

AUDIT STRATEGY MEMORANDUM

Shire of Katanning

Audit for the year ending 30 June 2024



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Executive Summary

Moore Australia has been engaged by the Office of Auditor General (OAG) Western Australia to perform an audit of the Shire of Katanning (the Shire)'s annual financial report for the year ending 30 June 2024.

The key purposes of this memorandum are to:

- set out the audit scope and approach in summary;
- communicate the key audit risk areas which we expect to be the focus of the audit procedures; and
- promote effective communication between the auditor and those charged with governance.

The contents of this document should not be disclosed to third parties without our prior written consent.

Audit Scope

The primary scope and objective are to express an opinion as to whether the Shire's general purpose financial report as a whole is free from material misstatements (whether due to fraud or error) and is prepared (in all material respects) in accordance with applicable Australian Accounting Standards, the *Local Government Act 1995 (as amended)* and the *Local Government (Financial Management) Regulations 1996 (as amended)*.

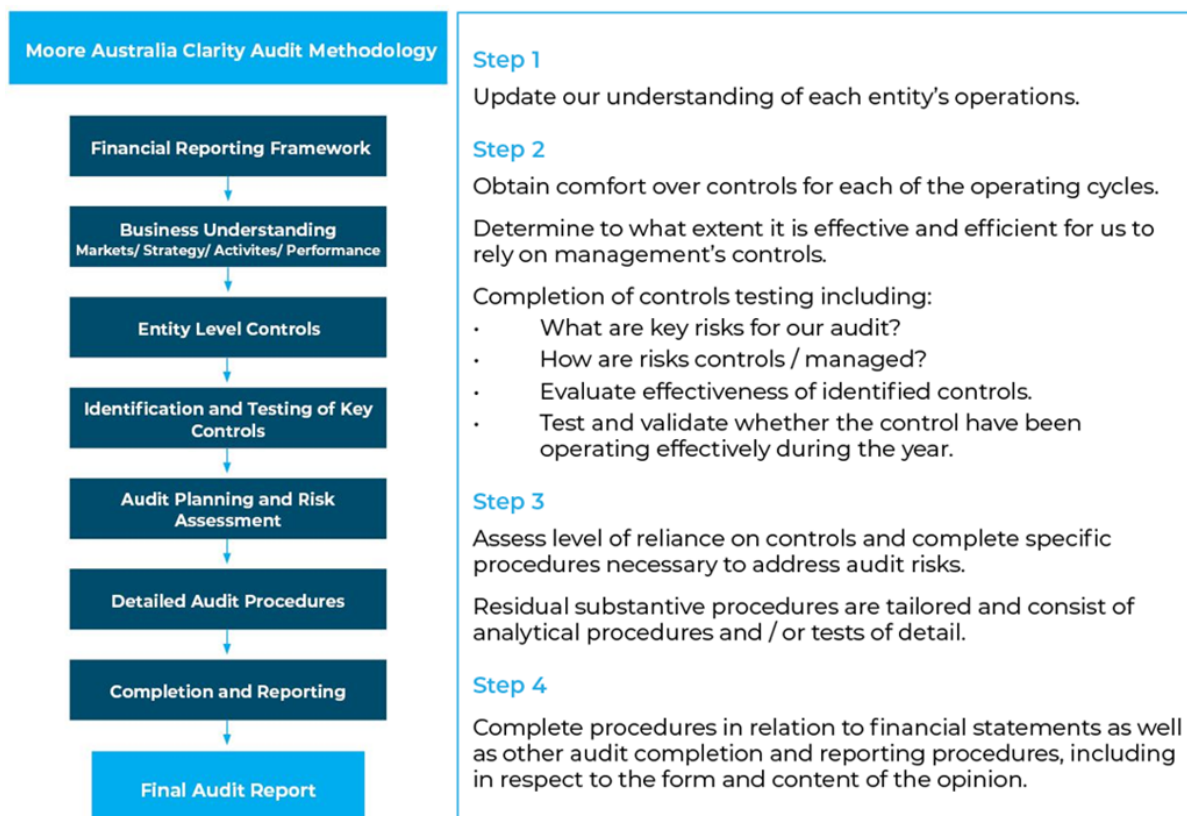
Additional Scope/Work

Should additional matters or issues arise requiring additional audit work we will discuss these with the OAG Director. The OAG Director will advise the Shire of any additional fees associated with this work.

Summary of Audit Methodology

The audit will be conducted using our National methodology and audit automation system (CaseWare) which are underpinned by policies, procedures and templates to ensure the appropriate level of consistency and quality is achieved.

Methodology



Approach

Our audit process generally contains three phases being planning, fieldwork and completion.

The planning phase is critical to the audit process as this is where we assess the audit risk. Our methodology focuses on the Shire's underlying business risks, recognising that audit risk is affected by the business risks of the Shire, as well as by how well Management and Council address those risks.

The most critical aspect of our planning is the assessment of risk and consideration of where material misstatements could occur.

Our audit approach focuses on areas that represent higher risk to the Shire. Our methodology uses a risk based approach to evaluate and, when appropriate, to test the effectiveness of internal controls with the expectation that reliance can be placed on the operating controls. We will make a combined assessment of inherent and control risk for significant accounts and the related financial report assertions. We will then establish a portfolio of audit procedures that are customised based on the Shire's significant accounts, critical areas, disclosures and classes of transactions, as well as our assessment of risk, including the risk of fraud.

Our procedures include both substantive tests of details and tests of controls for significant account balances, transactions and disclosures.

Materiality and Sampling

Materiality

Materiality is set at the planning stage to ensure that an appropriate level of audit work is conducted. It is also set at the reporting stage in order to assess the impact of an item on the financial report.

Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut off point rather than being a primary qualitative characteristic which information must have if it is to be useful. An item would be considered material to the financial report if, through its omission or non-disclosure, the financial report would no longer show a true and fair view.

This does not mean that transactions of an amount under the materiality level will not be tested, rather the setting of a planning materiality is used as a basis for determining sampling levels and analysing results in order to assist in the completion of an efficient and effective audit.

We will report uncorrected misstatements aggregated during our audit, and determined by management to be immaterial, both individually and in aggregate to the annual financial report. We will seek written explanation from management, explaining the reasons for not adjusting the misstatements.

Sampling

In line with the requirements of Australian Auditing Standards, a key element of our audit approach is the sampling of transactions for testing across all key control aspects and material account balances.

Our assessment of risk and determination of materiality are key inputs in determining the nature and level of the sample size of transactions to be tested within any particular area of our audit.

While this is always a key area of audit judgement, we confirm that our determination of samples selected for testing is supported by Moore Australia's audit methodology and procedure manual as well as our audit automation software, CaseWare. Thus, we confirm our approach to sampling is designed so as to provide a sufficient level of confidence in considering our audit conclusions arrived at from our testing.

Key Risks and Focus Areas

As part of our risk assessment, we identified key risks based on our extensive knowledge of the industry and experience. This risk assessment process is designed to ensure that we focused our audit work on the areas of highest risk. Our assessment and responses will be updated throughout the engagement to ensure that all areas of material risk are addressed.

Set out below is an overview of what we have identified as the key risks and focus areas for the audit of the financial report for the year ending 30 June 2024:

- Revenue recognition
- Completeness of liabilities and expenses
- Valuation of Property, Plant & Equipment and Infrastructure
- Accounting for employee related provisions
- Accounting for rehabilitation costs
- Disclosures in the financial report
- Fraud risk and management override of controls
- Adequacy of the design and implementation of internal controls

Detailed below are the audit procedures that will be performed to address these risks.

Judgmental Matters and Estimations

The preparation of the financial report requires the use of management judgments and accounting estimates or assumptions, which affect the reported amounts of assets, liabilities, income and expenses, and disclosure of contingent assets and contingent liabilities. Certain estimates can be particularly sensitive because of their significance to the financial report and the possibility that actual future events affecting them may differ significantly from management's current assumptions and expectations.

In relation to the Shire, our assessment is that no account balance (other than as noted below) is critically affected by management judgments or accounting estimates. Given the nature of the Shire's revenue, expenses, assets and liabilities - accounting for them is not overly complex nor affected by contentious accounting practices.

Major accounts affected by management judgments or accounting estimates are:

- Accounting for employee related provisions
- Accounting for rehabilitation costs
- Depreciation of non-current assets
- Fair valuation of land and buildings and infrastructure

Where necessary we will challenge the judgments of management based on our examination of evidential matter relating to those estimates.

Key Audit Risks and Focus Areas

Revenue recognition

Different revenue streams are required to be recognised at either a point in time or over time depending on the nature of the transactions and their performance obligations. Revenue is to be recognised in accordance with AASB 15 *Revenue from Contracts with Customers* and AASB 1058 *Income of Not-for-Profit Entities*. The Shire's main sources of revenue are government grants, rates, and other fee for service revenue streams. Given the different revenue streams, there is a risk that revenue may not be recognised as required.

Key audit procedures to address the risk:

- Review and test the application of the Shire's revenue recognition policies for application under AASB 15 and 1058;
- Review the design and implementation of internal controls by documenting and performing walkthroughs of the revenue cycles;
- Given the nature of government grants, agree funding to third party documentation including funding agreements & invoices, and vouch receipt of funds in accordance with our established sampling methodology. We will also test the recognition of contract liabilities to ensure proper accounting in accordance with AASB 15 and 1058;

- For other revenue streams, sample test to supporting tax invoices and bank statement receipts; and
- Conduct year end analytical review procedures for all revenue streams.

In the process of identifying the risk of fraud in revenue, we will consider the following factors:

- Nature of the revenue transactions.
- The complexity of the transactions.
- Materiality of the transactions.

Having regard to the above factors, we will conclude as to whether the presumption of fraud risk related to revenue recognition is applicable.

Completeness of Liabilities and Expenses

There is an inherent risk that expenditure, and corresponding liabilities are not brought to account in the correct accounting year. Most of the Shire's expenses relate to employee costs, materials and contracts and depreciation. To address the risk of underreporting we will:

- Obtain post year end bank statements up until the time of our audit testing and agree a sample of bank payments to supporting documentation (e.g., tax invoices, payroll reports);
- Supporting documentation will be traced to posted expenditure accounting transactions to check if transactions were recorded in the correct accounting year;
- Review the fixed asset register for capital transactions that were operational in nature that should have been expensed as repairs and maintenance rather than capitalised; and
- Review the design and implementation of internal controls by documenting and performing walkthroughs of the expenditure cycles.

Property, Plant & Equipment and Infrastructure

These are the biggest classes of non-financial assets reported in the Shire's statement of financial position where there is a mix of cost (plant and equipment) and fair value (land, buildings and infrastructure) accounting involved.

There is a significant inherent risk given the nature of assets held and judgement applied in determining fair values as well as depreciation expense.

For the year ended 30 June 2023, the Shire reported Property, Plant & Equipment and Infrastructure balances of \$58.9mil and \$159.2mil respectively. For 30 June 2023 the Shire recognised a depreciation expense of \$5.3mil.

To address the risks involved we will:

- Document and test key financial controls around property, plant & equipment and infrastructure balances;
- Assess accounting policies associated with fair value assessments and ensure they are in accordance with accounting standards;
- Conduct sample substantive testing of asset additions and disposals;
- Review management's impairment assessment against the Shire's circumstances;
- Also review fair value disclosures to ensure they are in accordance with AASB 13 requirements;
- Assess what action, the Shire has undertaken in respect of the audit qualification in the prior year and determine whether a qualification is necessary in respect of the year ending 30 June 2024. Review revaluations of infrastructure assets performed during the year, including valuation techniques and assumptions applied. This will include an assessment of the valuer's qualifications and expertise;

- Finally with respect to depreciation, the following procedures will be performed:
 - Review the Shire's depreciation policy for the various asset classes and assess the reasonableness of rates used;
 - Document and test key financial controls around the calculation of depreciation; and
 - Perform recalculations based on our sampling approach.

Accounting for employee related provisions

A major part of the Shire's liabilities pertains to employee-related annual leave and long service leave provisions. As at 30 June 2023 the annual leave and long service leave provision value is \$298k and \$434k respectively. Provisions involve a degree of management estimation and uncertainty in their calculation in respect of present value inputs (inflation rates and discount factors), timing and probabilities of settlement.

Key audit procedures to be performed:

- Agree underlying information to staff employment contracts and approved leave applications;
- Review present value calculations in accordance with AASB 119, including inflation, discount and probability factors; and
- Review the disclosure of the provisions to ensure they are consistent with AASB 119.

Accounting for Rehabilitation Costs

The Shire operates the Katanning Landfill Site. There is a present obligation to rehabilitate/make good at the end of the asset's useful life.

Accounting for rehabilitation costs involves a degree of management estimation and uncertainty in their calculation in respect of inflation rate, discount factor and work costs. There is a risk that the asset and the related liability may not be recognised in accordance with AASB 116 *Property, Plant, and Equipment* and AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.

To address this risk we will:

- Enquire of management if there is a change in circumstances regarding the Shire's present obligation to make good the landfill site and verify the representation to relevant agreements;
- Enquire about investigation progress made on the sites noted and if available review the Shire's rehabilitation costs worksheet to ensure cost estimates relating to the asset and liability are calculated using a reasonable approach in accordance with AASB 116 and AASB 137; and
- Assess the adequacy of the required disclosures in the financial report.

Disclosures in the Financial Report

The Shire, as a class 3 local government, is required to disclose material information in relation to:

- Auditor remuneration;
- Contingent assets and liabilities;
- Post balance date events;
- Related party transactions (including key management personnel);
- Capital commitments; and
- Information required by legislation.

We will review the processes completed by the Shire to assess whether they are robust and this disclosure requirements are addressed adequately. These procedures will include a review of the system and the records used by the Shire to ensure material disclosures are prepared based on proper records and accounts.

Fraud Risk and Management Override of Controls

Management is involved in day-to-day operations and monitoring of the Shire, which gives them the ability to manipulate accounting records and prepare fraudulent financial reports by overriding controls in place. Due to the unpredictable way in which such an override could occur, this leads to potential fraud risk and is always assessed as a significant risk.

To address the risk of management override, the following procedures will be performed:

- Review of journal entries and other adjustments for evidence of possible material misstatements due to fraud;
- Understanding delegated authorities and their impact on management override controls;
- Evidence of appropriate segregation of duties;
- Review of accounting estimates and application of accounting policies for evidence of bias or aggressive accounting practices; and
- For significant or unusual transactions, we will evaluate the business rationale (or the lack thereof) for evidence of fraudulent financial reporting or misappropriation of assets.

Adequacy of the design and implementation of Internal Controls (including IT General Controls)

The integrity of financial information relies on the security, integrity and reliability of the Shire's information technology general controls (ITGC) environment. As part of our planned audit approach, we will evaluate the Shire's system of internal controls primarily to enable us to determine the appropriate nature and extent of our procedures.

We will review the design (efficiency) and implementation (operating effectiveness) of the key financial controls by documenting our understanding of the systems, performing tests of controls, and conducting walkthroughs. As part of this, we will follow up on previous year management letter findings.

We will also conduct a high-level ITGC review of key controls relating to:

- System Security
- Technology Framework
- Service Management, Operations and Change Control
- Security Governance and Reporting
- Security training

Once completed, we will evaluate the results of the high-level ITGC review to determine whether additional testing or identification of additional controls is required to enable us to rely upon the financial management information generated by the system.

We will follow up on these matters during the current year audit. The following matters were noted during the previous audit.

Findings	Rating		
	Significant	Moderate	Minor
1. Depreciation on buildings not calculated properly	✓		
2. Fair Value of infrastructure assets	✓		
3. Fuel inventory reconciliation not performed		✓	

Our review does not constitute a comprehensive review. Accordingly, the Audit Committee may wish to discuss with management any matters they may have raised with respect to particular systems, which may necessitate a more comprehensive review.

It should be appreciated that our audit procedures are designed primarily to enable us to form an opinion on the financial report and therefore may not bring to light all weaknesses in systems and procedures which may exist. However, we aim to use our knowledge of the Shire gained during our work to make comments and suggestions which, we hope, will be useful to you.

Adoption of changes to The Act and Accounting Standards

We will consider changes that have occurred in AIFRS, the Act and other relevant parts of the regulatory framework as part of our audit. There are no significant changes, that we are aware of at the timing of writing, that will impact on the accounting results and disclosure requirements for the year ending 30 June 2024.

Change in Regulations for 2023-24

An update on recent changes to the Local Government Act and Regulations, as part of the Local Government Reform, is available on the DLGSCI website ([Local government reform | DLGSCI](#)). One of the changes that impact the 2023-24 financial reporting included changes to the *Local Government (Financial Management) Regulations 1996*, where Regulation 17A has been amended to require local governments to revalue their land, buildings and infrastructure assets every 5 years from the asset's last valuation date. Local governments may revalue these assets earlier if they choose to do so.

AASB 2021-2 Amendments to Australian Accounting Standards – Disclosure of Accounting Policies and Definition of Accounting Estimates

The Standard amends:

- AASB 7 *Financial Instruments*: Disclosures, to clarify that information about measurement bases for financial instruments is expected to be material to an entity's financial statements;
- AASB 101 *Presentation of Financial Statements*: to require entities to disclose their material accounting policy information rather than their significant accounting policies;
- AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*: to clarify how entities should distinguish changes in accounting policies and changes in accounting estimates; and
- AASB Practice Statement 2 *Making Materiality Judgements*: to provide guidance on how to apply the concept of materiality to accounting policy disclosures.

Key Deliverables and Timetable

The following timetable is a broad outline of the key deliverables and timing aspects of the audit:

ENGAGEMENT ACTIVITY	INDICATIVE TIMING
Audit planning	17 May 2024
Entrance meeting	20 June 2024
Interim audit visit	25 – 27 June 2024
OAG interim review of audit file	23 July 2024
Interim management report (if any matters to be reported)	6 August 2024
Receipt of complete, balanced and certified draft financial report	30 September 2024
Final audit visit	21 – 25 October 2024
OAG final review of audit file	19 November 2024
Issuance of audit concluding memorandum	3 December 2024
Concluding (exit) meeting	10 December 2024
Date CEO sign off on financial report	10 December 2024
Final sign-off of auditor's report & management report	17 December 2024

To help deliver audit opinion on time as agreed by the Shire in the proposed audit schedule above, please follow the requirements and timelines for provision of information to the audit team as listed below:

- provide certified financial statements by latest 30 September 2024; submit the audit file/folder that supports the financial statements in three working days from the receipt of the certified financial statements, unless another date is agreed by your engagement leader; and

- submit audit information in three working days from the date of request, unless another date is agreed by your engagement leader.

Please provide the information in a timely manner in order to avoid delays in the agreed reporting timeline and potential impact on the auditor's report.

The Audit Team and Independence

Audit Team

The Audit Team assigned to this engagement is set out below:

NAME	ROLE	CONTACT DETAILS
Aram Madnack	OAG Director	aram.madnack@audit.wa.gov.au Phone no: 6557 7674
Wen-Shien Chai	Engagement Partner	wen-shien.chai@moore-australia.com.au Phone no: 9224 0172
Gilles Chan	Engagement Senior Manager	gilles.chan@moore-australia.com.au Phone no: 9224 0179
Oscar Smith	Engagement Senior	oscar.smith@moore-australia.com.au Phone no: 9224 0190
Derrick Phuah	Engagement Intermediate	derrick.phuah@moore-australia.com.au
Sheila Ndilowe	Engagement Intermediate	sheila.ndilowe@moore-australia.com.au

The primary objective will always be to balance our experience and knowledge of the Shire with appropriate independence and objectivity of thinking. The development of our people will always be a key objective. Our assurance team will be supported by our specialist technical, taxation and support teams.

Independence

We have established policies and procedures designed to ensure our independence, including policies on holding financial interests in the Shire and other related parties, business relationships, employment relationships, and the provision of non-audit services.

We have assessed our audit independence at the planning stage and to the best of our knowledge and belief, we are of the opinion that each engagement team member and partners of all Moore network firms in Australia are not in contravention of the auditor independence and ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* that are relevant to our audit of the financial report in Australia.

We have also fulfilled our other ethical responsibilities with the Code. We have further considered the safeguards the Moore Australia network has in place, and we are not aware of any services being provided that would compromise our independence as external auditor.

Other Key Matters

Environmental, Social and Governance

Entities should refrain from disclosing ESG matters or climate-related risks in financial statements (and where applicable, KPIs) as there is currently no established reporting and auditing frameworks for state or local government entities. These frameworks are still in the development phase.

Auditor's Responsibility to Consider Fraud

As auditors, we obtain reasonable assurance that the financial report (taken as a whole) is free from material misstatements due to fraud or error.

Accordingly, certain procedures will be performed as part of our audit by way of enquiry, evaluation and review as required by the Australian Auditing Standards on fraud, ASA 240.

Responsibilities of Management and the Council

Management is responsible for the preparation of the Shire's Annual Financial Report that gives a true and fair view in accordance with Australian Accounting Standards, the *Local Government Act 1995 (as amended)* and the *Local Government (Financial Management) Regulations 1996 (as amended)* and for such internal controls management determines are necessary to enable the preparation of the Annual Financial Report that is free from material misstatement, whether due to fraud or error.

The primary responsibility for the prevention, deterrence and detection of fraud remains with the Council.

In preparing the Annual Financial Report, management is also responsible for assessing the Shire's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting.

The Council is responsible for overseeing the Shire's financial reporting process.

Under "Clarity" Australian Auditing Standards, as a precondition of accepting the engagement we are required to determine whether the financial reporting framework to be applied in the preparation of the Shire's Annual Financial Report is acceptable. Given that the Shire's Annual Financial Report continues to be prepared as a general-purpose financial report in line with previous years and with no changes in terms of regulations or other issues that might impact the requirements of the report, as at the date of issuing this report we continue to consider this framework acceptable.

As part of the audit requirements, Management is to provide the auditor a written representation that:

- they have fulfilled their responsibility for the preparation of the financial report in accordance with the applicable and other statutory reporting requirements, including where relevant their fair presentation, as set out in the terms of the audit engagement;
- they have provided the auditor with all relevant information and access as agreed in the terms of the audit engagement;
- all transactions have been recorded and are reflected in the financial report; and
- (if any) significant representations made by management for which the auditor is relying on in forming the audit opinion.

Template letters will be provided towards the finalisation of the audit for this matter.

Confidentiality

This document is strictly confidential and although it has been made available to management and those charged with governance to facilitate discussions, it may not be taken as altering our responsibilities to the Shire arising under our audit contract with the OAG.

The information contained in this document is confidential and cannot be conveyed to any party other than the party to which it is directed.

Conflicts of Interest

The firm is not aware of any existing or potential relationship, transaction or holding that would compromise its objectivity in the conduct of the services provided. Should the possibility of a perceived or actual conflict arise the matter would be raised with the Shire immediately and activities suspended until the issue was resolved to your satisfaction.



Wen-Shien Chai
Partner
[Moore Australia Audit \(WA\)](#)

Date: 12 June 2024

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