

## **Proposed issues for inclusion in a submission to the Office for Local Government**

### **Risk Management and Internal Audit for Local Councils in NSW**

#### **1. Clarification of the role of the Audit, Risk, and Improvement Committee (ARIC) in Council finances**

It is recommended that the Guidelines be reviewed further to ensure it is clear throughout that the ARIC's role is limited to advisory and assurance purposes only, particularly with respect to Council financial results and reports.

The current wording contained on page 9 of the Guidelines with respect to Council's financial position and performance of the Guidelines for ARIC could be construed as giving ARIC broader remit than intended pursuant to s428A(d) of the *Local Government Act 1993*, which includes financial management. The assurance with respect to council financial results should continue to rest with the NSW Auditor-General and external audit processes. In particular, Byron Shire Council has a Finance Committee, and Financial Reports are regularly prepared for Council which is considered adequate transparency for Council financial affairs.

It is unclear what purpose is served by ARIC reviewing Council's financial statements prior to being certified by Council, given financial statements are subject to external audit.

#### **2. Costs to Council**

It is noted that the increased functions of ARIC are also likely to result in an increase in costs to Council. This is due to member fees for the prequalified member and the Chair which are expected to be more than currently paid (there is currently limited public information about these fees), furthermore it is expected that more than four meetings per year will likely occur in order to acquit the minimum range of functions and meetings required (eg the Guidelines require meetings between ARIC Chair and Mayor, meetings between ARIC Chair and internal audit staff). It is also noted that further costs will be incurred if Council is to:

- provide ARIC with secretariat support, in particular to assist in the coordination and preparation of a larger number of annual and four yearly reports/assessments;
- provide ARIC with a budget, or at least a means to be able to engage expertise (at Council's expense) as it considers necessary;
- be required to pay for members' fees for any additional meetings the ARIC considers necessary as it can elect to hold private meetings at its discretion with only voting members present (it is suggested such meetings be pre-approved by the General Manager or capped in some way so that it is not abused given no Council or staff representatives will be present);
- engage either a third party or peer reviewer to undertake an independent assessment of Council's performance every four years to review the effectiveness of the ARIC function;
- required to pay for fees for the ARIC to meet privately once per annum with the internal auditor without the General Manager;
- pay superannuation for ARIC members;
- undertake an annual search of members for bankruptcy each year on the National Personal Insolvency Index (to ensure members are not bankrupt);

- learning and development costs (it is considered that members should possess sufficient skills and qualifications prior to appointment and that Council should not be liable for learning and development costs they consider necessary to acquit their obligations as ARIC members);
- receive and coordinate responses to requests for information from ARIC members in order to fulfil the provision of direct and unrestricted access to council resources and information;
- insure members and Chairs for professional indemnity and public liability.

### **3. Tiers for Council ARIC membership but not for reporting requirements**

The Guidelines as presently drafted allocate Councils into a tiered system with respect to membership requirements that consider factors such as population, proximity to urban or regional centres, financial status, OLG understanding of Council performance and risk profile. Based on these factors it is requested that a corresponding tiered approach be applied to the level of detail and number of reports required to be produced by councils and ARIC to meet requirements particularly given tier 1 and tier 2 Councils may not have the resourcing of a tier 3 Council.

It is noted that in addition to the multiple new reporting requirements under the Guidelines there continues to be multiple layers of assurance including NSW Auditor-General, external audit, and internal audit, which would further support the proposition for a reduction in the number of reports required, or at least a minimum threshold for reports to reflect the tier allocation system.

### **4. Disputes between ARIC and General Manager – lack of process and appeal mechanism**

The Guidelines do not fully articulate the dispute resolution process for issues between ARIC and the General Manager or Senior Council staff. There is concern in assigning responsibility to Council for being the intermediary to resolve such disputes, when there is likely to be a Councillor on the ARIC. Councillors may have wider interests which they may inadvertently consider, particularly as the Council appoints the General Manager.

It is recommended that a third independent party be engaged from the outset to manage any dispute and potential bias and ensure that only relevant factors are considered. There should also be a clearly defined independent process to appeal any decision made in respect of the dispute, given the potential reputational and financial ramifications for Council and parties involved if an adverse finding is made.

### **5. Dismissal of members and appeal mechanisms**

The Guidelines note that ARIC members can be dismissed by the Council prior to the expiry of their term where the pre-qualified member has:

- breached conditions of the prequalification scheme or become ineligible
- breached council's code of conduct
- performed unsatisfactorily
- declared or is found to be in a position of conflict of interest which is unresolvable.

The similar list for non-prequalified members also expressly includes bankruptcy, and an adverse change in capacity or capability, or experienced an adverse change in business status. It is

unclear why the dismissal requirements are not consistent between the prequalified and non-prequalified members, nor what would be deemed satisfactory to constitute “an adverse change in business status” or “capacity”. Without a process there is concern it could result in a legal dispute to remove a member which could be costly, both financially and reputationally, to both Council and member concerned. It is also unclear how a Council would become aware of a bankrupt member, unless the member self-disclosed.

The Guidelines do not contain any procedure to investigate and determine a concern which might be raised nor how any concern should be raised with the governing body (Council) in the first instance. Furthermore, there is no appeal mechanism contained in the Guidelines which is important given any dismissal could have reputational impacts for all parties.

It is also requested the Guidelines consider what might happen in the situation where a member (prequalified or non-prequalified) is charged with a crime or has criminal proceedings commenced against them. Is it possible for a member to stand aside and a new member be appointed until such time as the matter is resolved? This would enable the ARIC to continue to function to full effect, particularly for tier 2 and tier 3 Councils where a loss of one member may affect quorum.

## **6. Pre-qualification ARIC member requirement**

The rigour in meeting certain pre-qualification requirements (for the Chair of any ARIC, and for Byron Shire Council one other member) may make it challenging to attract suitably qualified candidates, or at least attract a range of quality candidates to consider. This is exacerbated by the increased demands on time by members under the new arrangements, and the process for qualification could make it a disincentive to those community members who possess the skills set and could make an important contribution but may already be successfully employed. Although there are regional centres within an hour of Council, factoring in travel time can be a disincentive to many busy people.

In a Local Government Area such as Byron Shire with a very small population (31,550 residents as at the 2016 ABS census) the requirement for pre-qualification of one member other than the Chair, could be challenging to fulfill. The tier 3 exemption should also apply to tier 2 councils if a suitable pre-qualified member cannot be found, particularly in light of the extensive independence requirements.

It is noted that ARICs can be shared by councils under a joint arrangement however, this may not be practical due to governing body preferences and time constraints on members of neighbouring ARICs.

## **7. ARIC member independence requirements**

It is acknowledged that ARIC members should be independent, and this is essential in ensuring that there is confidence in their findings however, the prescriptive list contained in Guidelines (page 23) could disqualify many suitably qualified ARIC members given Byron Shire Council has a relatively small population (31,550 people as per 2016 ABS Census). It may be challenging to find a candidate who has not:

- provided services to Council within the past three years (it is acknowledged they should not be a current provider of services);
- run as a candidate in the last election of council;

- previously acted as an advocate of a material interest on behalf of the council (it is suggested this be capped within a timeframe);
- have a close family member who is a substantial shareholder, owner, officer, or employee of a company that has a material business, contractual relationship, direct financial interest with the council or a related entity. As Byron Shire has a small population, it is entirely conceivable that a well-qualified candidate may be precluded from seeking ARIC membership because their daughter works casually at a local café which occasionally provides catering to Council. It is considered this conflict could be declared and managed appropriately, however the Guidelines, as currently drafted, do not currently allow for Councils to exercise any discretion or measures necessary to manage such conflicts.

## **8. Clarification of ARIC membership terms**

The Guidelines require clarification with respect to the ARIC membership terms, as page 26 states that members should be rotated periodically to avoid perceptions of bias or conflicts of interest, and that initial membership is four years (one council term). The Guidelines also state (on the same page) that membership renewal dates are to be staggered to ensure there is no loss of corporate knowledge.

If Councils must appoint for a four-year term, and the Guidelines do not provide any flexibility with length of membership terms, clarification would be appreciated as to how members can be appointed for a four-year term, and also fulfil the requirement for terms to be staggered.

## **9. Chair membership prior to commencement of ARIC terms**

It is not clear from the Guidelines whether the prior service of a proposed Chair or Member of the ARIC is taken into account from June 2027. For example, is a Chair precluded from seeking membership of the ARIC if they served for six years immediately prior to the commencement of the ARIC membership provisions in June 2027? It is suggested the Guidelines provide explicit clarification on this matter.

## **10. Appointment of staff to direct internal audit activities**

It is noted that for councils which elect to undertake internal audit functions in-house the requirement for the General Manager to consider the views of the ARIC prior to appointing the staff member to oversee the internal audit function is a fettering of the General Manager's employment discretion. As the ARIC undertakes an advisory and assurance role it should not have a role in the employment of staff.

## **11. Internal Audit Function Reporting**

The Guidelines provide for the internal audit function to remain independent from council management and to do this it is proposed to have a dual reporting line:

1. Administratively to the General Manager (or other senior role);
2. Functionally to the ARIC.

The requirement for the General Manager to consult the ARIC Chair on the resourcing required by the internal audit function fetters the administrative powers of the General Manager who either employs or engages the internal auditors and who has budgetary and advisory considerations to Council (which for smaller councils could be considerable). If the internal

auditors believe they are insufficiently resourced for the work required there are several other avenues for them to raise concerns, including through the annual internal audit work plan process, assessment process, and at ARIC meetings.

It is unclear why it is proposed that the General Manager has no role in the reporting of the internal audit findings to the ARIC – if the General Manager is expected to prepare and implement action plans to address any internal audit findings, it is general practice for the internal auditors to canvas their findings with the General Manager prior to reporting to the ARIC. This ensures that the General Manager has the opportunity to ensure that findings are relevant and actionable by Council. It will also be the secretariat function that prepares the report on behalf of the internal auditors to the ARIC and generally such reports must be approved by the General Manager for inclusion in the ARIC agenda.

It is concerning that the ARIC is not required to consult or consider the priorities of the Council or consider concerns of the General Manager (who is charged with significant responsibility in ensuring Council complies with the *Local Government Act 1993* and other legislative and operational obligations), in setting the annual and four yearly work plans for the internal audit function.

**12. Clarification that the model terms of reference for ARIC do not need to be adopted before June 2027.**

It is not expressly stated in the Guidelines when the model terms of reference for the ARIC need to be adopted, only that the member provisions (which are in the terms of reference) must be in place by June 2027.

**Other issues which could be raised:**

- 13.** Proxies are not permitted for ARIC members (quorum for a tier 2 council with the minimum three independent members is two voting members). This could create problems with ARIC meetings proceeding in a timely manner and impact delays in areas of council business if a meeting is delayed or does not proceed as more than one of the three voting members is absent.
- 14.** There can only be one Councillor member (non-voting) and they must not be the Mayor.
- 15.** The ARIC Chair can meet with the Mayor at any time and similarly the Mayor can request a meeting with ARIC Chair at any time.
- 16.** The Guidelines recommend that the ARIC, General Manager, and Council meet (by calling an extraordinary meeting) each year to discuss the annual assessment. It is suggested that the means by which format of the annual assessment is more flexible (ie a separate section of a quarterly ARIC meeting).
- 17.** It is unclear from the Guidelines if the Terms of Reference required to be adopted by the ARIC can form part of the Constitution or if it must be a separate document.
- 18.** If the ARIC Chair disagrees with the attestation statement prepared by the General Manager which must be published in the council's annual report each year (the General Manager must also consider the views of the ARIC Chair) the Chair can submit their own report to Department of Planning, Industry, and Environment (DPIE). It is unclear what further action, if any, is taken by DPIE upon receipt of a separate report by the ARIC Chair.
- 19.** Where a council chooses to outsource the internal audit function there should be greater flexibility for the position responsible within council for the outsourcing (and therefore with obligations to the ARIC) should be able to be a suitably qualified or experienced senior manager within Council rather than just be the staff member who provides coordination

and administrative support to the ARIC (refer page 59 of Guidelines). The Guidelines state that where an internal audit function is outsourced the Chair of the ARIC will do the “heavy lifting” and be the primary source of advice on findings and recommendations.

#### Reporting Requirements for the ARIC proposed under the Guidelines

Number	Requirement
1.	Adoption of a <b>Model Internal Audit Charter</b> .
2.	ARIC to review performance and efficacy of Council’s internal audit activities once per Council term and report to Council on outcome of review and recommendations.
3.	General Manager to include <b>attestation statement</b> in annual report indicating if ARIC, risk management framework and internal audit function complied with Guidelines – to be self-assessed by General Manager in consultation with ARIC.
4.	ARIC to review and provide advice on Council’s <b>internal audit activities</b> .
5.	ARIC activities relevant to council needs are to be agreed between ARIC and Council during <b>development of Terms of Reference</b> .
6.	ARIC to have a <b>strategic plan that covers 4 years</b> to ensure all matters in s428A of the LGA are covered (commensurate with risk profile and size of Council). It must be adopted at the start of the Council term, and reviewed annually.
7.	ARIC to develop an <b>annual work plan</b> in consultation with Council, General Manager, and head of internal audit function/senior managers.
8.	General Manager must, in consultation with ARIC, ensure there is a data collection or performance management system to collect data to measure KPIs.
9.	ARIC to provide <b>quarterly updates</b> to Council and General Manager, and it must happen after every meeting.
10.	ARIC to provide an <b>annual assessment</b> to Council each year. General Manager to receive an advance copy to develop an action plan to address issues identified and be jointly considered by Council.
11.	<b>Annual assessment meeting</b> between ARIC, Council and General Manager to discuss assessment report. Observers can be invited to attend where appropriate.
12.	<b>Strategic assessment every 4 years</b> on all matters listed in s428A of the LG Act. General Manager must be provided a copy of the assessment in advance to enable an action plan to be developed. The ARIC must develop a plan for any internal audit issues.
13.	<b>Strategic assurance meeting every 4 years</b> with ARIC, Council and GM to consider ARIC strategic assessment and action plans. It is suggested this be in the form of an extraordinary Council meeting (Guidelines).
14.	<b>Model Terms of Reference</b> must be developed between Council and ARIC to provide clear guidance on how it can serve Council.
15.	<b>Chair of ARIC and General Manager to meet regularly</b> to discuss key issues and review performance.
16.	<b>ARIC voting members only</b> to meet once a year with the external auditor.
17.	<b>ARIC Chair to meet with Council internal audit staff at least once per year.</b>
18.	<b>ARIC to review Council’s financial statements</b> before they are certified by Council.
19.	<b>ARIC Minutes must be approved by the Chair</b> before being circulated and once confirmed as accurate they must be signed by the Chair.
20.	<b>ARIC must meet privately once per annum</b> with <b>internal audit function head</b> and/or <b>external auditor</b> without General Manager.
21.	<b>General Manager</b> must appoint a Council employee to provide secretariat support to the ARIC.

22.	ARIC will require a <b>budget</b> to support its members, any experts it wishes to engage etc. Council and ARIC Chair to agree at start of Council term on costs or alternatively the ARIC is to seek Council permission prior to engaging any external advice.
23.	<b>Learning and Development:</b> ARIC Chairs and members encouraged to keep informed of current developments and maintain and develop skills.
24.	<b>Council must conduct a 4 yearly review of effectiveness of ARIC function</b> in accordance with the International Professional Practice Framework. Can be outsourced or review internally but get it externally assessed or peer reviewed.
25.	<b>Notice periods</b> for Members resigning or not running for re-election to be <b>agreed by Council and ARIC</b> . Exit meetings to be offered.