



#E2021/131297  
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25 November 2021

Council Governance Team  
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Dear Council Governance Team

### **Draft Risk Management and Internal Audit Guidelines**

Byron Shire Council and its Audit, Risk and Improvement Committee (ARIC) makes the attached submission in respect of the *Draft Risk Management and Internal Audit Guidelines for Local Councils in NSW* (the Guidelines) published by the NSW Office for Local Government.

The primary concern expressed by Byron Shire Council is the substantive increase in role and responsibility for ARICs proposed by the Guidelines, as well as the limited detail surrounding the implementation of the Guidelines in practice. There are also several matters raised in the Guidelines that require greater clarification, for example, whether the role of the ARIC in the preparation of council financial statements is to consider the process used to prepare the statements, or if an assurance function is expected, due to conflicting statements in the Guidelines.

Byron Shire Council is supportive of the tiered approach used to classify Councils predominantly for membership composition and would like to see this approach extended to ARIC and Council reporting requirements.

Should you wish to discuss any aspect of Byron Shire Council's submission further, please contact Ms Alexandra Keen, Audit, Risk and Improvement Coordinator, Byron Shire Council, on telephone 02 6626 7129 or email: [akeen@byron.nsw.gov.au](mailto:akeen@byron.nsw.gov.au).

Yours sincerely

Mark Arnold  
General Manager



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## **Byron Shire Council Submission Draft Risk Management and Internal Audit Guidelines for Local Councils in NSW**

**November 2021**

### **1. Clarification of the role of the Audit, Risk, and Improvement Committee (ARIC) in the review of council financial statements**

It is suggested that the Guidelines be clarified with respect to the ARIC role, to limit it to advisory and procedural assurance purposes only, given the many layers of audit that already exist (local council finance committees, internal audit, external audit, NSW Audit Office, and other project specific Government audits (State and Federal)), with respect to Council financial results and reports.

Presently, there is no clear guidance about the role of the ARIC in relation to financial reports, and the wording on page 29 of the Guidelines with respect to ARIC members being able to consider annual financial statements, and the further content on page 79 of the Guidelines with respect to the expectation that the ARIC will advise on whether there has been compliance with accounting standards and the **accuracy** of council financial statements prior to external audit, requires clarification.

### **2. Increases in costs to councils**

It is expected that due to the increased functions of ARIC there is likely to be a corresponding increase in costs to councils in several areas, which could be an additional resourcing issue for small to mid-tier councils (tier 1 and tier 2) who may not have the operating budget of larger councils. The areas where increases may be experienced by council:

- Fees for prequalified member and the Chair (if they follow the current NSW ARIC fee structure) could be significantly more than what some councils are remunerating.
- Additionally, there are likely to be more than four ARIC meetings per year in order to acquit the minimum range of functions and meetings required (as well as the possibility of ARIC members holding private voting member only meetings), and an expected increase in length of these meetings.
- Increase in secretariat support to ARIC to assist with the increase in reporting requirements and assessments, and facilitation of requests for information from members.
- Providing a formal budget, or at least a means to be able to engage expertise (at Council's expense) as the ARIC considers necessary.
- Engaging 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.
- Fees for the ARIC to meet privately once per annum with the internal auditor without the General Manager.
- Requirement to pay superannuation for ARIC members.
- Additional search fees to undertake an annual search of independent members for bankruptcy each year on the National Personal Insolvency Index (to ensure members are not bankrupt).
- Potential for incurring learning and development costs for ARIC members (however, due to more stringent membership skill requirements it is considered that members should possess sufficient skills and qualifications prior to appointment so that councils

are not required to cover learning and development costs for members to appropriately acquit their obligations as ARIC members).

### **3. Tiers for council ARIC membership for reporting requirements**

The Guidelines as presently drafted, assign a tiering system to councils 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/assessments, required to be produced by councils and ARIC to meet requirements. This tiering is particularly of concern to tier 1 and tier 2 Councils which may not have the resourcing of a tier 3 Council, and equally may not have the same risk profile.

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

### **4. Dispute and appeal processes and appeal mechanisms**

It would be helpful for councils if the Guidelines included clear steps on the dispute resolution should any issues arise between the ARIC and the General Manager/ senior council staff. Importantly there should also be a clear appeal mechanism.

As presently drafted, the Guidelines assign responsibility for resolving disputes to council which is a concern when there is likely to be a Councillor on the ARIC, and the council appoints both parties (ARIC and the General Manager). A concern for requiring a council to be charged with resolving any disputes is that it may inadvertently consider wider interests, and there is no appeal mechanism to the Office of Local Government or other independent body if a party feels they have been aggrieved given the potential reputational and financial ramifications for a council and parties involved in an adverse finding.

It is suggested that a means to resolve this could be the engagement of an independent party (ideally from a pool of appropriately qualified dispute resolution practitioners) to manage any dispute, to keep the process free of bias, and to ensure that only relevant factors are considered.

### **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 an adverse change in business status. It is unclear why the dismissal requirements are not consistent between the prequalified and non-prequalified members, and further guidance is requested on what would be deemed satisfactory to constitute "an adverse change in business status" or "capacity" in the context of the Guidelines. 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. Without clear guidance, and established considered non-legal appeal mechanisms, the dismissal of a member could become a legal dispute which would have financial and reputational costs for all parties.

It is also unclear how a Council would become aware of a bankrupt member, unless the member self-disclosed, hence a council may need to undertake an annual bankruptcy check of members.

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. A possibility to resolve this could be for the Guidelines to require an ARIC member to stand aside until the matter is determined, and a new (possibly temporary) member appointed in the absence of the Guidelines permitting proxy members. This would enable the ARIC to continue to function to full effect, particularly for tier 1 and tier 2 councils where a loss of one member may affect quorum.

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

The rigour in meeting certain pre-qualification requirements (for the Chair of any ARIC, and for at least one other member for tier 2 councils) may make it hard to attract suitably qualified candidates, or at least attract a range of quality candidates to consider for many rural and regional councils. The pre-qualification process is expected to be an additional challenge to attracting qualified candidates, as will the increasingly onerous obligations on members which are akin to directors' duties, and the expected increased demands on members' time could all be a disincentive to many local community members who possess the skill set and could provide a valuable contribution.

This issue could be managed through the adoption of a tiered reporting and assessment process, as proposed in point 3 of this submission. Although there are regional centres within an hour of Council, factoring in travel time can be a constraint for many potential candidates.

In a regional Local Government Area, such as Byron Shire with a very small resident population (31,550 residents as at the 2016 ABS census), the requirement for pre-qualification of one member other than the Chair, could also present a challenge. The tier 1 exemption should also apply to tier 2 councils such that if a suitable pre-qualified independent member cannot be found, a council could apply for a waiver from this requirement from the Department of Planning, Industry and Environment.

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 recommendations and advice, however, the prescriptive list contained in Guidelines (page 23) could disqualify many suitably qualified ARIC members in some regional and rural local government areas. 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. For example, 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 child works casually at a local business which provides services to Council.

The Guidelines, as drafted, do not allow councils to manage any actual or perceived conflict of interest, or to exercise any discretion, when councils are otherwise entrusted to manage conflicts regularly across day-to-day business (including at council meetings and in the context of council decisions).

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

The Guidelines require further 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, but also that initial membership is four years (one council term). The Guidelines further state (on the same page) that membership renewal dates are to be staggered to ensure there is no loss of corporate knowledge. It is suggested that to ensure there is knowledge continuity on the ARIC that a percentage, or majority, of independent members remain on the ARIC during the length of the Council term to reduce the risk.

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 considered when appointing members pursuant to the new Guideline requirements which are expected to commence from June 2027. For example, is a Chair precluded from seeking membership of the ARIC if they served for eight consecutive years immediately prior to the commencement of the ARIC membership provisions in 2027? Or does the two consecutive term maximum appointment provision only apply to ARICs appointed from 2027?

## **10. Councillor member on the ARIC**

Byron Shire Council supports at least one member of the ARIC being a councillor member (non-voting), as there is significant value to the ARIC, and the governing body, in the councillor member being able to contribute to discussions from a governing body perspective, as well as being a conduit for providing contextual information to both parties on key priorities. The Office of Local Government may wish to consider making this position a voting position given the majority of ARIC members under the new arrangements will be independent.

## **11. 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.

## **12. 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 another 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 oversight for 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 directly with the General Manager or senior manager overseeing the audit function, 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 of a council has no role in the reporting of the internal audit findings to the ARIC. In practice, if a council General Manager is expected to prepare and implement action plans to address any internal audit findings, the internal auditors should be able to canvas their findings with the General Manager prior to reporting to the ARIC. This ensures that the General Manager can sufficiently resource and respond to recommendations. It will also be the secretariat function that prepares the report on behalf of the internal auditors to the ARIC, and in practice many councils require agenda items and reports to be approved by senior management for inclusion on an ARIC agenda.

It is concerning that the ARIC is not required to consult or consider the priorities of the Council or consider any 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.

## **13. 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 ARIC member provisions (which are in the terms of reference) must be in place by June 2027.

### **Other matters:**

14. The devolution of risk management into a formal framework under legislation has the potential for the approach taken by councils to risk management to become more risk averse for fear of criticism or adverse findings from regulators.
15. Proxies are not permitted for ARIC members (quorum for a tier 2 council with the minimum three independent members is two voting members). The prohibition of proxy members has the potential to be problematic for tier 1 and tier 2 councils who appoint only minimum membership (due to resourcing constraints), should a member resign/depart suddenly as it

may result in the delay of ARIC meetings and impact council business. This could be resolved by giving the councillor member voting rights or permitting independent member proxies.

- 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 (i.e., 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 stand-alone 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. It is recommended this be addressed in the Guidelines.
- 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). It should be open to a suitably qualified or experienced senior manager within council rather than only reside with the staff member who provides coordination and administrative support to the ARIC (refer page 59 of Guidelines).