

Declaration of financial / conflict of interests to be recorded prior to dealing with each item.

11. Internal Audit Report May 2013

Previous Items	N/A
Responsible Officer	Acting Chief Executive Officer
Service Area	Internal Auditor
File Reference	
Applicant	Nil
Owner	Nil
Attachment 1	Internal Audit Report May 2013

PURPOSE

1. To provide the Audit and Risk Committee with assurance that the financial and statutory functions of the Shire are being undertaken in accordance with the provisions of the *Local Government Act 1995*, associated regulations, the Australian Accounting Standards, other legislation and that key controls are operating effectively.

BACKGROUND

2. The Internal Auditor examined and reviewed a number of areas in accordance with the Audit Plan and changes to legislative requirements. The areas covered in his report included:
 - Novated Leases
 - Fringe Benefits Tax (FBT)
 - Tendering
 - Procurement and Accounts Payable
 - Light Vehicle Policy/Insurance
 - Investments and Investment Policy
 - Bank Reconciliations
 - GST on Fees and Charges
 - Mail Remittances and Cash Receipts

DETAILS

3. The following summarises the findings and action being taken by management:

Novated Leases

4. A consultant's review established that quotations received from the finance provider of the lease (Easifleet) for two employees were not reflected properly in the individuals pay. An internal review established that there were four employees in total with new novated leases not paying the correct amount of group tax each month. Appropriate remedial action is being taken to remedy the matter by the 30 June 2013. Procedures have been implemented to prevent a reoccurrence of this issue.

Fringe Benefits Tax

5. A follow up review of log books found that a significant number of employees were not completing their log books correctly. To address this training was conducted in April 2013 by Grant Thornton for all staff with a Shire vehicle.

Tendering

6. The Shire developed a new procedural guide for tendering and procurement to address the recommendations of the Forensic Audit into the Kalamunda Water Park. The new guide is now being used for new tenders and has been tested for compliance with legislation and probity. Training is being arranged for employees by Human Resources.

Procurement/Accounts Payable

7. A review of purchases was conducted to ensure purchase orders were being properly raised from purchase requisitions and that purchase orders were being approved within delegated limits. A sample of supplier's invoices were compared to purchase orders for evidence of approval within delegated limits, timing of raising of order with invoice dates, checking for receipt of goods pricing, and passing of invoices for payment.

Light Vehicle Policy and Insurance

8. A review of the Light Vehicle Policy was undertaken to ensure that certain requirements regarding insurances of the vehicles was being met.

Investments

9. The Investment Policy was reviewed to ensure it had been updated for legislative changes that came into force on 20 April 2012.

Bank Reconciliations

10. Bank reconciliations were reviewed to ensure they were being done regularly and independently reviewed. Ensured there were no long outstanding items and all bank statement items were being journalised to the general ledger.

GST on Fees and Charges

11. Reviewed GST on fees and charges based on legislative changes by the Australian Taxation Office following the withdrawal of the Treasurers determination (Division 81).

Mail Remittances and Cash Receipts

12. Reviewed procedures for mail remittances of receipts and payments at the front counter in the administration building to ensure there was a proper segregation of duties between the receipt of remittances, accounting for receipts and banking of proceeds.

STATUTORY AND LEGAL IMPLICATIONS

12. *The Local Government Act 1995, Local Government (Financial Management) Regulations 1996, Fringe benefits Tax Assessment Act 1986 and its regulations.*

POLICY IMPLICATIONS

13. Light Vehicle Policy (ADM9).
Purchasing Policy (PUR1).

PUBLIC CONSULTATION/COMMUNICATION

14. Nil.

FINANCIAL IMPLICATIONS

15. The implementation of the recommendations will reduce exposure to financial risk and loss to the Shire, and ensure it remains compliant with legislation.

STRATEGIC AND SUSTAINABILITY IMPLICATIONS

Strategic Planning Implications

16. *Kalamunda Advancing – Strategic Community Plan to 2023*
- | | |
|----------------|--|
| Strategy 6.3.3 | Regularly review the organisation's governance structure and procedures in response to changing circumstances. |
| Strategy 6.8.4 | Provide effective financial services to support the Shire's operations and meet sustainability planning, reporting and accountability requirements |

Sustainability Implications

Social Implications

17. Nil.

Economic Implications

18. Nil.

Environmental Implications

19. Nil.

OFFICER COMMENT

20. The issues identified and recommendations were discussed with management for implementation to improve the internal control framework, reduce any exposure to financial risk and ensure the Shire is compliant with legislative requirements.

Voting Requirements: Simple Majority

OFFICER RECOMMENDATION (A&R 11/2013)

That the Audit and Risk Committee:

1. Notes the following recommendations included in the Internal Audit Report for May 2013 – (Attachment 1):

Novated Leases

1. A new template should be used by Human Resources and employees for quotations received on a new novated lease to ensure the quotation agrees with the determination of an individual's fortnightly tax and net pay.
2. The template should be used by Human Resources as the basis for calculation and determining an employee's fortnightly pay.
3. Employees should sign the acceptance of quotation and attach it to the template as evidence that they agree with the tax determination and net pay.

Light Vehicle Policy (ADM9)

1. The Light Vehicle Policy requires updating to address the statutory obligations under FBT legislation in order to be compliant.
2. Employees with a Shire vehicle need to comply with the Light Vehicle Policy and FBT legislation.
3. Management need to consider the imposition of rules for the continual breaches by employees with Shire vehicles by either withdrawing the privilege, or requiring an employee to make a contribution for any additional FBT payable by the Shire.

Tendering

1. All staff involved with the tender process should familiarise themselves with the legislative requirements as set out in the purchasing policy and tender guide.
2. For transparency and compliance with legislation, the tender guide should be followed and the appropriate forms included with the guide used for all tenders.
3. Persons on the tender evaluation panel should have a clear understanding of the goods or services being evaluated and not have any conflict of interest.

Procurement/Accounts Payable

1. Management needs to ensure that purchase orders are never raised after the receipt of the suppliers invoice.
2. Employees are made aware of policy and procedures when ordering goods and services from suppliers.
3. Listings of approved accounts for payment are always retained.

Light Vehicle Policy and Insurance

1. Human Resources prepares, as a matter of priority, a central register of who is allowed to drive a shire owned vehicle.

Investments

1. The Shire Investment Policy requires updating to include the legislative changes that came into effect in April 2012
2. Management needs to consider whether a lower return verses the higher guarantee by holding investments with the WATC outweighs investments in ADI's spread between various trading banks paying a higher rate of return but a lower guarantee on investments.
3. Consideration be given to whether it would be preferable to consider a condition through delegations to the Chief Executive Officer and therefore not requiring a Council policy.

Bank Reconciliations

1. Items on the bank reconciliation should only include outstanding items such as un-presented cheques and outstanding deposits and not items that need to be put through the general ledger.

Mail Remittances and Cash Receipts

1. All trust receipts are separated from municipal funds and banked intact into the trust bank account directly and not transferred from municipal funds.
2. Requests the Acting Chief Executive Officer to provide a future report to the Audit and Risk Committee outlining the management responses to the recommendations contained in the internal audit report (Attachment 1).

Moved:

Seconded:

Vote:

Internal Audit Report May 2013

Financial Management Review

Objectives and Scope of the Internal Audit

The objective of the internal audit is to provide the CEO and the Audit and Risk Committee with assurance that the financial and statutory functions of Shire are being undertaken in accordance with the provisions of the *Local Government Act 1995*, associated regulations, the Australian Accounting Standards, other legislation and that key controls have operated effectively during the financial year.

This report covers areas examined in accordance with the Audit Plan and includes the following issues:

1. Novated Leases
2. Fringe Benefits Tax (FBT)
3. Tendering
4. Procurement and Accounts Payable
5. Light Vehicle Policy/Insurance
6. Investments
7. Bank Reconciliations
8. GST on Fees and Charges
9. Mail Remittances and Cash Receipts

Issue 1 - Novated Leases

Background

A Novated lease is a three-way agreement between an employer, an employee and a financier. The employee selects a car of their choice, the financier provides the funds and the employer makes the lease payment on behalf of the employee from their pre and post-tax salary.

Employees with vehicles under a new Novated leases expressed concern with Management that the packaged net salary benefit quoted by the service provider (Easifleet) differed from the net after tax benefit received in their fortnightly pay.

Directors and Managers with a Shire motor vehicle due for replacement are now salary packaging the replacement vehicle under a Novated lease. The benefit is to provide a more attractive remuneration package to employees while avoiding the need to provide a Shire owned motor vehicle.

This arrangement reduces the Shire's fleet of light vehicles, frees up capital, reduces operating expenditure on maintenance and running costs, and reduces the annual Fringe Benefits Tax (FBT) liability payable by the Shire.

An employee obtains a car of their choice within their salary package, with a pre-tax benefit over the lease term, and owns the vehicle on payment of the residual at the end of the lease. All running costs of the motor vehicle are structured as part of the lease payments with pre and post-taxable components.

Novated leasing is a specialised tax area requiring independent advice from a taxation specialist to examine the pre and post-tax arrangement and salary packaging structure. Three quotations were obtained from PricewaterhouseCoopers (PwC), Grant Thornton, and Ernst and Young, with PwC appointed to conduct the work for \$4,950.

The consultant reviewed two new Novated leases by comparing the quotes with an employee's tax calculation and net pay.

The report received from the consultant made a number of recommendations. These are summarised in Attachment 1 of the report with the action taken to address the matter.

The consultants review established that Easifleet's calculation of the GST exclusive lease costs and post-tax contributions for FBT, as per their quotation, were not reflected properly in the individuals pay.

The travel allowance was being incorrectly treated as a non-taxable reimbursement when it should have been a taxable allowance. A salary sacrifice component made up of vehicle lease payments, and an after tax reimbursement for FBT were not treated appropriately in the determination of the tax payable and in the calculation of the employees net pay.

Work Performed

The findings by the consultants were used to establish if any other employee with a novated lease was affected.

The internal review established there were four employees on new Novated leases not paying the right amount of group tax each fortnight. The amounts under-remitted required amendment for each employee and the correct amount remitted to the ATO by the 30 June 2013.

A new template was prepared for use by HR identifying the pre and post-tax deductions in the determination of income tax and net pay for employees with a new Novated lease as part of their salary package.

Action Taken by Management

Human Resources (HR) and the four affected employees were advised of the error. HR has taken action to correct this before the 30 June 2013 and remitting the correct amount of group tax to the ATO.

Issue 1 - Recommendations for Management Action Required

- 1. The new template should be used by HR and employees for quotations received on a new Novated lease to ensure the quotation agrees with the determination of an individual's fortnightly tax and net pay.**
- 2. The template should be used by HR as the basis for calculation and determining an employee's fortnightly pay.**
- 3. Employees should sign the acceptance of quotation and attach it to the template as evidence they agree with the tax determination and net pay.**

Issue 2 - Log Books - Fringe Benefits Tax (FBT)

Background

An independent assessment of the compliance of car fringe benefits by Grant Thornton conducted in November 2012 indicated that vehicle usage log books currently being maintained by Shire employees did not appear to be valid in terms of the FBT law and the ATO logbook guidelines.

New log books were issued to staff at the commencement of the FBT year with instruction on how to complete these log books in order for the Shire to be compliant with the *Fringe Benefits Tax Assessment Act 1986* and its regulations.

Work Performed

A follow up review has found that a significant number of employees still continue to complete their log books incorrectly. This will result in the Shire not being able to use the Operating Cost Method and having to apply the Statutory Formula Method in order to determine its FBT liability.

If an employee has private use of vehicles classed as non-cars the Shire should not be using the Statutory Formula Method. This usually results in a higher FBT liability and does not comply with legislation.

There appears to be a high degree of confusion and uncertainty among affected employees concerning the operation of the FBT laws with regard to the private and business use of vehicles and the correct manner of completing log books.

The Light Vehicle Policy (ADM9) requires log books to be completed.

Action Taken by Management

To address the confusion and the need to complete log books properly to be compliant, management arranged for two presentations to be conducted by Grant Thornton in April 2013 for employees with a Shire vehicle.

Issue 2 - Recommendations for Management Action Required

- 1. The Light Vehicle Policy requires updating to address the statutory obligation under FBT legislation in order to be compliant.**
- 2. Employees need to be aware of their obligations to comply with the Light Vehicle Policy and the FBT legislation.**
- 3. Management need to consider imposing rules for continual breaches by employees with Shire vehicles by either withdrawing the privilege, or requiring an employee to make a contribution for any additional FBT payable by the Shire.**

Issue 3 - Tendering

Background

The Shire has developed new procedural guides for tendering and procurement to address the recommendations of the Forensic Audit into the Kalamunda Water Park.

The main areas of concern reported by the forensic auditors included:

- A clear explanation for the awarding of tendered contracts was not always apparent.

- The total value of supplier's invoices exceeded the threshold in the Regulations and Shire purchasing policy to call for public tenders.
- Variations to contracts were not formally approved.

Review

A review of the evaluation process for two tenders was conducted using the tender guide and the attached forms. The two tenders evaluated were Tender C 1125 Construction of New Amenities Building, and Tender RFT 1203 Provision of Plant Hire and Auxiliary Plant Hire Services.

Outcome

The evaluation of the processes used for the calling of tenders and the evaluation and recommendation for the awarding of tenders indicated:

- The principles of probity were observed and the outcomes that were achieved were visible, defensible and auditable.
- The guideline had been followed.
- There was proper compliance with legislative requirements as per the *Local Government Act 1995* and *Local Government (Functions and general) Regulations 1996*, and the Shire of Kalamunda's Code of Conduct (ADM 5), Purchasing Policy (PUR 1) and Delegations.
- The evaluation panel included persons that had a clear understanding of the tender process and nature of the services required.

Issue 3 - Recommendations for Management Action Required

- 1. All staff involved with the tender process should familiarise themselves with the legislative requirements as set out in the purchasing policy and tender guide.**
- 2. For transparency and compliance with legislation, the tender guide should be followed and the appropriate forms included with the guide used for all tenders.**
- 3. Persons on the tender evaluation panel should have a clear understanding of the goods or services being evaluated and not have any conflict of interest.**

Issue 4 - Procurement/Accounts Payable

Background

The Forensic Investigation into the Kalamunda Water Park recommended a review and update of the Purchasing policy and procedures. This document is still in draft form and will be presented to the Risk and Audit Committee when completed.

The investigation highlighted a number of matters that will be addressed in the purchasing policy and procedures. This includes procurement activity on tendering, panel suppliers and quotations.

Review

An internal audit review was conducted of a sample of purchase requisitions issued between January and March 2013 to ensure they had been properly completed and that authorised purchase orders were raised. Review included evidence that goods were received and checked, orders were matched with invoices for accuracy of vendor pricing in accordance with the quotation and order.

Examined the tender register for completion in accordance with statutory requirements and whether it was up to date.

Checked a sample of payments to authorised listings of accounts for payment.

Ensured there were controls in place for the issuing of cheques in a register and that cancelled cheques were recorded and the original cancelled and retained.

Outcome and Action Taken by Management

There were instances where purchase orders were being raised after the invoice had been issued. This is a breach of proper purchasing procedure and was brought to management's attention. Management have been aware of the problem by referring this matter back to the appropriate managers to ensure it does not reoccur. The number of instances where this happens has fallen and is being monitored.

Authorised listings of creditor's accounts for payments were not being retained by accounts payable. This will be required by the external auditors as evidence that accounts have been checked by the cheque signatories and approved for payment. This has been brought to management's attention and authorised lists are now being retained.

Issue 4 - Recommendations for Management Action Required

- 1. Management needs to ensure that purchase orders are never raised after the receipt of supplier's invoices.**
- 2. Employees are to be made aware of policy and procedures when ordering goods and services from suppliers.**
- 3. Listing of approved accounts for payment are always retained.**
- 4. A register of cheques is maintained recording each batch of cheques issued and any cancelled entered in the register and retained.**

Issue 5 - Light Vehicle Policy and Insurance

Background

A review of the Light Vehicle Policy (ADM 9) indicates that Human Resources (HR) maintains a central register of who is allowed to drive a Shire owned vehicle in accordance with the approval of the Shire.

On request it was found that a central register is not being maintained by HR as required by policy.

Policy item 7 requires a nomination form to be completed by the employee with a Shire vehicle and submitted to insurance/payroll.

A review of the Motor Fleet Insurance Product Disclosure Statement with Zurich states " we will pay the amount for which:

1. you
2. any person legally licensed to drive, or be in charge of your vehicle, **with your permission....."**

This matter has been raised to ensure the Shire is not exposed to any risk of non-acceptance of liability by the insurer if a person drives a Shire car without Shire permission and the car is involved in an accident.

Issue 5 - Recommendations for Management Action Required

HR prepares, as a matter of priority, a central register of who is allowed to drive a Shire owned vehicle.

Issue 6 - Investments

Background

A new regulation prescribing restrictions on local government investment practices came into force on 20 April 2012.

A new heads of power under section 6.14 of the *Local Government Act 1995* (the Act) was inserted which allows regulations to prescribe limitations on the institutions that local governments can invest with and the types of investment products that can be utilised by local government.

This change has occurred to prevent local governments from investing in structured financial products such as Collateralised Debt Obligations (CDO's). With the collapse of Lehman

Brothers a number of local governments in Western Australia lost significant sums invested in these products.

The new regulation limits local governments to investing in:

- (a) authorised deposit takings institutions (ADI's) and the Western Australian Treasury Corporation for a term not exceeding 12 months;
- (b) bonds that are guaranteed by the Commonwealth Government or a State or Territory for a term not exceeding three years; and
- (c) Australian Currency

Shire Investments

Shire investments are currently held in ADI's with a spread between various trading banks e.g. NAB, CTB, ANZ etc. No investments are currently held by the Shire with the Western Australian Treasury Corporation (WATC).

Investments currently held with the various trading banks are guaranteed by the Commonwealth for up to \$250,000 with an additional fee for an increased guarantee on investments. Any investment held with the Western Australian Treasury Corporation attracts a State Government Guarantee for the full investment amount and term at no extra cost.

Interest rates between the trading banks and the WATC differ with the trading banks offering a slightly better rate of return but not the same level of guarantee on investment.

Issue 6 - Recommendations for Management Action Required

1. The Shire Investment policy requires updating to include the legislative changes that came into effect in April 2012.
2. Management needs to consider whether a lower return verses the higher guarantee by holding investments with the WATC outweighs investments in ADI's spread between various trading banks paying a higher rate of return but a lower guarantee on investments.
3. The Council considers whether it would be preferable to consider a condition through the delegations to the CEO and therefore not requiring a Council policy.

Issue 7 - Bank Reconciliations

Work Performed

Reviewed bank reconciliations to ensure they are being done regularly (monthly).

There were no long overdue or outstanding items.

Bank reconciliations were reconciled with the general ledger and being independently checked each month by the Manager Financial Services.

During the review items appearing in the bank reconciliation included items that should have been put through the general ledger during the month and not treated as a reconciling item.

Issue 7 - Recommendations for Management Action Required

Items on the bank reconciliation should only include outstanding items such as unpresented cheques and outstanding deposits and not items that need to be put through the general ledger.

Issue 8 - GST on Fees and Charges 2013/2014

Background

The Treasurer's determination (Division 81), which lists government charges that are exempt from GST, will no longer apply from 1 July 2013. From 1 July 2013, local governments must self-assess whether GST is payable and satisfy the requirements of a taxable supply.

Work Performed

Reviewed the work undertaken by Corporate Services of all fees and charges on whether GST is payable based on the ATO self-assessment process.

Outcome and Action Taken

The determination of GST was found to be correct in majority of instances. A few items required further clarification of the nature of the fees and charge from operations or clarification whether GST is applicable bases on whether the service forms a taxable supply.

Issue 9 - Mail Remittances and Cash Receipts

Work Performed

a) Mail remittances

A walk through was carried out of mail remittances to ensure that there was a proper segregation of duties between the person who opens the mail not having access to accounting records and that mail remittances to a cashier does not have access to accounting records to prepare the deposit.

b) Cash receipts

A walk through was carried of the cash receipting procedure at the front counter to unsure:

- Cash receipts are properly generated and issued
- Cheques are endorsed and included in the daily deposit
- There is a daily reconciliation of cash receipts to bank deposits and accounting records
- That deposits are collected and being banked regularly.
- Receipts for trust are separated from municipal funds.

Results

There is proper segregation between opening of mail with mail remittances forwarded to the front counter for receipting, banking and the accounting of receipts by accounts.

Receipts are placed in a secure location and collected by a courier for deposit on a regular basis but not daily.

Receipts of trust moneys are banked into municipal funds and then transferred into trust. The system does not allow trust receipts to be deposited directly into trust. This contravenes regulation 10 of the *Local Government (Financial Management) Regulations 1996* requiring money received by a local government to be paid into trust.

Issue 9 - Recommendations for Management Action Required

All trust receipts are separated from municipal funds and banked intact into the trust bank account directly and not transferred from municipal funds.