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4 November 2009

The Mayor
Councillor Fergus Thomson
Eurobodalla Shire Council
PO Box 99
Moruya NSW 2537

Dear Councillor Thomson

REPORT ON THE CONDUCT OF THE AUDIT – Section 417(3) YEAR ENDED 30 JUNE 2009

In accordance with the requirements of the Department of Local Government, and the provisions of Section 417(3) of the Local Government Act, 1993, we provide the following comments arising from our conduct of the audit of Council's books, records, and financial statements for the 2009 year.

Audit Scope

Our audit, which was conducted to provide reasonable assurance of detecting material misstatements in the financial statements, accorded with Australian Auditing Standards and statutory requirements, and we:

- evaluated the accounting policies and significant accounting estimates used by the Council in preparing the financial report, and
- examined a sample of the evidence that supports the amounts and other disclosures in the financial report.

An audit does *not* guarantee that every amount and disclosure in the financial report is error free. The terms 'reasonable assurance' and 'material' recognise that an audit does not examine all evidence and transactions. However, the audit procedures used should identify errors or omissions significant enough to adversely affect decisions made by users of the financial report or indicate that the Council had failed in its reporting obligations.

Whilst the main objective of our audit is to express an opinion on the financial statements, and to provide comments on the conduct of the audit, our audit opinion is generally *not* intended to provide assurance:

- about the future viability of the Council,
- that it has carried out its activities effectively, efficiently and economically, or about the effectiveness of its internal controls.

Audit Conclusion

Our audit of the financial reports for the year ended 30 June 2009 resulted in modified independent audit report for Council's General Purpose Financial Report. The qualification is due to our inability to obtain sufficient appropriate audit evidence to satisfy ourselves as to the fair value and recoverability of \$7.688M of CDOs included in Council's total investment portfolio. Our audit of the Special Purpose Financial Report resulted in an unmodified audit opinion.

Additional Audit Considerations and Comment

The following comments are provided in accordance with Section 415(3) of the Local Government Act, 1993 and Clause 227 of the Local Government (General) Regulation 2005.

Income Statement

Operating Result. Council's operating surplus increased from \$12.916M in 2008 to \$19.308M in 2009. This compared with a budgeted surplus of \$17.173M for the year.

Operating Result before Capital. The operating result before Capital grants and contributions was a deficit of \$507K compared with a surplus of \$408K in 2008. This compared with the original budget deficit of \$1.466M.

Depreciation. Included in the operating result was \$15.372M for the depreciation and amortisation of assets which increased from \$12.885M in the prior year and compared with the original budget of \$13.713M.

Operating Grants and Contributions. Operating grants and contributions for the year totalled \$13.854M and represented 14.8% of total income from continuing operations. This compares with \$12.522M and 15.5% in 2008.

Capital Grants and Contributions . Capital grants and contributions amounted to \$19.815M for the 2009 year and represented 21.2% of total income from continuing operations. This compares with \$12.508M and 15.5% for the prior year.

Rates and Annual Charges. Revenue from rates and annual charges increased to \$42.103M from \$39.497M in the prior year. This represented a 6.6% increase and was \$26K less than the original budget for 2009.

Balance sheet - Financial Position

Council's equity at 30 June 2009 amounted to \$889.983M and was increased by the net operating result for the year (\$19.308M surplus) and the net revaluation of water and sewer assets of \$8.441M.

The movement in non-current assets is due to the acquisition of property, plant and equipment (\$41.528M), revaluation of water and sewer assets (\$8.441M), disposals (\$3.090M) and depreciation (\$15.372M) of assets during the year.

The movement in non-current liabilities is due to the additional loan facility of \$10M drawn down during the year.

At balance date Council had not utilised any of its bank overdraft facility of \$2M.

Movements in Cash and Cash Equivalents

Council's cash and cash equivalent balances increased by \$8.592M during the year, with \$39.588M being provided from operations, \$37.092M utilised in investing activities for the acquisition and sale of non-current assets and \$6.096M provided from the net movement in loans.

Total Investments and Cash Balances

Council's total cash balance at 30 June 2009 was comprised of the following:

	2009 S'000	2008 S'000	Variance S'000
Externally restricted cash	18,368	11,657	6,711
Internally restricted cash	4,371	5,449	(1,078)
Unrestricted cash	<u>14,933</u>	<u>15,847</u>	<u>(914)</u>
<i>Total Cash & Cash Equivalents</i>	<u>37,672</u>	<u>32,953</u>	<u>4,719</u>

Externally restricted cash balances increased as a result of the net increase in various reserves such as specific purpose unexpended loans, sewerage services and other waste services.

Internally restricted balances decreased mainly due to net movements in specific Council reserves as outlined on Note 6(c) such as unexpended general fund loans and the infrastructure fund.

As detailed in our statutory audit report, volatility and uncertainty in global financial markets since mid 2008 has had a substantial impact on the Council's investment portfolio. At 30 June 2009 Eurobodalla Shire Council's investment portfolio totalled \$37.672M which was comprised of managed funds, Collateralised Debt Obligations (CDOs), term deposits and cash and cash equivalents.

As a result of the impact on global financial markets, Council reduced the carrying value of its investments by \$853K which is disclosed as an investment loss in Note 3(c) to the financial statements.

Working Capital (Net Current Assets)

	2009 S'000	2008 S'000	Variance S'000
Current assets	43,776	42,617	1,159
Current liabilities	<u>19,932</u>	<u>21,907</u>	<u>(1,975)</u>
Net current assets	23,844	20,710	3,134
Add: reclassified liabilities as per DLG	<u>3,994</u>	<u>3,477</u>	<u>517</u>
Adjusted net Current Assets	27,838	24,187	3,651
<i>Less: Commitments against working capital</i>			
Net external restrictions	<u>16,074</u>	<u>14,611</u>	<u>1,463</u>
<i>Unrestricted Working Capital</i>	<u>11,764</u>	<u>9,576</u>	<u>2,188</u>

Council's balance of net current assets has increased from \$20.710M in 2008 to \$23.844M at the end of the 2009 financial year.

Also included in net current assets are other commitments against the working capital balance which should be considered when assessing the adequacy or otherwise of Council's available (or uncommitted) working capital at 30 June 2009. The adjusted working capital after allowing for net external restrictions was \$11.764M (2008 - \$9.576M).

After taking into consideration Council's internal reserves, other liabilities that are anticipated to be funded from the 2009/10 operating budget and anticipated timing of rate revenues, the uncommitted working capital balance appears reasonable.

Performance Indicators and Trends

Prescribed performance indicators are included in Note 13 to the financial report and provide a comparison of the 2009 year results with prior years.

Abridged Note 13 – Statement of Performance Measurement

	2009	2008	2007	2006
Unrestricted current ratio	1.95:1	1.9:1	2.1:1	1.47:1
Debt service ratio	9.62%	6%	6%	7%
Rate coverage ratio	45.03%	47%	47%	47%
Rates & annual charges outstanding ratio	3.22%	3.01%	2.83%	3.14%
Asset renewals ratio	0.4155:1	0.45:1	N/A	N/A

Unrestricted Current Ratio. The ratio is within industry guidelines and is just below the Department of Local Government benchmark of 2:1.

Debt Service Ratio. The debt service ratio has increased in line with recent loan raisings but remains marginally below the industry benchmark of 10%.

Rates and Annual Charges Coverage Ratio. Council's rates and annual charges revenue represented 45.03% of 2009 total revenue, which is consistent with prior years and indicates the stability of Council's operations.

Rates and Annual Charges Outstanding Percentage. The amount of rates uncollected at year end expressed as a percentage of the total rates and annual charges collectible was 3.22%. This is a decline on prior years but remains well within the industry benchmark of 5%.

Asset Renewals Ratio. The ratio declined on the prior year and is below the industry guidelines of 1:1.

Progress with the recognition and valuation of roads and related infrastructure

A Project Team has been formed to identify and value roads and infrastructure. The Project Team includes the Asset Engineer, Council's Asset Accountant and the Asset Computer Systems officer to address the identification and valuation of infrastructure assets.

Council has drafted Asset Revaluation Project procedures and a detailed project plan has been developed to ensure the project is completed in a timely and efficient manner. Council has also prepared a detailed Asset Revaluation Methodology.

Legislative Compliance

As a result of our audit we advise that no material deficiencies in the accounting records or financial reports have come to our attention during the conduct of the audit, and that Council's accounting records have been kept accurately and conscientiously and in accordance with requirements of the Local Government Act, 1993, and Regulations.

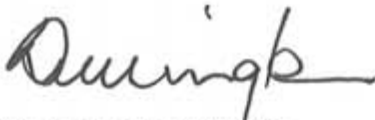
Council has complied with all statutory reporting requirements relating to Division 2 of Chapter 12 of the Local Government Act, 1993, the Code of Accounting Practice and Financial Reporting (Update 17), and other legislatively prescribed standards.

Conduct of the audit

All matters arising during the conduct of our audit have been appropriately attended to and there are no matters of audit significance that require mention in this report.

We would like to commend the courteous and professional manner in which Council's staff has acted throughout the conduct of our audit, and their willingness to consider issues that we raised and assist us with our audit.

Yours faithfully
PITCHER PARTNERS



CARL MILLINGTON
Partner