

Draft

**LGNSW Response to
Proposed Risk Management and
Internal Audit Framework**

December 2019

INTRODUCTION

Local Government NSW (LGNSW) is the peak body for local government in NSW, representing NSW general purpose councils and related entities. LGNSW facilitates the development of an effective community-based system of local government in the State.

LGNSW welcomes the opportunity to comment on the new Risk Management and Internal Audit Framework proposed for NSW local government. This submission is a draft awaiting review by the LGNSW Board. Any amendments made will be forwarded in due course.

GENERAL COMMENTS

LGNSW recognises the importance of the internal audit function within councils and supports the introduction of independent audit and risk management committees in principle. However, LGNSW and councils are concerned that the new Risk Management and Internal Audit Framework (the Framework) proposed by the Office of Local Government (OLG) represents regulatory overkill. Key concerns about the Framework include:

- **Over prescription.** The Framework lacks adequate flexibility and scalability to cater for the different needs and characteristics of councils.
- **Lack of engagement of the elected body.** The Framework prescribes that the Audit Risk and Improvement Committee (ARIC) will consist only of independent members. Excluding Councillor membership breaks a valuable connection between the ARIC and the governing body of council.
- **High costs** to be incurred in implementing and maintaining the Framework.
- **Powers of the ARIC.** Councils are concerned that the Framework provides the ARIC with powers over council staff and resources beyond, when it is meant to be an advisory body.
- **Potential duplication of oversight** adding to the excessive regulatory and reporting burden already imposed on local government in NSW.

There is overarching concern the proposed Framework will impose a much more rigorous, resource intensive and onerous audit and risk management regime on NSW local government than applies in other jurisdictions, or to State Government and corporations. The Framework discussion paper fails to make a compelling case for the imposition of such heavy handed regulation.

LGNSW is disappointed that little heed appears to have been paid to the findings and recommendations of the IPART Final Report on the *Regulatory and Compliance Burdens on Local Government*.

KEY ISSUES

Over Prescription – Lack of Flexibility and Scalability

The proposed Framework is a prescriptive “one size fits all” model that fails to recognise the diversity of councils in NSW. The Framework does not provide adequate scalability. It only concedes minimal variances in terms such as scaled sitting fees and allowing shared internal audit arrangements, including ARICs. The core elements of governance structure and reporting and compliance arrangements will apply to all councils regardless of size or relative risk.

The Framework contradicts the Australian Standard on which it is meant to be based. Among other things, AS ISO 31000:2018 states that an organisation’s approach to risk management must be based on the following principles to ensure it is effective:

- the risk management framework and process is customised to the organisation
- risk management is inclusive of all stakeholders and enables their knowledge, views and perceptions to be considered
- risk management takes into account human and cultural factors
- integration of risk management into a council should be a dynamic and iterative process, customised to the organisation’s unique needs and culture
- the organisation’s risk management framework must be based on the unique needs, characteristics and risks of the organisation, and its external and internal context.

The Framework fails to satisfy these principles and therefore does not deliver the NSW Government’s desired outcome of an approach that reflects the unique structure and needs of NSW local government and minimises the administrative and resource impacts for councils.

LGNSW agrees with Rous County Council that at a minimum, the Framework needs to allow for differentiation of councils based on category and type (general purpose or special purpose county councils).

Engagement with the Elected Body

LGNSW maintains councils should have the option of appointing Councillors to the ARIC in addition to independent members. This is the practice of many councils that already have ARICs. Councillor representation provides for clear communication between the elected body and the ARIC and helps ensure that both bodies understand their respective roles and responsibilities. LGNSW agrees with the position submitted by The Hills Council that as the elected body of council provides oversight and is responsible for the financial performance of councils, it is appropriate that Councillors are represented on the ARIC.

Without Councillor membership, the main form of communication between the ARIC and the elected body will be through formal minutes and the annual report. This one-way communications channel is not conducive to effective interaction between the two bodies.

LGNSW understands that the practice of having board member representation on ARICs is common in the private sector, being allowed by the ASX Corporate Governance Council and other authorities. It also accords with the following AS ISO 31000 principle:

- risk management is inclusive of all stakeholders and enables their knowledge, views and perceptions to be considered.

High Cost

It is difficult to quantify the costs of implementation and the ongoing operation of the Framework based on the information available. However, conservative estimates submitted by The Hills Shire Council indicate the cost of internal audit and risk management expertise, secretariat support and payment of sitting fees to ARIC members will exceed \$500,000 per annum.

The Hills is a large council, but given the lack of scalability of the Framework, the costs for smaller councils are likely to be only marginally lower. LGNSW recognises that the Framework allows for shared audit and risk management functions, including Chief Audit Executive (CAE) and the ARIC, however the extent of these potential savings is unknown and forming such shared service arrangements may prove to be elusive.

Adoption of the Framework will involve a major cost imposition on councils that will need to be recovered by increased rates or cuts to services.

Powers

The Framework discussion paper states the ARIC is to provide an advisory and assurance role only, and is to have no administrative function, delegated financial responsibility or any management functions (p30). However, elsewhere the Framework infers the ARIC will have a range of powers in relation to access to staff and resources and have decision making roles. For example, disputes between the General Manager and the CAE are to be resolved by the ARIC, while the General Manager is meant to be accountable to the elected body.

The role of the CAE, reporting lines and delegations also seem to have the potential to generate conflict. For example, having the CAE report functionally to the ARIC and administratively to the general manager will be a potential source of tension. The CAE is employed by the General Manager but is required to assess and report on the effectiveness of the General Manager in discharging their role. There are obvious practical difficulties with this approach.

Duplication of Oversight

Local government in NSW is already subject to extensive oversight by the OLG, the Audit Office, ICAC, the NSW Ombudsman and a range of other State Government agencies that interact with councils. Many councils feel that the proposed Framework is unnecessarily onerous and inflexible given the high level of transparency and accountability that already applies to local government.

OTHER ISSUES

Committee Members

LGNSW objects to the proposal that ARIC members are to be exclusively selected from the panel of prequalified audit and risk committee independent chairs and members administered by the NSW Government (NSW Procurement - a business entity of the NSW Government).

Councils should have the option of securing suitably qualified people through other channels such as Local Government Procurement, the procurement operations of ROCs and JOs or through direct advertising. It is inappropriate for the Framework to dictate the source of candidates and create a monopoly provider.

Further, the prequalification criteria should include knowledge and understanding of local government. Local government is very different to the private sector and other spheres of government. Knowledge of the roles, responsibilities and operation of local government would help make ARIC members more effective.

Regulations & Guidelines

LGNSW, councils and other stakeholders cannot provide a comprehensive response on the proposed Framework in the absence of the draft regulations and guidelines that will support it. The discussion paper advises the Framework will be supported by new regulations. These will prescribe the requirements that councils are to comply with when appointing their Audit, Risk and Improvement Committee and establishing their risk management framework and internal audit function. They will also include internal audit as a function of the Committee under section 428A(2)(i) of the Local Government Act. The Local Government Regulation will provide the Model Internal Audit Charter and Model Terms of Reference for Audit, Risk and Improvement Committees which all councils must adopt and comply with. This information is critical for assessing the Framework.

CONCLUSION

LGNSW supports the objective of improving internal and risk management in councils and is mindful of the significant advances that have been made over the past decade or so. LGNSW has long advocated the adoption of the internal audit function and the establishment of audit and risk committees by councils.

LGNSW supports the general intentions of the proposed Framework but does not support the Framework as it currently stands. The proposed Framework will impose a costly and unwarranted regulatory burden on NSW local government.

LGNSW will be pleased to work with OLG on a revised Framework that will provide scalability and a greater degree of flexibility to help ensure that audit and risk management systems in councils are commensurate with risk.

Please contact Shaun McBride, Chief Economist, on 9242 4072 or email shaun.mcbride@lgnsw.org.au if you would like to discuss any aspect of this submission.

