



Gladstone Regional Council

**2020 Interim report to the
Mayor**

10 June 2020

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Councillor Matt Burnett
Mayor
Gladstone Regional Council
PO Box 29
GLADSTONE QLD 4680

Dear Mr Burnett

2020 Interim report

We present to you our interim report for Gladstone Regional Council for the financial year ending 30 June 2020. This report details the results of our interim work performed to 10 June 2020. In this phase we assess the design and implementation of your internal controls, and whether they are operating effectively. To date our work has not identified any new significant deficiencies in your internal controls.

This report also includes our assessment your internal control framework; and a summary of significant deficiencies, control deficiencies, financial reporting and other matters identified to date.

The *Auditor-General Act 2009* requires the Auditor-General to report to parliament on an issue raised during an audit if he considers it to be significant. The results of your entity's audit will be included in our report to parliament on results of Local Government audits.

At this stage, the Auditor-General is working towards continuing to table most of the planned reports for this year but, given the current environment and associated community sensitivities, we will keep the tabling timeframe under continued review. I know that your focus is currently on responding to COVID-19 and that this may be a challenge over an extended period. As a result, if you find any of QAO's requests (or timeframes) difficult, we can work through revised response methods and dates.

If you have any questions or would like to discuss the audit report, please contact myself on (07) 3257 8807 or Will Fellowes on (07) 3257 8309.

Yours sincerely



Steven Bosiljevac
Contact Audit Partner



Will Fellowes
Contract Audit Director

cc. Kerry Phillips, Chair Audit Risk and Improvement Committee
Leisa Dowling, Chief Executive Officer



Audit progress

Emerging risk—COVID-19	Action required
<p>COVID-19 poses several risks and challenges to entities globally and the Queensland public sector is no different. It is hard to determine the longevity of this pandemic, or the financial impact this may have. In Section 2 Emerging risks we have provided a summary of what these challenges may be for your organisation and what this means for your financial statements and the statutory deadlines. We have also included as a new area of audit focus the impact of COVID-19 on the carrying value of assets.</p>	
<p>Internal control assessment and issues</p> <p>Testing of internal controls is completed for all relevant business processes for the period 1 July 2019 to 30 April 2020. We have assessed the elements of your internal control environment, as well as the progress made towards resolving prior year issues. There was one prior year matter raised which is detailed in Section 5 of this report that relates to outdated asset management plans.</p> <p>Based on the results of our testing completed to date, we have assessed your internal control environment as generally effective, meaning the environment does support an audit strategy that can rely upon these controls.</p>	On track
<p>Financial reporting issues and other matters</p> <p>Key financial reporting matters for FY20 include:</p> <ul style="list-style-type: none">• The first-time adoption of AASB 1058 – <i>Income for Not-for-Profit Entities</i>, AASB 15 – <i>Revenue from Contracts with Customers</i> and AASB 16 – <i>Leases</i>. This will require consideration and judgement from management to determine the impacts of the new standards, including required disclosures in the financial statements.• The comprehensive valuation of the road network which is currently being finalised with the external valuers.• Consideration in relation to the carrying values of assets (financial and non-financial) in the context of a COVID-19 environment. <p>One financial reporting matter and one other matter are a work in progress from the prior year (both due 30 June). Section 5 provides an update on prior year issues.</p>	Action required
<p>Areas of audit significance</p> <p>Progress of work against the key areas of audit significant provided in the external audit plan is on track and highlighted in the briefing paper tabled at the June 2020 ARIC meeting. We have not identified any significant issues with these areas of significance.</p> <p>The impact of COVID-19 on the carrying values of assets, particularly receivables and Council's investment in the Gladstone Airport Corporation, has been identified as a new / emerging area of audit significance.</p>	On track
<p>Milestones—financial reporting and audit deliverables</p> <p>The key financial reporting milestones up to 30 June are outlined below:</p> <ul style="list-style-type: none">• Draft proforma financial statements due by 19 June 2020. Feedback will be provided on the proforma accounts to be incorporated into the 30 June 2020 draft financial statements.• Accounting papers on known accounting issues by 19 June 2020. The finance team has prepared position papers on the impact of the new accounting standards. The outcome of these papers will be incorporated into the 30 June 2020 draft financial statements in terms of accounting treatment and disclosures.• The valuation process is underway for the road network with an extended due date for finalisation of 31 July 2020 (from 19 June).	On track



2. Emerging risks



COVID-19 is testing the resilience and agility of entities as they tackle multiple challenges, such as supporting their staff and the community, and managing sustainable operations. Management should continue to assess the impact of COVID-19 on their financial results and internal control environment.

The AASB and AuASB are continuing to issue in-depth guidance to chief financial officers, audit committee members, directors and auditors refer [here](#).

We will continue to consider the implications of this pandemic and have identified the following key areas that may impact Gladstone Regional Council. Some of these risks also translates to a heightened risk of fraud that will require increased professional scepticism, both from management and auditors.

Area of concerns and associated risk	What to consider
<p>Going concern</p> <p>Material uncertainties that cast significant doubt on the ability to continue as a going concern, such as the extent of the effect on future revenue and costs and the unknown duration of the event.</p> <p>Several revenue streams such as airport fees and charges and other recurrent income may reduce. Timing of cash inflows may also be impacted.</p>	<p>Consider future information for at least, but not limited to, the twelve months after reporting date, for example travel bans, community restrictions, government assistance, financial health of key suppliers and customers, existing financial resources and likely period of expiry if conditions continue or deteriorate.</p> <p>We have released a blog on how to manage your cash reserves in uncertain times. Please visit our website for further information.</p>
<p>‘Everyday’ internal controls</p> <p>Most entities have expanded to working from home to support social distancing. With any change in working arrangements comes an increased risk of controls failing, particularly manual controls and where controls previously operated with a high level of management oversight within an office environment.</p>	<p>Remain vigilant with your monitoring of internal controls during this time. This could mean your entity may need to implement new controls or revise current controls to accommodate the new work environment.</p> <p>We have recently issued a blog on impact of operational controls under new working arrangements on our website.</p>
<p>Information technology and cyber security</p> <p>Entities’ exposure to cyber security risks increases in vulnerable and uncertain times as their resources are focused on being re-deployed to address critical matters. There is also a risk that identifying cyberattacks may be potentially delayed causing financial and/or reputational risks.</p>	<p>Entities will need to periodically remind everyone of the increased cyber security risks in these times so their staff remain vigilant.</p> <p>Multi-factor authentication, if not already in place, should be activated immediately.</p> <p>Information technology staff should maintain visibility across the network. This will allow entities to proactively monitor the cyber environment and respond quickly if potential attack is in progress.</p>
<p>Valuation of property, plant and equipment</p> <p>Economic uncertainty and imposed community restrictions may impact the ability of valuers to accurately perform comprehensive and/or desktop valuations and meet the fair value measurement requirements of AASB 13.</p>	<p>Entities may need to consider a number of factors when valuing their assets under current replacement cost.</p> <p>Refer to Appendix C for detailed guidance. We have also released a blog on this issue on our website.</p>



2. Emerging risks (cont'd)



Area of concerns and associated risk	What to consider
<p>Accounting for leases</p> <p>As a result of COVID-19, some entities (those accounting for as a lessee in a lease) may receive 'rent holidays' and other exemptions from their lessors.</p> <p>This could have an impact on the accounting of the right of use assets and the associated liabilities.</p>	<p>In assessing whether there has been a change in the scope of the lease, entities should consider whether there has been a change in the right of use conveyed to the lessee by the contract—examples of a change in the scope of a lease include adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term.</p> <p>A rent holiday or rent reduction alone is not a change in the scope of a lease.</p> <p>Speak to your QAO contact to understand how this may impact your situation.</p>
<p>Impairment of receivables</p> <p>There is an increased likelihood that debtors may take longer to pay and, in some instances, not be able to pay their obligations at all.</p>	<p>Based on reasonable and supportable information, reassess whether there has been a change in the risk of default by the debtor. If is deemed that the risk of default does exist, determine the probability of default and the loss that is likely to arise.</p>
<p>Financial statement disclosure</p> <p>Several disclosures in the financial statements will be impacted</p>	<ul style="list-style-type: none">• Revisit the going concern assessment disclosed in the financial statements• Consider the appropriateness of the classification of debts between current and non-current• Consider disclosing additional information about significant judgement and estimates











Some of these risks also heightens the risk of fraud. Management should enhance the controls in place to detect any fraudulent activities that entities may be exposed to. As auditors, we consider fraud risk to be pervasive to the financial statements and will increase our professional scepticism in carrying out the audit of the financial statements of Gladstone Regional Council.



3. Internal control issues



The following table summarises our reporting on deficiencies in internal controls. Refer to [Section 5](#) for the status of prior year issues.

Internal control issues by COSO element	Number of significant deficiencies		Number of deficiencies		Rating
	Current year issues	Prior year unresolved issues	Current year issues	Prior year unresolved issues	
 Control environment Structures, policies, attitudes and values that influence daily operations	-	1	-	-	
 Risk assessment Processes for identifying, assessing and managing risk	-	-	-	-	
 Control activities Implementation of policies and procedures to prevent or detect errors and safeguard assets	-	-	-	-	
 Information and communication Systems to capture and communicate information to achieve reliable financial reporting	-	-	-	-	
 Monitoring activities Oversight of internal controls for existence and effectiveness	-	-	-	-	
Total issues	-	1	-	-	

Our ratings



Effective

No significant deficiencies identified



Partially effective

One significant deficiency identified



Ineffective

More than one significant deficiency identified



4. Financial reporting issues and other matters

The following table summarises the status of financial reporting issues and other matters identified through our audit as at 10 June 2020.

Financial reporting issues and other matters							
	Prior year			Current year			
	Unresolved	Resolved— current year	Re-raised— current year	Not yet due	Unresolved	Resolved pending QAO verification	Resolved
High risk	-	-	-	-	-	-	-
Medium risk	1	-	-	-	-	-	-
Low risk	-	-	-	-	-	-	-
*Other matters	1	-	-	-	-	-	-

*Queensland Audit Office only tracks resolution of other matters where management has committed to implementing action.



5. Prior year issues



Status

The following table summarises the status of issues and other matters reported by audit in prior years.

Internal control issues

Financial reporting issues

Significant deficiency	Deficiency	Other matters	High	Medium	Low

Reference	Rating	Issue	Status
Internal control issues			
FY18 – IT4		<p>Asset management plans are outdated</p> <p>Council has not completed updating its asset management strategy and asset management plans with the existing plans a number of years old.</p>	<p>Work in progress</p> <p>The SAMP was signed off by the CEO November 2019. A review is underway for further updates and improvements. The asset management plans are being developed with assistance from external contractor Jacobs and is on track to deliver draft documents by 30 June 2020.</p> <p>Action date: 30 June 2020</p>
Financial reporting issues			
FY18 – FR1		<p>Asset valuations – RDTI assets resulting in material adjustments</p> <p>We noted that material adjustments were needed to correct the value of RDTI assets in the prior period.</p>	<p>Work in progress</p> <p>This is part of a continual improvement program and will continue to be addressed as part of the FY20 valuation process.</p> <p>Action date: 30 June 2020</p>
Other matters			
19CR-1		<p>Reporting on controlled entities and beneficial enterprises</p> <p>It was noted that Council does not:</p> <ul style="list-style-type: none"> Have a formal policy on establishing controlled entities or beneficial enterprises (or being a party to such enterprises). Always provide financial information on beneficial enterprises to Council as part of reporting. <p>Specifically refer to beneficial enterprises in Council's conflict of interest policies.</p>	<p>Work in progress</p> <p>This matter will be addressed as part of interim audit process. A corporate policy is in development.</p> <p>Action date: 30 June 2020</p>





Our rating definitions

	Definition	Prioritisation of remedial action
Significant deficiency 	<p>A significant deficiency is a deficiency, or combination of deficiencies, in internal control that requires immediate remedial action.</p> <p>Also, we increase the rating from a deficiency to a significant deficiency based on:</p> <ul style="list-style-type: none"> the risk of material misstatement in the financial statements the risk to reputation the significance of non-compliance with policies and applicable laws and regulations the potential to cause financial loss including fraud, or where management has not taken appropriate timely action to resolve the deficiency. 	<p>This requires immediate management action to resolve.</p>
Deficiency 	<p>A deficiency arises when internal controls are ineffective or missing, and are unable to prevent, or detect and correct, misstatements in the financial statements. A deficiency may also result in non-compliance with policies and applicable laws and regulations and/or inappropriate use of public resources.</p>	<p>We expect management action will be taken in a timely manner to resolve deficiencies.</p>
Other matter 	<p>An other matter is expected to improve the efficiency and/or effectiveness of internal controls, but does not constitute a deficiency in internal controls. If an other matter is not resolved, we do not consider that it will result in a misstatement in the financial statements or non-compliance with legislative requirements.</p>	<p>Our recommendation may be implemented at management's discretion.</p>

Financial reporting issues

	Potential effect on the financial statements	Prioritisation of remedial action
High 	<p>We assess that there is a high likelihood of this causing a material misstatement in one or more components (transactions, balances and disclosures) of the financial statements, or there is the potential for financial loss including fraud.</p>	<p>This requires immediate management action to resolve.</p>
Medium 	<p>We assess that there is a medium likelihood of this causing a material misstatement in one or more components of the financial statements.</p>	<p>We expect management action will be taken in a timely manner.</p>
Low 	<p>We assess that there is a low likelihood of this causing a material misstatement in one or more components of the financial statements.</p>	<p>We recommend management action to resolve; however, a decision on whether any action is taken is at management's discretion.</p>





What is internal control?

'Internal control' is the processes, systems, records and activities that your entity designs, implements and maintains to provide you with reasonable assurance about the achievement of organisational objectives regarding:

- reliability of financial reporting
- effectiveness and efficiency of operations
- compliance with applicable laws and regulations.

Your governing body and executive management collectively are responsible for preparing reliable financial statements in accordance with generally accepted accounting principles. They are similarly responsible for maintaining effective internal control over financial reporting.

Our assessments of your internal control framework

The auditing standards that we must comply with require us to understand and assess those aspects of your internal control that relate to our financial statement audit objectives. In the planning phase of our audit, we sought to understand and evaluate how controls are designed and implemented. We communicated to you the results of our analysis in our external audit plan.

If we decide that we can rely on your controls, we must then test them to confirm they operated effectively. The results of our testing may highlight deficiencies in your internal controls. We assess whether any identified deficiencies in internal control constitute, individually or in combination, a significant deficiency in internal control.

Limitations of our reporting on internal control deficiencies

No system of internal control can provide absolute assurance about the absence of error or compliance. Even in the absence of identified control weaknesses, inherent limitations in your internal controls over financial reporting may not prevent or detect material misstatements.





Public sector entities in Queensland comprehensively fair value their property, plant and equipment at least once every five years. However, valuation policies of entities also require that specific appraisals be undertaken where an asset class has experienced significant and volatile changes in value (that is, 20 per cent or more).

The current economic downturn may impact the fair value of the assets. Each entity's situation needs to be considered individually. However, here are our general thoughts on whether we think asset classes are likely to move by more than 20 per cent over a short period.

Valuation basis	Our assessment
Current replacement cost	<ul style="list-style-type: none"> Given the nature of these assets are long term, our experience tells us that the key drivers for the valuation inputs for these asset classes are rarely volatile. Condition and useful lives of these long-term assets are also unlikely to be impacted as a result of COVID-19.

In addition to the economic downturn, entities will have to consider the impact of restrictions that have been posed that prevent site visits by external valuers. This will impact local governments that are located in rural, remote and indigenous locations where some councils have restricted access to their communities to prevent the spread of COVID-19. Where such travel restrictions have been placed, entities will need to consider suitable alternatives such as those below.

Valuation factors	Consideration points
Gross replacement cost	<ul style="list-style-type: none"> Using internal models (for internally constructed assets) or recent purchase price (assets acquired externally) to support unit rates. Where internal models are not workable, indexation is often enough for gross replacement cost. However, before relying on an index, consider whether: <ul style="list-style-type: none"> there have been any significant changes in unit rate categories since acquisition or the last detailed revaluation there has been a notable change in the modern substitute asset since the last detailed revaluation your engineering and finance staff have sufficient information to cost the modern substitute and make adjustments for the differences in service levels between the modern substitute and the existing asset.
Useful lives	<ul style="list-style-type: none"> Review the standard useful lives for each component and document the reasonableness of these useful lives. Review for individual assets whose useful lives are deviating from the standard life and adjust, as necessary.

Materiality should also be considered when assessing valuations. Rolling valuations may mean that only one or two asset classes are due for a comprehensive valuation this year. If the most material classes are still within their cycle, and it is only one of the smaller classes due for revaluation this year, it may be possible to defer the specific appraisal of the smaller classes of assets and perform an alternative overall assessment.

We understand that you may have trouble completing your valuation in accordance with your planned timetables. Please continue to discuss your specific circumstances and timetables with your engagement leader.



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