disposal of real estate assets and infrastructure, property, plant and equipment which contributed \$484,000 and \$384,000 respectively to Council's cash inflows.

Cash flows from Financing Activities

The net cash flow used in financing activities was \$95,000. No borrowings were drawn in the current financial year.

Repayments were in line with the requirements of the loans.

(e) Comparison of Actual and Budgeted Performance

Council's surplus from continuing operations after capital amounts of \$2,554,000 was \$637,000 more than Council's original estimated surplus of \$1,917,000.

It is not the intent of this report to provide detailed analysis of individual budget variations. Note 16 of Council's financial statements address the contributing factors to budget variations in detail.

(f) Other Matters

National Competition Policy

In accordance with the requirements of National Competition Policy guidelines, Oberon Council has prepared special purpose financial statements on its business units for the year ended 30 June 2013. Council has determined that it has two business units within its operations: Water and Sewerage.

The Division of Local Government's July 1997 guidelines 'Pricing and Costing for Council Businesses: A Guide to Competitive Neutrality' outlines the process for identifying and allocating costs of activities and provide a standard of disclosure requirements. These disclosures are reflected in Council's pricing and/or financial reporting systems and include taxation equivalents, Council subsidies, rate of return on investments in business units and dividends paid.

An unqualified audit report on the special purpose financial statements for the year ended 30 June 2013 has been issued.

Management letters

An interim management letter was issued on 5 June 2013.

A final report will be prepared upon completion of our year end review.

(g) Legislative compliance

Due date for submission of financial statements

As a result of our audit we advise that Oberon Council did not comply with the provisions of Section 416 of the Local Government Act (NSW) 1993, which requires that the financial statements be prepared and audited within four months of the end of the financial year.

During the 2012-'13 financial year, Council experienced significant staff losses in its Finance Department. This resulted in resourcing issues which impacted on Council's ability to complete the financial statements within the required time frame.

Council accordingly made a request under Section 416 of the Local Government Act 1993 for an extension of time for the submission of its 2012-'13 financial statements. Approval for this extension was received from the Division of Local Government, with a revised due date for submission of 29 November 2013 confirmed by the Division.

Council was unable to meet this revised due date for submission.

Preparation of month end reconciliations

We also advise that Oberon Council did not comply with the provisions of Regulation 207 of the Local Government (General) Regulation 2005 which requires that the responsible accounting officer must take all reasonable measures to ensure that assets of or under the control of council are properly accounted for.

Further, we advise that Oberon Council did not comply with the provision of Section 412 of the Local Government Act (NSW) 1993, which requires that Council keep accounting records as are necessary to correctly record and explain its financial transaction and its financial position. These records must also be kept in a manner and form which facilitates the preparation of financial reports and convenient and proper auditing of those reports.

The definition of accounting records contained in Regulation 196 of the Local Government (General) Regulation 2005 specifies that accounting records include "any cash receipt record, assets register, contracts register, stores register or ledger, debtor's ledger and creditor's ledger.

For the year ended 30 June 2013, Council did not prepare a bank reconciliation between the end of April 2013 and 30 June 2013. The next completed bank reconciliation was for the period ended 31 July 2013.

For the year ended 30 June 2013, Council did not maintain a stores ledger between the end of April 2013 and the end of June 2013.

Reporting of invested monies

Our audit also found that Oberon Council did not comply with the provisions of Regulation 212 of the Local Government (General) Regulation 2005, which requires the responsible accounting officer of a council to provide council with a written report of money that council has invested under Section 625 of the Local Government Act (NSW) 1993.

Further, we advise that Oberon Council did not comply with the provisions of Regulation 207 of the Local Government (General) Regulation 2005 which requires that the responsible accounting officer must take all reasonable measures to ensure that assets of or under the control of council are properly accounted for.

The monthly report submitted to Council includes Council's investments in Council's term deposits, other investments and bank balances.

No completed, authorised bank reconciliation for May 2013 was able to be provided for audit. The bank account (cash book) balance reported to Council for 31 May 2013 at its meeting on 18 June 2013 was an overdraft of \$1,295,956.44.

No bank reconciliation was performed at 30 June 2013, and a manual bank reconciliation for 30 June 2013 was prepared for audit purposes in November 2013.

The bank balance reported for 30 June 2013 to Council at its meeting on 16 July 2013 was an overdraft of \$1,227,702.05. The bank balance included in the financial statements at 30 June 2013 was \$61,293.85. This is a variance of \$1,288,995.90 in the actual balance of Council's bank account compared to the balance reported to Council.

Stores stock take

As a result of our audit, we advise that Oberon Council did not comply with the provisions of Regulation 207 of the Local Government (General) Regulation 2005 which requires that the responsible accounting officer must take all reasonable measures to ensure that assets of or under the control of council are properly accounted for.

Council undertook a physical count of its stores in June 2013. This count resulted in a variance between the physical (stocktake) count and the stores ledger of \$40,898.81. This variance does not appear to have been either resolved or accounted for.

(h) Matters Relating to the Electronic Presentation of the Audited Financial Statements

This auditor's report relates to the financial statements of Oberon Council for the year ended 30 June 2013 included on Council's web site. Council is responsible for the integrity of Council's web site. We have not been engaged to report on the integrity of the web site. The auditor's report refers only to the statements named above. It does not provide an opinion on any other information which may have been hyperlinked to/from these statements. If users of this report are concerned with the inherent risks arising from electronic data communications they are advised to refer to the hard copy of the audited financial statements to confirm the information included in the audited financial statements presented on this web site.

Conclusion

Except for the matters noted at item (g) above:

- (a) The Council's accounting records have been kept in a manner and form that facilitated the preparation of the general purpose financial statements and allowed proper and effective audit of this report;
- (b) The Council's accounting records have been kept in a manner and form that facilitated the preparation of the special purpose financial statements and allowed proper and effective audit of this report; and
- (c) All information relevant to the conduct of the audit has been obtained.

Yours faithfully
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Per:

A handwritten signature in black ink that reads "Leanne Smith". The signature is written in a cursive, flowing style.

Leanne Smith
Partner