The Auditor-General provides assurance to Parliament on the accountability and performance of the Victorian Public Sector. The Auditor-General conducts financial audits and performance audits, and reports on the results of these audits to Parliament.

On the 26th of February 2015, the Auditor-General tabled his financial audit report, *Local Government: Results of the 2013–14 Audits*. 
The Victorian local government sector comprises 79 local councils, 11 regional library corporations (RLCs) and 13 associated entities. Local government is recognised in Victoria’s constitution as the third tier of government.

This report provides the results of the financial audits of these 103 entities.
Unqualified audit opinions, or clear audit opinions, are positive written expressions provided when the financial report has been prepared, and presents fairly, the transactions and balances for the reporting period, in accordance with the requirements of the relevant legislation and Australian Accounting Standards.

Unqualified audit opinions were issued on the financial reports of all entities for 2013–14. Parliament can therefore have confidence in those financial reports.

Four entities did not meet the legislated time frame for finalising their financial statements. Each was granted an extension.

Results of financial reports:

- Unqualified audit opinions issued for all entities in 2013–14.
- 95% (96% in 2012–13) of local councils met their statutory reporting time frame of 30 September 2014.
Parliament can have confidence in the fair presentation of performance statements of all 79 local councils as they all received clear audit opinions for 2013–14.

From the 1st of July 2014, local councils must prepare performance statements in accordance with the Local Government Performance Reporting Framework. The new regime requires extensive financial and non-financial information to be disclosed.

Local Councils will need to ensure they have appropriate systems in place to completely and accurately report on these performance indicators.
The overall operating result for all local councils deteriorated from a surplus of $1.23 billion in 2012–13 to $923.6 million in 2013–14, a decrease of $306 million.

The reduced surplus was largely attributed to the Commonwealth government’s announcement in its May budget that it would not pay the 2014–15 grants in advance. This followed five years in which some grant payments were paid in advance.

Twenty-one local councils reported underlying operating deficits in 2013–14 (eight in 2012–13). A key reason for this was a change in the timing of the Commonwealth government’s financial assistance grants.

Had the grants continued to be paid in advance, only 12 councils would have reported underlying operating deficits. Future operating results should not be similarly impacted as the new arrangements will have been in place for the entire year.
Our report highlights financial sustainability risks of local councils using six financial sustainability indicators as at 30 June 2014, and trends over a five-year period.

The indicator results are calculated using the financial transactions and balances included in each entity’s statutory financial report. Financial sustainability should be viewed from both a short- and long-term perspective, and over the trend period.

Five entities had a high financial sustainability risk rating at 30 June 2014, with three impacted by the delay in refinancing debt into the new Local Government Funding Vehicle (LGFV)

The LGFV was established by the Municipal Association of Victoria to provide longer-term debt financing for local councils. A total of $240 million was borrowed by 30 local councils. These borrowings require interest-only repayments until maturity of the debt in five or seven years. This means the total interest paid will be higher than what they would have paid had the principal been gradually reduced over the term of the loan. There is also a risk that local councils will not have the funds available to fully repay the loan when the debt matures.

The changed timing of the Commonwealth Government financial assistance grants in 2013-14 had a greater impact on large and small shire councils, with 17 reporting underlying deficits for the year (compared to seven in 2012–13)
We identified the following key challenges for local government:

1. The Commonwealth Government announced in its May 2014 Budget that it would pause the indexation of its financial assistance grants to local councils. This will have a greater impact on small and large shire councils that rely on these grants to support their operations. These councils will need to monitor, control and constrain expenditure growth if grant revenue is unlikely to increase in the foreseeable future.

2. The government has announced that it will introduce a rate capping policy for the 2016–17 financial year. Local councils will need to review and update their budgets to respond to this change.

3. From the 1st of July 2014, local councils must prepare performance statements in accordance with the Local Government Performance Reporting Framework. The new regime requires extensive financial and non-financial information to be disclosed.

While local councils have a mature environment in place to provide assurance around financial performance information, the environment for reporting non-financial performance information about services and outcomes has not historically been as robust.
Internal controls at councils were adequate for maintaining the reliability of financial reporting. Nevertheless, we identified a number of instances where important internal controls need to be strengthened. These matters were reported to the local councils and their management teams, and included 99 high- and medium-risk rated matters (compared to 79 in 2012–13).

Our review of our previous year’s audit findings identified that 61 per cent of high- and medium-risk internal control deficiencies are yet to be rectified. That these control deficiencies should remain unresolved is a very poor reflection on both the management and governance of these councils. Local councils need to accelerate the rate at which they are resolving our audit findings.

To provide local councils with adequate time to action internal control issues identified in 2013–14, a follow up will be conducted by VAGO as part of the planning for the 2014–15 audit.

A status update will also be provided to local councils as part of the 2014–15 interim management letters.
In 2013–14, Victoria’s 79 local councils spent $2.4 billion procuring materials and services, and $1.9 billion in payments for capital works. The effective management of creditors is vital as the volume and value of invoices processed increases.

The management of creditors and grants by local councils was generally sound, however controls could be strengthened by developing comprehensive policies, introducing more effective management practices, and enhancing policy compliance monitoring.

In addition, while most of the elements of better practice were included in local council policies and procedures, 37 local councils (or 46 per cent) did not clearly articulate the conditions under which local councils negotiated their terms of trade with creditors.

Further, a regular cleanse of the vendor masterfile would enable the detection and removal of duplicated inaccurate and superfluous data. It would also improve the operational efficiency of the system and mitigate the risk of fraud. It was therefore disappointing that 56 per cent of local councils did not undertake routine cleansing of the vendor masterfile.

The use of corporate card and/or purchasing cards provides local councils with reduced administrative costs, and greater convenience and flexibility for staff compared to using cash or cheques. It can, however, expose entities to different risks of inappropriate or unauthorised expenditure if appropriate controls aren’t in place. Controls need to be effective to ensure corporate card and/or purchasing cards are used appropriately for local council purposes.
Local councils distributed approximately $24 million in 2013–14—compared to $27 million in 2012–13—towards supporting local community activities through community grants. These programs assist local councils to strengthen communities by empowering individuals and community organisations to respond collectively to community needs.

While most local councils had policies and procedures in place for individual grant programs they administer, only 42 councils (or 53 per cent) had an overarching grant administration policy and procedure in place.

Our review of the selected community grants also identified:

• twenty-six (or 33 per cent) of the assessed grants did not record conflicts of interest of the members of the grant assessment panel

• thirteen (or 16 per cent) of the assessed grants were not acquitted subsequent to payment to determine the legitimacy of the transactions for which the grants were being used and whether or not the objectives of the grant had been met.

Twenty-eight local councils (or 35 per cent) do not produce reports to senior management and council on the progress and outcomes of the grants.
Overall, 11 recommendations have been made:

- 2 specifically relating to financial reporting processes and 2 relating to performance reporting for local councils in preparation for the Local Government Performance Reporting Framework
- 1 specifically relating to creditor management
- 5 recommendations relating to the administration/management of grants, and
- 1 recommendation in relation to ensuring the audit findings are addressed by management on a timely basis.

All recommendations have been accepted and can be found on page xii of the report.
All our reports are available on our website.

If you have any questions about this or other reports, or if you have anything else you would like to discuss with us including ideas for future audit topics, please call us on 03 8601 7000 or contact us via our website.