

AMENDED ITEM



Item No: 3.5
Title: Outcome of Forensic Audit
Department: Corporate Affairs

9 March 2021 Ordinary Council Meeting

Reference: F2021/00035 - D14498706
Author: Michael Ross, Unit Manager, Procurement and Projects
Executive: Natalia Cowley, Acting Director, Corporate Affairs

Report purpose

To provide a summary of the recent Legal and Financial Forensic Analysis undertaken by Clayton Utz. To provide a report on completion of this work in accordance with the resolution of Council.

Executive Summary

Central Coast Council engaged Clayton Utz on 26 October 2020, to undertake a Legal Analysis. Clayton Utz engaged KPMG to undertake the Financial Forensic Analysis. The purpose of the engagement was to advise Council of any evidence indicating Council's liquidity issues or use of restricted funds in breach of the Local Government Act were as a result of corruption.

Clayton Utz further requested KPMG undertake a targeted forensic review of a sample fund to gain understanding of Central Coast Council financial accounting practices and adherence to the Office of Local Government Guidelines. Council's Domestic Waste Fund (DWF) was selected as a sample fund.

This review has now been finalised with the submission of the Clayton Utz Legal and Financial Forensic Review closeout document.

The review has not identified any evidence that Council's current liquidity issues or use of restricted funds in breach of the Local Government Act was the result of corrupt conduct.

It is recommended that this is the final report to Council regarding the Forensic Audit, and future effort and Council resources focus on implementing improvements in Council financial management and reporting.

Corporate Affairs Recommendation

- 1 *That Council receive the "Clayton Utz Legal and Financial Forensic Review closeout document" attached to this report.*
- 2 *That Council note that the reporting requirements in accordance with resolution 1081/20 have now been met.*

3.5 Outcome of Forensic Audit (contd)

- 3 *That Council note that it will continue to receive a monthly report to a Council meeting detailing the financial position of Council at month end (being the Investment Report) as required under the Local Government Act 1993.*

Background

At its ordinary meeting held 12 October 2020, the Council resolved in part,

970/20 *That Council note the forensic internal audit of Council's finances underway, including the establishment of a working group to implement a 100-day action plan to recovery.*

980/20 *That Council consider the draft 100-day recovery action plan and financial forensic scope documentation at a workshop to be held on Thursday 15 October 2020.*

At its Ordinary Meeting held 26 October 2020, Council resolved in part;

1081/20 *Each (fortnightly) Council meeting during the next 12 months will receive a report that details;*

- i. the financial position of council at that time*
- ii. progress against the 100 day action plan*
- iii. progress of the Forensic Audit, until completed*
- iv. an outline of any other relevant strategy in response to the Financial Crisis and progress against those strategies*
- iv. progress against any Performance Improvement Order that is in place.*

Central Coast Council engaged Clayton Utz on 26 October 2020, to undertake a Legal Analysis. Clayton Utz then engaged KPMG to undertake a Financial Forensic Analysis. The purpose of the engagement was to advise Council of any evidence indicating Council's liquidity issues or use of restricted funds in breach of the Local Government Act were as a result of corruption.

During the development of the Administrator's 30-day Interim Report, the causes of the financial crisis became known, so the scope of the forensic review was focused on the review of actual financial transactions and specifically the allocation of costs and funding for a specific Council area, which was Council's Domestic Waste Fund (DWF) and adherence to Office of Local Government Guidelines.

Current Status

Clayton Utz have finalised the Legal and Financial Forensic Analysis and provided a close out document detailing related findings. This document is attached.

3.5 Outcome of Forensic Audit (contd)

In summary, Clayton Utz have confirmed their analysis has not identified any evidence that the Council's current liquidity issues or use of restricted funds in breach of the Local Government Act was the result of corrupt conduct. Rather, the current financial circumstances appear to have arisen from legacy issues associated with financial systems, transparency from the time of Council amalgamation and poor financial management practices.

Clayton Utz further note that the combined findings are generally consistent with those provided within the Administrators 30 day interim report dated 2 December 2020.

The review of the apportionment model that is used by Council to allocate costs between the Domestic Waste Fund (DWF) and the General Fund identified \$4 million of expenses over the three years to 30 June 2020, which should be reallocated from the General Fund to the DWF.

Further commentary was provided relating to the existing fund balance and growth over the three years to 30 June 2020. Council develops detailed expenditure and income modelling which plans for accumulated surpluses. Council use this surplus to absorb anticipated higher service delivery costs in future years associated with changing regulatory requirements and implementation of the Central Coast Waste Resource Management Strategy.

The sampling of waste transactions reviewed did not identify any transactions allocated to DWF that were not consistent with guidance provided by the Office of Local Government.

Clayton Utz further stated that having regard to the reviews completed to date it would be reasonable for Council to conclude that further investigation would be unlikely to disclose any new or additional reasons for its current financial circumstances, and resources would be best utilised by focussing on implementing improvements in financial management and reporting. For this reason, no further Forensic Audit reports are recommended at this time.

It is noted that at the Ordinary Meeting held 26 October 2020, Council resolved in part as follows:

- 1081/20 *Each (fortnightly) Council meeting during the next 12 months will receive a report that details;*
- v. *the financial position of council at that time*
 - vi. *progress against the 100-day action plan*
 - vii. *progress of the Forensic Audit, until completed*
 - iv. *an outline of any other relevant strategy in response to the Financial Crisis and progress against those strategies*
 - viii. *progress against any Performance Improvement Order that is in place.*

In response to this resolution a monthly report has been provided to Council setting out progress against the Business Recovery Plan and including any update regarding this Legal and Financial Forensic Analysis.

3.5 Outcome of Forensic Audit (contd)

Further, Council is receiving monthly financial reports (Investment Report) which sets out Council's financial position. This reporting is being provided in accordance with the Local Government Act.

No Performance Improvement Order is currently in place and as such there is no requirement to report against progress.

For these reasons, no further action is proposed in response to resolution 1081/20.

Link to Community Strategic Plan

Theme 4: Responsible

Goal G: Good governance and great partnerships

R-G2: Communicate openly and honestly with the community to build a relationship based on transparency, understanding, trust and respect.

Attachments

- 1 Clayton Utz Legal and Financial Forensic Review closeout document D14508893

Email

24 February 2021

Mr Rik Hart
Acting Chief Executive Officer
Central Coast Council
PO Box 20
WYONG NSW 2259

Dear Rik

Central Coast Council: Legal and Financial Forensic Analysis

We have been engaged by Council to provide advice and assistance on the investigation of its liquidity issues and management of restricted funds.

1. Scope of engagement

1.1 Clayton Utz was engaged pursuant to a letter of instruction dated 16 October 2020. During the course of our engagement, we were instructed to:

- (a) advise on whether a formal notification was required under the section 11 of the *Independent Commission Against Corruption Act 1988 (ICAC Act)*; and
- (b) engage KPMG to undertake a targeted forensic accounting review of Council's Domestic Waste Fund (**DWF**).

1.2 The purpose of this letter is to summarise the factual conclusions of those reviews and provide a recommendation to Council as to whether further investigations are warranted. This summary must be read in the context of and is subject to all comments, assumptions and qualifications contained in the referenced reports. Defined terms, where used, have the meaning given to them in the referenced reports.

2. Legal review

2.1 Clayton Utz undertook investigations for the purposes of providing Council with legal advice on whether a formal notification is required under the section 11 of the ICAC Act. Our advice was contained in our letter dated 19 November 2020 which also provides a summary of the investigations undertaken.

2.2 As a result of our investigations, we found that there were no reasonable grounds at that time to suspect that the Council's liquidity crisis and use of restricted funds in breach of the *Local Government Act 1993 (LG Act)* was the result of corrupt conduct. Rather, the information obtained by us indicated that the causes of the Council's financial circumstances were due to:

- (a) legacy issues with lack of control, financial systems and transparency from Gosford Council inherited on amalgamation, including from the Gosford Council rescripting incident in 2016;
- (b) problems, delays and lack of transparency when integrating the financial systems on amalgamation;

Mr Rik Hart, Central Coast Council

24 February 2021

- (c) delay and lack of transparency in establishing a single financial system after amalgamation;
- (d) a long-term and established practice of reallocating funds within the single bank account between the General Fund and restricted funds;
- (e) mismanagement of the single bank account and lack of financial controls;
- (f) general poor financial management practices; and
- (g) lack of early warning mechanisms.

3. **KPMG DWF review**

3.1 In accordance with Council's instructions, we engaged KPMG to undertake a targeted forensic accounting review of the DWF, the scope of which was detailed in KPMG's email to us dated 18 December 2020.

3.2 KPMG was instructed to:

- (a) obtain an understanding of Council's waste function;
- (b) review Council's allocation of costs and funding between the DWF and General Fund; and
- (c) consider Council's allocation of funds to the DWF, having regard to the guidance provided by the Department of Local Government.¹

3.3 KPMG provided us with its final report on 22 February 2021 which sets out its findings in relation to the targeted forensic accounting review of the DWF (**KPMG Report**).

3.4 A summary of the key findings arising from KPMG's forensic accounting review of the DWF as set out in the KPMG Report is as follows:

- (a) Council's DWF balance increased from \$42.2 million to \$90.4 million in the three years to 30 June 2020;
- (b) Council attributes the increasing balance in the DWF to increasing future costs related to environmental legislation (including tip remediation costs), new Council objectives and the volatility of waste commodity markets;
- (c) a review of the Apportionment Model that is used by the Council to allocate costs between the DWF and General Fund identified that \$4 million of expenses in the three years to 30 June 2020 should be reallocated from the General Fund to the DWF;
- (d) Council has relied on the reasonableness of the cost calculations of the former Councils in setting its annual charges. Since amalgamation, annual charges have been updated on an annual basis in line with CPI, rather than on the basis of an assessment of the reasonable cost to the Council for providing domestic waste

¹ *Council Rating and Revenue Raising Manual (2007)*, Department of Local Government.

Mr Rik Hart, Central Coast Council

24 February 2021

services. The Council is currently performing an assessment of its annual charges which includes a review of its current and forecast waste management costs. This assessment was not performed on amalgamation due to the complexities around reliably forecasting costs for the newly formed Council when long-term contractual agreements were in the process of being renegotiated.; and

- (e) a review of a selection of sample waste transactions (for example, non-domestic waste expense transactions) did not identify any transactions allocated to the DWF that were not consistent with the guidance provided by the Department of Local Government.

3.5 KPMG has recommended that Council:

- (a) adjust the DWF and General Fund accounts to reallocate \$4 million of expenses to the DWF; and
- (b) update its cost apportionment calculation procedures to prevent the errors being repeated in future calculations.

3.6 Although not within the scope of its targeted forensic accounting review, we note that the KPMG Report has not identified any information or evidence that would indicate the Council's current liquidity issues or use of restricted funds in breach of the LG Act was the result of corrupt conduct.

4. **Conclusions and recommendations**

4.1 The investigations undertaken by Clayton Utz and the forensic accounting review undertaken by KPMG as detailed in this letter did not identify any evidence that the Council's current liquidity issues or use of restricted funds in breach of the LG Act was the result of corrupt conduct. Rather, the current financial circumstances appear to arise from legacy issues from the time of Council amalgamation and poor financial management practices.

4.2 The conclusion in 4.1 above is generally consistent with the findings of:

- (a) the Draft DMB Report provided to Council in October 2020; and
- (b) the Administrator's 30 day Interim Report dated 2 December 2020.

4.3 Having regard to the outcome of the several reviews that have now been completed, it would be reasonably open for the Council to conclude that:

- (a) further investigation of the Council's current liquidity issues or use of restricted funds in breach of the LG Act is unlikely to disclose any new or additional reasons for its current financial circumstances; and
- (b) Council's efforts should now focus on implementing improvements in its financial management and reporting. In this regard, it is recommended that the Council implement the recommendations made by KPMG in so far as they relate to the DWF.

Mr Rik Hart, Central Coast Council

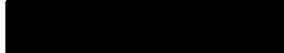
24 February 2021

Should you wish to discuss any aspect of the summary report above, please do not hesitate to contact us.

Yours sincerely



Brendan Bateman, Partner



Alison Packham, Senior Associate



Our ref 224/14605/81010314