



AUDIT COMMITTEE MEETING

MINUTES

Committee Brief

- *Recommend the appointment of the auditor to the Council;*
- *Assist the auditor to ensure audits are conducted successfully and timely;*
- *Examine the audit report and ensure appropriate action is taken;*
- *Prepare reports on actions taken and forward to the Minister;*
- *Meet with the auditor at least once a year; and*
- *Review enhanced scope of audit.*

An ordinary meeting of the Audit Committee was held in the Shire President's Office, Lowood Road, Mount Barker WA 6324, 11.15am Tuesday 16 December 2008

Rob Stewart
CHIEF EXECUTIVE OFFICER

Committee Members

Cr K Forbes; Cr M Skinner; Cr J Mark

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1 DECLARATION OF OPENING / ANNOUNCEMENT OF VISITORS

11.15 am The Chairperson declared the meeting open.

2 RECORD OF ATTENDANCE / APOLOGIES

Members Present

Cr M Skinner (Chairperson)

Cr K Forbes, AM

Cr J Mark

Staff

Mr Rob Stewart, Chief Executive Officer

Mr John Fathers, Deputy Chief Executive Officer

3 CONFIRMATION OF MINUTES

Moved Cr J Mark, seconded Cr K Forbes AM

THAT the Minutes of the Ordinary Meeting of the Audit Committee, held on 10 September 2008 as circulated, be taken as read and adopted as a correct record.

CARRIED

4 REPORTS OF COMMITTEE MEMBERS AND OFFICERS

4.1 INVESTMENT POLICY REVIEW - GOVERNMENT GUARANTEE

Mr J Fathers – Deputy Chief Executive Officer discloses an interest (S 5.70 of the Local Government Act 1995) for this item due to his board membership of Plantagenet Community Financial Services Ltd.

File No: FM/120/6

Attachment: WALGA Infopage
Analysis of Interest Rates
Credit Ratings

Responsible Officer: Rob Stewart
Chief Executive Officer

Author: John Fathers
Deputy Chief Executive Officer

Proposed Meeting Date: 16 December 2008

Purpose

The purpose of this report is to advise the Audit Committee of the Council's current investment strategy and to note and consider a report on today's Council agenda regarding this matter. That report follows:

“Purpose

The purpose of this report is to consider the Council's current investment strategy given the recent global economic situation.

Background

On 12 October 2008, the Australian Government announced guarantee arrangements for deposits and wholesale funding of eligible authorised deposit-taking institutions (ADIs).

The arrangements are designed to promote financial system stability in Australia, by supporting confidence and assisting ADIs to continue to access funding at a time of considerable turbulence. They are also designed to ensure that Australian institutions are not placed at a disadvantage compared to their international competitors that can access similar government guarantees on bank debt.

The Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding (the Guarantee Scheme) formally commenced on 28 November 2008. Under the Guarantee Scheme, eligible ADIs can obtain guarantees for deposit balances totalling over \$1 million per customer and for wholesale funding liabilities. Access to the Guarantee Scheme is voluntary. Eligible institutions wanting to access the guarantee for their large deposit balances or wholesale funding from 28 November 2008 need to apply to the Scheme Administrator.

Separate arrangements apply for deposit balances totalling up to and including \$1 million per customer per institution. Such deposits are guaranteed by the Australian Government under the Financial Claims Scheme and this guarantee is free.

A recent Infopage from the Western Australian Local Government Association has confirmed that local governments are among the small number of depositors with large deposit balances who will need to make decisions regarding applying for the guarantee. The Government announcement indicates that the guarantee fee will initially be set at:

- 0.7% per annum for AA rated institutions;
- 1.0% per annum for A rated institutions;
- 1.5% per annum for BBB rated institutions.

Statutory Environment

The authority for a local government to invest surplus funds comes from Section 6.14 of the Local Government Act 1995. Section 18 of the Trustees Act 1962 also details investment powers of trustees.

Other recent legislation is covered in the Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008 and the Banking Amendment Regulations 2008 (No. 1).

Consultation

Consultation has taken place with Mr Rob Stewart - Chief Executive Officer.

Financial Implications

This matter has a direct impact on the security of the Council's surplus funds and the revenue to be made from investment of those funds. The security issues are discussed in the Officer Comment section of this report.

With regard to income, in the current financial year, the amount available for investment purposes ranged from approximately \$2.0 million to approximately \$3.5 million (from municipal, reserve and loan funds). The Council's 2007 / 2008 budget provides for income from investment of \$185,000.00.

The interest rates on the Council's current term deposits range from 6.25% to 8.40%, with the interest rates having reduced significantly in recent months. Due to the current relationship with Bendigo Bank, the Shire's investments attract current market rate plus 0.15%. This equates to a bonus of approximately \$3,000.00 per year.

A recent analysis of interest rates being offered by a selection of other AA, A and BBB rated institutions is attached. The Bendigo Bank is currently offering very competitive rates. If the Council chose to invest in other financial institutions, this could enable it to diversify its investments so that it had less than \$1 million in each one, thereby qualifying for the free government guarantee on all investments.

For the sake of simplification, three scenarios have been considered, based on an average yearly investment of \$2.5 million at currently quoted interest rates:

Scenario 1 – The Council continues to invest all its surplus funds with Bendigo Bank and does not elect to pay the Government Guarantee. In this scenario the Council's return would be \$156,250.00.

Scenario 2 – The Council continues to invest all its surplus funds with Bendigo Bank and does elect to pay for the Government Guarantee. In this scenario the Council's return would be \$118,750.00, the cost of the Government Guarantee being quite significant (In this scenario \$37,500.00)

Scenario 3 – The Council spreads its investment pool among three (or more) banks. With total funds in each bank less than \$1 million, the free Government Guarantee applies. In this scenario the Council's return would be \$146,100.00. This reflects lower interest rates currently being offered by other major banks.

If a position like Scenario 3 was adopted, it is recommended that individual bank accounts continue to directly represent particular funds or pools of money (such as reserve funds, restricted funds, unspent loan funds etc).

The additional option would be to engage a broker to invest the Council's surplus funds in an even more diverse portfolio. There would be a cost associated with managing a more diversified investment strategy (in staff time or investment brokers), although this would be minimal if the Council chose to spread its investments around the banks with branches in Mount Barker and Albany. This option would provide only limited support to the community bank. However, there would be a safety net in place if any one of those banks went into financial difficulties.

Policy Implications

This matter could result in amendments to the Council Policy No. F/RI/1 – Investments. At present, this policy (among other things) directs that all surplus funds be invested with the Bendigo Community Bank.

Strategic Implications

There are no strategic implications for this report.

Officer Comment

A copy of the Council's current investment policy (reaffirmed by the Council at its meeting held on 27 May 2008) is reproduced below for information.

OBJECTIVE:

To document and provide the necessary information for the delegated officers to invest surplus funds.

POLICY:

1.0 Purpose of Policy

1.1 The purpose of this policy is to ensure that:

- *The Council conforms with its fiduciary responsibilities under Section 6.14 of the Local Government Act and Section 18 (1)(a) of the Trustees Act 1962 (the 'Prudent Person' rule);*
- *At all times, the Council has in place a current set of policies and delegations for its Investments Officers; and*
- *Adherence to the guidelines by all officers with delegated authority to invest / control surplus funds.*

- 1.2 *This Policy is to be made available to all employees involved in daily investment decisions.*
- 1.3 *Notwithstanding the provisions of this Policy, the general financial management obligations imposed under the Local Government Act 1995 and the Local Government (Financial Management) Regulations 1996 should at all times be complied with.*

2.0 *Prudent Person Rule*

- 2.1 *The investment options available to local government authorities in Western Australia were altered in June 1997 with changes to the Trustees Act. With the passage of changes to the Trustees Act, the list of prescribed investments has been removed and replaced by the Prudent Person rule.*
- 2.2 *The main features of the prudent person rule include:*
- *Exercising the care, diligence and skill that a prudent person would exercise in managing the affairs of other persons; and*
 - *A duty to invest funds in investments that are not speculative or hazardous.*
- 2.3 *In exercising powers of investment, there are important matters for consideration:*
- *The purpose of the investment and the needs and circumstances;*
 - *The desirability of diversifying investments and the nature of and risk associated with existing investments;*
 - *The need to maintain the real value of capital and income; The risk of capital or income loss or depreciation; The potential for capital appreciation;*
 - *The likely income return and timing of the income return; The length of the term of the proposed investment;*
 - *The liquidity and marketability of the proposed investment; The aggregate value of the investment;*
 - *The effect of the proposed investment in relation to the tax liability (if any);*
 - *The likelihood of inflation affecting the value of the proposed investment; and*
 - *The costs of making the proposed investment; the results of a review of existing investments.*

3.0 *Investment Objectives*

- 3.1 *To add value through prudent investment of funds.*
- 3.2 *To support the local community bank without putting the Shire's surplus funds to any undue risk.*
- 3.3 *To have ready access to funds for day-to-day requirements, without penalty.*

4.0 *Authority to Invest*

- 4.1 *The Shire of Plantagenet's surplus funds are to be invested in term deposits or negotiable certificates of deposit with Bendigo Community*
-

Bank. Any proposal to invest funds in another institution, for whatever reason, is to be referred to the Council.

- 4.2 Investments from the municipal, loan, reserve and trust accounts are to be kept separate and distinct.*
- 4.3 Funds may be invested for terms ranging from one (1) to six (6) months based on predicted cash flow requirements.*
- 4.4 The Deputy Chief Executive Officer places, withdraws or re-invests sums up to \$500,000.00 jointly with the Accountant or Chief Executive Officer, in accordance with the Chief Executive Officer's delegation.*
- 4.5 The Chief Executive Officer places, withdraws or re-invests sums over \$500,000.00 jointly with the Deputy Chief Executive Officer or Accountant in accordance with the Chief Executive Officer's delegation.*

5.0 Review and Reporting

- 5.1 A cash flow report is to be monitored by the Accountant at least weekly to ensure cash funds are available to meet commitments.*
- 5.2 Investments will be managed actively as they mature with reviews by the Deputy Chief Executive Officer on a monthly basis.*
- 5.3 Bendigo Bank's short term credit rating as defined by Standard and Poors is to be monitored on a monthly basis by the Deputy Chief Executive Officer. Any downgrading of the A-2 rating is to be reported to the Council.*
- 5.4 For audit purposes, certificates must be obtained from the bank confirming the amounts of investment held on the Council's behalf at 30 June each year.'*

As outlined above, the current policy provides for surplus funds to be invested in term deposits or negotiable certificates of deposit (NCD) with Bendigo Community Bank and a special rate is applied by Bendigo Bank to all of the Council's funds on deposit. It has clearly been the intention to support the local community bank. It is considered prudent to review that policy in light of the current global economic situation.

A standard feature of most investment policies is the desire to achieve an adequate level of diversification to spread risk. The Council will recall that its previous Investment Policy (replaced in November 2006) required that no more than 70% of funds be invested with one organisation. The lack of diversification in the current policy could be seen to be relatively risky and the Council should decide whether it is happy to continue in that vein or whether it wants to adopt a more risk averse position.

Bendigo's 'Community Bank' is a branch banking model which involves local people in solving their own banking needs. Community Bank branches provide communities with an opportunity to enhance control over their community's capital, ensuring more money stays in the district for local investment.

It is considered desirable to support the local community bank, provided that other fiduciary responsibilities are complied with, although the Council should be conscious of the risk and put adequate controls in place to mitigate that risk. The Council has done this by defining a bottom level credit rating (A-2) and regularly monitoring Bendigo Bank's credit rating.

Standard and Poor's credit ratings relating to Bendigo Bank have not altered since the current policy was adopted. Their short term credit rating is currently A-2 and the long term credit rating is BBB+. It may be prudent to include both short and long ratings in the Council's policy.

During discussions with Bendigo Bank at the time of the adoption of the policy, it was advised that the bank is 148 years old and has never made a loss. It is a conservative organisation which is subject to very strong prudential requirements. Funds invested with Bendigo Bank are put into a pool to spread the risk. The bank has the highest credit ratings it can achieve for its size.

The Shire's auditors have previously advised that the Council may choose to invest in one institution, subject to the recommended controls being in place.

From a purely risk aversion point of view, the Council should reconsider adopting a more diverse investment strategy. Also, it is considered appropriate to secure the Government Guarantee on funds, whether by paying for it or by diversification. It will therefore be recommended that the Council spreads its funds among local banks to achieve the Government Guarantee, whilst minimising its cost to the Council.

However, it is considered that the failure of any of the major Australian banks is so unlikely that the Council can still be confident in retaining its current position, if it wishes to continue to fully support the Community Bank. Nevertheless, given that this position is relatively risky from a diversification perspective, it would be prudent to elect to pay the Government Guarantee. If the Council agrees with this, the associated costs will be considered as part of the half yearly budget review. This position would continue to include the controls placed within the policy.

Voting Requirements

Simple Majority

OFFICER RECOMMENDATION

That amended Council Policy F/RI/1 – Investments, as follows:

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POLICY:

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1.1 The purpose of this policy is to ensure that:

- The Council conforms with its fiduciary responsibilities under Section 6.14 of the Local Government Act and Section 18 (1)(a) of the Trustees Act 1962 (the 'Prudent Person' rule);
- At all times, the Council has in place a current set of policies and delegations for its Investments Officers; and
- Adherence to the guidelines by all officers with delegated authority to invest / control surplus funds.

- 1.2 This Policy is to be made available to all employees involved in daily investment decisions.
- 1.3 Notwithstanding the provisions of this Policy, the general financial management obligations imposed under the Local Government Act 1995 and the Local Government (Financial Management) Regulations 1996 should at all times be complied with.

2.0 Prudent Person Rule

- 2.1 The investment options available to local government authorities in Western Australia were altered in June 1997 with changes to the Trustees Act. With the passage of changes to the Trustees Act, the list of prescribed investments has been removed and replaced by the Prudent Person rule.
- 2.2 The main features of the prudent person rule include:
 - Exercising the care, diligence and skill that a prudent person would exercise in managing the affairs of other persons; and
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- 2.3 In exercising powers of investment, there are important matters for consideration:
 - The purpose of the investment and the needs and circumstances;
 - The desirability of diversifying investments and the nature of and risk associated with existing investments;
 - The need to maintain the real value of capital and income; The risk of capital or income loss or depreciation; The potential for capital appreciation;
 - The likely income return and timing of the income return; The length of the term of the proposed investment;
 - The liquidity and marketability of the proposed investment; The aggregate value of the investment;
 - The effect of the proposed investment in relation to the tax liability (if any);
 - The likelihood of inflation affecting the value of the proposed investment; and
 - The costs of making the proposed investment; the results of a review of existing investments.

3.0 Investment Objectives

- 3.1 To add value through prudent investment of funds.
- 3.2 To support the local community bank without putting the Shire's surplus funds to any undue risk.
- 3.3 To have ready access to funds for day-to-day requirements, without penalty.

4.0 Authority to Invest

- 4.1 The Shire of Plantagenet's surplus funds are to be invested in term deposits or negotiable certificates of deposit with Bendigo Community

Bank and other banks with branches in Mount Barker or Albany, subject to their Standard and Poor's long term credit rating being at least BBB+ and the short term rating being at least A-2. Any proposal to invest funds in another institution, for whatever reason, is to be referred to the Council.

- 4.2 Investments from the municipal, loan, reserve and trust accounts are to be kept separate and distinct.
 - 4.3 Funds may be invested for terms ranging from one (1) to six (6) months based on predicted cash flow requirements.
 - 4.4 The Deputy Chief Executive Officer places, withdraws or re-invests sums up to \$500,000.00 jointly with the Accountant or Chief Executive Officer, in accordance with the Chief Executive Officer's delegation.
 - 4.5 The Chief Executive Officer places, withdraws or re-invests sums over \$500,000.00 jointly with the Deputy Chief Executive Officer or Accountant in accordance with the Chief Executive Officer's delegation.
 - 4.6 Investments are to be diversified with the aim of retaining less than \$1 million with each bank, thereby eliminating the cost of the Federal Government Guarantee on funds.
- 5.0 Review and Reporting
- 5.1 A cash flow report is to be monitored by the Accountant at least weekly to ensure cash funds are available to meet commitments.
 - 5.2 Investments will be managed actively as they mature with reviews by the Deputy Chief Executive Officer on a monthly basis.
 - 5.3 Bendigo Bank's short term credit rating as defined by Standard and Poors is to be monitored on a monthly basis by the Deputy Chief Executive Officer. Any downgrading of the long term BBB+ or short term A-2 rating is to be reported to the Council.
 - 5.4 For audit purposes, certificates must be obtained from the bank confirming the amounts of investment held on the Council's behalf at 30 June each year.'

be adopted."

OFFICER RECOMMENDATION

That the report of the Deputy Chief Executive Officer relating to the Council's Investment Policy, be received.

COMMITTEE DECISION

Moved Cr K Forbes AM, seconded Cr J Mark

That it be recommended to the Council that surplus funds continue to be invested solely with the Bendigo Community Bank and that the Council elects to pay the 1.7% premium for the Federal Government guarantee.

CARRIED

5 GENERAL BUSINESS / MATTERS ARISING

5.1 2007/2008 AUDIT – TELECONFERENCE WITH AUDITOR DAVID TOMASI

Attachment: **UHY Haines Norton Audit and Management Reports**

During discussion at the Audit Committee Meeting held on 16 December 2008, the Shire's auditor, David Tomasi was asked to outline his views on the audit of the Shire for the 2007/2008 financial year. Mr Tomasi advised that the outcome was very positive, with a lot fewer points raised and the Shire being in a better financial position. It was also pleasing to see an improvement in the preparation of accounts with proper procedures and processes having been established. Nevertheless, this would continue to be monitored. Mr Tomasi pointed out that he was happy to speak to the Audit Committee at any time during the year if it had any queries or concerns.

The Deputy Chief Executive officer, Mr Fathers advised that he was progressing investigations into the suggested method of depreciation of infrastructure. It was also advised that there is expected to be a continued reduction in outstanding rates, particularly due to the sale of a number of Valley View Tree Farm lots and improvements to collection procedures. However, the cash position at the end of 2008/2009 could worsen due to restricted and committed funds being allocated towards the HACC and medical centre projects.

6 NEXT MEETING

To be advised.

7 MEETING CLOSURE

11.50 am The Chairperson declared the meeting closed.

CONFIRMED: CHAIRPERSON _____ **DATE:** _____ / _____ / _____