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Shire of Kalamunda

Audit Findings Report

To the Audit and Risk Committee for the year ended 30 June 2015

Level 1, 10 Kings Park Road
West Perth WA 6005
PO Box 570
West Perth WA 6872
T +61 8 9480 2000
F +61 8 9322 7787
E info.wa@au.gt.com
W www.grantthornton.com.au

The Audit and Risk Committee
Shire of Kalamunda
2 Railway Road
KALAMUNDA WA 6926

9 November 2015

Dear Sirs/Madams,

REPORT TO THE AUDIT AND RISK COMMITTEE FOR THE YEAR ENDED 30 JUNE 2015

Please find attached our Report to the Audit Committee for the year ended 30 June 2015.

We have substantially completed our audit work, with only the following matters outstanding:

- Receipt of signed financial statements and signed management representation letter – we understand these items will be received shortly.

We take this opportunity to extend our appreciation to the finance team, in particular Rajesh Malde, Waruni De Silva and Peter Hayes, for their assistance and cooperation during the course of the audit.

This report has been prepared for the Audit and Risk Committee of the Shire of Kalamunda (the Council) only. It should not be quoted or referred to, in whole or in part, without our prior written consent. No warranty is given to, and no liability will be accepted from, any party other than the Council. This report should be read in conjunction with our audit engagement letter and any other formal correspondence addressed to the Audit and Risk Committee regarding this year's audit.

We strive for a high level of client satisfaction, and our business is built around the relationships we maintain with our clients. We want to hear feedback from our clients, both positive and negative, to ensure the services we provide exceed expectations.
If you receive our Client Satisfaction Survey, we would greatly appreciate if you would please take the time to provide your feedback.

We trust that you find this report informative and we appreciate the opportunity to be of service to you. If you have any queries or wish to discuss any issues further, please do not hesitate to contact me.

Yours faithfully
GRANT THORNTON AUDIT PTY LTD

M A Petricevic
Partner

Your Grant Thornton audit team: Key contacts

Mark Petricevic
Partner
T +61 8 9480 2185
E mark.petricevic@au.gt.com

Michael Hillgrove
Concurring Partner
T +61 8 9480 2000
E michael.hillgrove@au.gt.com

Gina Witherington
Manager
T +61 8 9480 2146
E gina.witherington@au.gt.com

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Key areas of audit focus – Summary page

Focus area	Risk*	Management judgement	Material adjustment	Control recommendation	Control deficiency classification
Revenue recognition	✓	✓	No	No	-
Property, plant & equipment and infrastructure	✓	✓	No	No	-
Operating expenses and trade payables	✓	✓	No	No	-
Employee Costs and Entitlements	✓	✓	No	No	-
Investment in Joint Ventures	✓	✓	No	No	-

** Risk refers to Reasonably Possible Risk (per Grant Thornton audit methodology) or a Significant Risk (per ASA 315)*

Audit materiality

Basis	Normal range	Account value $000	Materiality - 2015 $000	Materiality - (prior year) $000
Expenses	0.5% - 3%	53,206	1,064	N/A

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Key areas of audit focus

Account description	Type	Value – 2015 $000	Value – 2014 $000	Risk	Management judgement
Operating Revenue	Revenue	52,915	48,128	✓	✓
Non-operating grants, subsidies and contributions	Revenue	3,951	2,143	✓	x
Trade and other receivables (Current)	Asset	2,082	2,007	✓	x

Details of risk

Revenue relates to the following:

- Rates
- Operating grants, subsidies and contributions
- Interest earnings
- Other revenue
- Non-operating grants, subsidies and contributions

Each of these revenue streams are recognised under varying revenue recognition criteria and, thus, the Council's recognition of revenue in the period is scrutinised against the criteria, ensuring validity in recording of the related transactions and balances.

Audit procedures performed

- For rates recorded, we performed analytical procedures, comparing amounts recorded in the year to approved budgets by Council and investigated any significant variations.

- Rates receivable balances were tested on a sample basis to ensure the debtor balance was valid and appropriately classified. This test placed an emphasis on pensioner balances that had been deferred. For those accounts deferred, we ensured the ratepayer was a certified pensioner.

- On a sample basis, grants and subsidy amounts recorded were traced to grant agreements and proof of receipt. The focus of this test was to ensure that grants and subsidies recorded were received and in the full control of the Council. Work was undertaken to ensure efficiencies gained in the grant acquittal process.

- For interest earnings, our audit procedures compared amounts recorded to our expectations, which were formed by recomputing interest earned based on cash and term deposit balances held throughout the year and the related interest rates.

- We performed substantive testing on amounts recorded as fees and charges, tracing recorded entries to supporting deposits or invoices. A high level analysis of each trial balance account was used to identify any significant variances from budget. These variances were investigated and resolved through discussions with management and corroborating evidence.

Conclusion

Our substantive procedures identified $1.9m being transferred to a reserve relating to a developer contribution which commenced in the prior period. Under Local Government Regulations, funds received under the DCA must be held in a reserve account. We note that a reserve accounts was created in June 2015 and the funds transferred from a Trust account to a Reserve account during the current financial year. The first draft of the financial statements noted a movement through the current periods net result to ensure the funds were appropriately transferred . Disclosure has been included to remove the transfer from the current periods net result and transfer the funds from the Trust account to the separate Reserve account including the $1.2m during the current period.

There were no other material misstatements of revenue or receivable balance identified.

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Key areas of audit focus

Account description	Type	Value – 2015 $000	Value – 2014 $000	Risk	Management judgement
Property, plant & equipment	Asset	154,922	158,016	✓	✓
Infrastructure	Asset	241,179	158,952	✓	✓
Changes on revaluation (net)	Other Comprehensive Income	83,382	1,897	✓	✓
Depreciation	Expense	(7,556)	(9,415)	✓	✓

Details of risk

Property, plant and equipment and infrastructure are key risk areas for the Council given the judgment applied in computing fair value amounts as in line with legislation, as well as determining and calculating the depreciation charge.

Expenditures in the year are also at risk of being recorded inappropriately if capitalisation policies are not being followed correctly.

Audit procedures performed

- Asset reconciliation schedules were reconciled to the trial balance and financial report.
- We reviewed the depreciation charge, comparing the amounts recorded to our own calculated expectations using asset cost and written-down balances, useful lives of the assets, and depreciation rates as outlined in the financial report.
- For those expenditures incurred and capitalised in the period, we selected a sample from invoices and charges, and vouched to supporting documentation to ensure the expenditures were capital by nature.
- The Council appointed an independent valuer to undertake the valuation of infrastructure assets, inclusive of roads, footpaths, kerbs, bridges, and drainage. Our approach to auditing the fair value determination and related adjustments is outlined below:
- We obtained an understanding of the processes and controls in place at the Council to record fair value and ensure completeness of information provided to the valuer. This was accomplished via discussions with the infrastructure team and review of the infrastructure register and systems. We were able to gain comfort over how management ensured its valuation was inclusive of all assets in the Council's jurisdiction.
- We scrutinised the inputs and calculations against a sample of assets. This included a re-calculation of the fair value to ensure the system was performing the calculations correctly. On a sample basis, unit costs and units of measurement were traced to source documents where possible.
- We note from our procedures that approximately $7.7m of assets – split between stormwater drains and stormwater pits – were not valued by the independent valuer. Audit has undertaken procedures on a sample basis to ensure that Managements inputs were consistent with the external value. We noted a minor error in relation to this process of $0.25m – the amount has been disclosed in the schedule of uncorrected misstatements.

Conclusion

We noted no material misstatements of property, plant and equipment, infrastructure assets and the related depreciation expense or revaluation adjustments.

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Key areas of audit focus

Account description	Type	Value – 2015 $000	Value – 2014 $000	Risk	Management judgement
Operating expense	Expense	52,632	50,953	✓	✓
Trade and other payables	Liability	6,475	5,465	✓	✓

Details of risk

The Council expends significant amounts on its operating activities and derives large trade payable and accrual balances. There is a risk that the accruals and trade payable balances owing as at 30 June 2015 are understated due to the timing of invoices received from suppliers and the nature of the estimates required for accruals.

Audit procedures performed

- We obtained the creditors (trade payables) sub ledger and used our audit software to search for debit balances or duplicate invoices within the sub ledger.

- We reviewed the calculations of prepayments and accruals and ensured they were reasonable by agreeing to supporting documentation.

- We performed an analytical review of operating expenses by comparing general ledger account balances to prior year and budgets. Where significant variations were identified, we obtained explanations from management and corroborated those explanations.

- In order to search for possible unrecorded misstatements, our audit procedures included a review of disbursements incurred by the Council post 30 June 2015. For significant disbursements, we ensured that the related payable was captured in the correct period.

Conclusions

No material misstatements of trade and other payables or operating expenses were identified.

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Key areas of audit focus

Account description	Type	Value – 2015 $000	Value – 2014 $000	Risk	Management judgement
Employee costs	Expense	23,036	21,036	✓	x
Employee provisions	Liability	3,324	3,017	✓	✓

Details of risk

The recording of the employee entitlement provision requires rigorous tracking, a reliance on payroll systems and also includes the application of management's judgements and estimates. Management applies wage inflation rates and discount factors for those entitlements that are expected to be realised beyond one year from the balance date. On-costs, such as superannuation, are also factored into the computations.

Employee costs are the most significant costs of the Council. Thus, there is risk that the costs are not being accounted for appropriately in the period and that fictitious or fraudulent activity is occurring in the payment of employees.

Audit procedures performed

- We performed a review of payroll expenditures recorded in the period, using disaggregated payroll information by department and by month. We analysed the data against both budgeted figures and prior period comparatives. Any significant variances were discussed with management and corroborated through the review of source documents, such as employee contracts, termination letters or letters of resignation.

- The annual leave and long service leave schedules were reviewed to ensure that management was appropriately and reasonably applying wage inflation rates, discount factors, and on-costs.

- We tested the annual leave and long service leave schedules by ensuring each schedule contained all entitled employees. This was performed by using our audit software to match employees included on the last pay run in the period to the schedules.

- On a sample basis, we selected employee data from the annual leave and long service leave schedule, comparing all inputs to source documents. An example of this is employee leave taken in the period. This data was traced to evidence of leave approval by management.

- We also recomputed the current/non-current classification of long service leave using Managements inputs. An immaterial adjustment has been noted to reclass $0.4m from current long service leave to non current – this adjustment has been summarised in the Schedule of Uncorrected Misstatements.

Conclusions

Per the substantive procedures performed, no material misstatements of employee entitlements and costs were identified.

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Key areas of audit focus

Account description	Type	Value – 2015 $000	Value – 2014 $000	Risk	Management judgement
Investment in Joint Ventures	Asset/Income	2,280	6,778	✓	x

Details of risk

We note the Councils' investment in the EMRC. At 30 June 2015 the Council held 16.93% interest and recorded income amounting to $2.2m. As per the accounting policy notes, the Council recognises its share of income/loss for the period using the equity method under AASB 111.

Audit procedures performed

- The accounts of EMRC are audited separately from that of the Council for the year ended 30 June 2015. We received a copy of the audited financial statements and did not note any qualification points or other matters that would impact the results of the Council.

- The accounts of EMRC included an adjustment of $4.212m to Other Comprehensive Income being the revaluation of assets. It is our view that the revaluation gain should be reflected in the revaluation reserve of the Council rather than being taken directly to the Other Comprehensive Income Statement. We do note that the Councils' share of the revaluation adjustment is immaterial, being $0.46m and as such, we have proposed an adjustment in the Schedule of Uncorrected Misstatements.

Conclusions

Per the substantive procedures performed, no material misstatements noted.

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Control deficiency classifications

We have ranked the issues raised in order of their importance and risk to the Council, (including the COSO classification which is a generally accepted framework for evaluating controls over financial reporting) to enable you to prioritise. The key to the colour coding used below is as follows:

Material weakness	Critical area that represents relatively high risk to the Council since this is a material weakness; i.e. a control gap that may result in material misstatements and has a likelihood of occurrence that is not remote. Action should be taken immediately.
Significant deficiency	Important matter that represents medium risk to the Council which would be classified as a significant deficiency; i.e. a control gap that may result in material misstatements but has a remote likelihood of occurrence. Action should be undertaken to rectify the issue before the next reporting period.
Deficiency	Housekeeping or administrative matter that represents relatively low risk to the Council which is a deficiency, i.e. a control gap that is assessed to result in inconsequential misstatements.

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Current year recommendations

Control deficiency classification	Observation and implication	Recommendation	Management response
Significant Deficiency	From work performed and on review of the Forrestfield DCA agreement , it was noted that all cost contribution received from the payers are to be maintained in a reserve account instead of trust account. Testing identified that the transfer of funds from trust account to reserve account indirectly increased the income received during the year. This resulted in an overstatement of profit during the year by $1.9M. This has been amended by Management in the finalised version of the financial statements and the amount has been shown in OCI rather than Net Result.	The Council has rectified the breach of the regulations during the period and has created a separate cash backed reserve account. Disclosure has been made in the accounts to this effect.	The matter was rectified immediately once it was brought to our attention. Both the Trust and Reserve amounts have always been fully cash backed and treated as restricted funds.
Deficiency	From work performed and review of Western Power agreement, it was noted that the Management has accrued for a liability that did not exist as at year end and recognised a receivable for claim that was yet to be approved. This resulted in an overstatement of assets and liabilities by $500K. This has been amended by the Management in the finalised version of the financial statements.	Management should implement appropriate review procedures to mitigate any misstatements and not to recognise any liabilities or assets that have not existed as at year end.	Treatment was based on work on completion of the underground power project in the Kalamunda CBD. The accrual and claim was made on the expectation of Western Power sending a completion bill for works undertaken. The project has only recently been finalised in October 2015 and confirmation received recently which noted no further claims were due from the Shire. Therefore it was prudent at the time to make a provision for the charge and the claim when constructing the draft accounts.
Deficiency	From test of control performed on the infrastructure assets, it was noted that the Management did not maintain the source documents (Ms. Excel sheets and handwritten documents) prepared by the surveyors and used to update the database. Once data reflected on the source documents were imported into the database, they were disposed.	Management should maintain a copy of the source documents in a separate server that act as a backup or reference should there be any errors arise.	It has been brought to the attention of the appropriate officers and will not happen in the future.

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Fraud

Scope of audit services regarding fraud

In accordance with Auditing Standard ASA240, our required objectives with regards to fraud are:

- To identify and assess the risks of **material misstatement** of the financial report due to fraud;
- To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- To respond appropriately to fraud or suspected fraud identified during the audit

Responsibility of the directors and management

The directors and management are required to consider the risk of fraud within the company, and are responsible for maintaining a system of internal control to prevent, or detect material misstatements to the financial statements arising from instances of fraud.

Detailed fraud detection services?

Grant Thornton's Forensic Consulting division specialise in providing fraud detection services, and can efficiently perform this value-add service. This testing is designed to detect fraud of values far lower than audit materiality.

What have we done in our audit to address the risk of fraud?

- Considered conditions present that increase the risk of fraud
- Conducted planning discussions with management regarding the risk or existence of fraud, policies and procedures in place to prevent and detect fraud
- Planned the nature and extent of our audit tests having regard to the risk of fraud.
- Reviewed accounting estimates for management bias
- Evaluated the business rationale for unusual transactions
- Maintained professional scepticism throughout the audit
- Reviewed the appropriateness of journal entries and year-end accounting adjustments
- Evaluated if any identified audit misstatements are indicative of fraud
- Incorporated unpredictable audit procedures into our audit plan and testing

Conclusion

Management confirmed that to the best of its knowledge and belief there have been no instances of fraud during the period, and our procedures did not uncover any matters to report.

Communication of audit matters with those charged with governance

In accordance with Auditing Standards, we are required to communicate a number of matters with those charged with governance which is covered by our audit planning report, within this audit findings report, and in the table below.

Matters for Grant Thornton to consider	Description*	Exceptions
Irregularities and illegal acts	We have not become aware of any material irregularities or illegal acts	No
Non-compliance with laws and regulations	Refer to the discussion below.	Yes
Access to books & records, and conduct of audit	We have been presented with all the necessary books and records and explanations requested of management	No
Appropriateness of accounting policies	We have not detected any material deficiencies in the accounting policies disclosed	No

Matters for Grant Thornton to consider	Description*	Exceptions
Material uncertainties and going concern	We have not detected any material deficiencies in management's assessment of the going concern assumption	No
Disagreements with management	We have had no material disagreements with management	No
Independence of auditor	National internal independence checks are performed annually	No

Without qualification to the audit opinion, we draw attention to the Statement of Comprehensive Income. Clause 6.5.16.1 of the Shire of Kalamunda Local Planning Scheme No.3 requires the local government to establish and maintain a reserve account in accordance with the Local Government Act 1995 for each Development Contribution Area into which Cost Contributions for that Development Contribution Area will be credited and for which all payments for Infrastructure and Administrative costs within that Development Contribution Area will be paid.

Our audit procedures indicated that a reserve account was not created for the DCA during the year ended 30 June 2014. We acknowledge the funds were held in Trust at 30 June 2014. At balance Date the reserve account has been created with additional disclosures included in the financial report.

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Schedule of uncorrected misstatements

No	Description	Asset $000		Liability $000		Equity $000		Net Profit $000	
		DR	CR	DR	CR	DR	CR	DR	CR
1	To adjust set off of the receivable that has not been received as at year end and is not considered to be income for the Council.	336	(336)						
2	Being adjustment to transfer gain recognised through equity method from other income to revaluation reserve					(460)	460	460	
3	To adjust reclassification of current and non current long service leave.			(424)	424				
4	To recognise extrapolated variance on fair valued adjustment for infrastructure assets not independently valued	251					(251)		(251)
Total		587	(336)	(424)	424	(460)	(209)	460	(251)

We have discussed with management the above uncorrected misstatements, and are satisfied that both individually and in aggregate, they are not material to the financial report as a whole.

Disclosures

We note the Council's disclosure of Infrastructure in Note 8. The revaluation of assets during the year resulted in an overall increase of $83,382,588 which is net of a decrement of $8.16m. AASB 116 states that increments and decrements can only be offset within the same class of asset. It is relatively silent mandatory requirements to define class which is consistent with Note 8. We have noted industry practice this reporting period to disclose decrements on similar assets, where no revaluation increment has previously been recognised in the reserve, to the Income Statement. As a result, we have recommended additional disclosure be made to the accounts which states that it is policy of the Council to treat Infrastructure sub classes as one class of asset – being infrastructure and that the sub classes in Note 8 are purely for disclosure purposes. Decrements are therefore offset against increments in sub-categories within the infrastructure assets class with the net credit movement passed in Council's Statement of Comprehensive Income. We have recommended the impact on the alternative disclosure method also be included in the accounts for completeness.

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Developments in financial reporting

Contained within Note 1 of the financial statements are new accounting standards that may impact on the company in future reporting periods.

Below is an update on the status of accounting standards which are proposed to be subject to major changes:

Standard	Applicable from annual periods	Links for further information
AASB 15 **Revenue from customers with contracts**	Commencing 1 January 2018	TA Alert 2014-04 IFRS Newsletter (June 2014) – Special Edition on Revenue
AASB 9 **Financial Instruments**	Commencing 1 January 2018	TA Alert 2009-22, TA Alert 2010-49, TA Alert 2013-13, TA Alert 2014-09
Leases (upcoming new standard)	Uncertain, unlikely before 1 January 2018	IASB's Leases Project webpage

Technical Accounting (TA) Alerts and other technical resources

We understand the task of keeping up with changes can be daunting, particularly given the length of some of the new standards; to assist you with this we publish TA Alerts on our website (www.grantthornton.com.au).

TA Alerts also cover some contentious/difficult accounting concepts which the technical teams of both Grant Thornton International and Grant Thornton Australia have received a number of queries requiring guidance/clarification; available on our website here.

In addition, there are a range of other IFRS/technical resources available on our website, including:

- IFRS Top 20 Tracker financial
- Impairment of Assets - A guide to applying IAS 36 in practice
- Under control? A Practical guide to applying IFRS 10 consolidated Financial Statements
- Navigating the accounting for business combinations: Applying IFRS 3 in practice
- Deferred tax: A Chief Financial Officer's guide to avoiding the pitfalls
- AASB 107: Statement of Cash Flows – A guide to avoiding common pitfalls and application issues
- AASB 132: Financial Instruments Presentation – Liability or equity?
- Intangible Assets in a Business Combination – Identifying and Valuing Intangibles under IFRS/AASB 3: Business Combinations
- Example financial statements

Grant Thornton also has dedicated technical resources/National Audit Support division which can either be contacted via your audit contact or directly on nationalaudit.support@au.gt.com.

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IFRS training
Expert accounting & audit opinions
Systems & controls reviews
Compliance audits & reviews
Privately held business
Business & strategic planning
Compliance services
Tax advisory services
Private wealth advisory
Outsourced accounting solutions

Advisory services
Financial advisory
Acquisition & investments
Due diligence
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