

# **Draft Submission to Office of Local Government on Draft Guidelines for Risk Management and Internal Audit for Local Councils in NSW**

November 2021

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## 1. 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 Office of Local Government (OLG) draft Guidelines for Risk Management and Internal Audit for Local Councils in NSW.

This is a draft submission and is subject to review and approval of the LGNSW Board. Any changes will be advised at the earliest opportunity.

## 2. Background

LGNSW recognises the importance of the internal audit and risk management functions in organisations and has promoted the strengthening of these functions in the local government sector. Robust internal audit and risk management processes are essential to improved accountability, transparency and protecting councils from avoidable risk. LGNSW recognises the need to establish Audit and Risk and Improvement Committees (ARICs) to oversee these functions. LGNSW agrees that the ARICs should have a high degree of independence if they are to be effective. LGNSW itself has established an independent ARIC to strengthen governance in our own organisation.

The majority of councils have strengthened their audit and risk management practices over the past decade and most now have some form of audit and risk management committee in place.

The OLG's draft Risk Management and Internal Audit Framework put out for consultation in 2019 (the Framework) was generally supported in principle by local government but it also generated considerable debate, with many councils raising concerns about many elements of the proposed Framework. LGNSW's December [2019 Submission](#) on the Framework reflected these views. Common issues raised in response to the proposed Framework included:

- **Lack of Flexibility:** The Framework lacked adequate flexibility and scalability to cater for the different needs and characteristics of councils. For example, it did not adequately recognise the resource limitations of rural and regional councils and the difficulty in attracting qualified ARIC members.
- **Lack of engagement of the elected body:** The Framework prescribed that the Audit Risk and Improvement Committee (ARIC) will consist only of independent members. Excluding Councillor membership was seen to break a valuable connection between the ARIC and the governing body of council.
- **High costs** to be incurred in implementing and maintaining the Framework. This includes sitting fees, superannuation, insurance, travelling and accommodation costs where face to face meetings are held, the cost of administrative support, demands on council staff and the costs of any external advice that may be commissioned by the ARIC.
- **Powers of the ARIC and potential conflicts:** Councils were concerned that the Framework provided the ARIC with powers over council staff and resources when it is only meant to be an advisory body. Councils raised the potential for conflict and complications arising from the dual reporting lines of the Internal Auditor.
- **Potential duplication of oversight:** With local government already being subject to extensive regulation and scrutiny by numerous State Government agencies, the Auditor General and ICAC.

The overarching concern was that the proposed Framework would impose an excessive regulatory burden on councils.

LGNSW commends the OLG for its comprehensive consultation with the sector in developing both the Framework and subsequently, the Draft Guidelines. It is clearly evident that the OLG has been receptive to the views of councils on the Framework and has sought to incorporate constructive responses in the draft Guidelines. The key responses are summarised in the following section.

### **3. OLG Responses**

LGNSW welcomes the changes proposed by the OLG. There appears to be broad acceptance of the draft Guidelines, with councils generally acknowledging that they go a long way towards addressing many of the issues raised by councils. The key changes include:

- A new tiered ARIC model for metropolitan, regional and rural/remote councils and joint organisations and county councils with reduced prequalification requirements to better reflect the different needs of councils and their ability to attract ARIC members enabling a mix of prequalified, non-prequalified, independent and non-voting Councillor members and new eligibility criteria for non-prequalified and councillor members.
- A more 'principles-based' approach to the ARIC, Internal Audit and Risk Management functions reduce prescription.
- Clearer links between the ARIC and the governing body to ensure the governing body receives maximum value from ARIC's expertise.
- Reduced ARIC costs with ARIC member fees to be at council's discretion.
- ARIC members can have more local government experience with some independence requirements reduced and new ability to allow local community perspective/knowledge as a criterion for appointment to an ARIC.
- Clearer links between the ARIC and the governing body to ensure the governing body receives maximum value from ARIC's expertise. This includes annual and quarterly meetings.
- Stronger ARIC member appointment and induction processes.
- More flexibility for councils regarding confidentiality of ARIC agendas and minutes.
- ARIC given unrestricted access to general manager and senior staff only – access to other staff requires general manager's approval.
- New ability for shared arrangements for councils, county councils and joint organisations to reduce costs.
- More flexibility in implementation and workforce resourcing, e.g. risk management refocused as a 'function' rather than a dedicated position so it can be shared with other council roles and fit into council's existing organisational structure.
- Some clarification of internal audit dual reporting line to the ARIC and general manager.
- More flexibility to implement the internal audit function within council's existing organisational structure and attract internal audit staff, including removal of specific role title for the head of the internal audit function and provision for internal audit function to report to a staff member other than the general manager.
- Performance review process streamlined to reduce costs.
- Expanded resources providing templates, examples, checklists, tools etc for internal audit and risk management functions.
- Attestations to be signed by general manager, no requirement for ARIC Chair to co-sign.

LGNSW also welcomes the staged implementation with the Framework to commence on 4 June 2022 with full compliance for Internal Audit and Risk Management deferred until 2024 and full compliance for ARIC composition deferred to 2027. This will provide time for the Framework to be concurrently tested and modified if needed.

## 4. Ongoing Concerns

Despite the numerous changes the OLG has made, particularly to assist rural and regional councils and Joint Organisations (JOs), many are still of the view that the requirements are still too onerous and are concerned that they will not be able to comply with the new requirements. Feedback from councils ranges from outright opposition to the introduction of ARICs through to modest recommendations to amend the draft Guidelines. The issues largely fall into the same categories as those raised in responses to the draft Framework.

**Securing ARICs Members:** Many councils anticipate difficulty in sourcing suitably qualified ARIC chairs and other independent members for many rural councils, even under less onerous Tier 1 criteria. It should be noted that a number of rural councils couldn't even get sufficient candidates to form a full complement at the council elections, without the obstacle of having to satisfy ARICs membership criteria. Rural councils have less capacity to pay ARIC members, and in many cases will be relying on volunteers. This will adversely impact their ability to attract a suitable Pre-Qualified Chair and other independent members. There are also concerns about potential fee shopping by Pre-Qualified Chairs and other members, forcing up costs. Hay Shire Council has proposed a simplified ARIC membership requirement for Tier 1 councils which is discussed further under Alternative Models below.

**Councillor Membership of ARICs:** LGNSW and councils welcome the inclusion of Councillors as optional members of the ARIC, even in a non-voting capacity. There is a general consensus across councils, rural, regional and metropolitan, that it is valuable to engage Councillors in ARICs, as voting or non-voting members or even as observers. There are benefits to the operating of councils from having Councillors who are aware of ARICs processes. It is also generally accepted that the majority of members should be independent.

Councils have raised the question of why Councillor membership is limited to one. It should be sufficient that the majority of voting members are independent. LGNSW recommends that additional Councillors should be able to participate.

**High Costs:** Many councils, particularly rural councils, are still concerned about the high costs associated with the establishment and maintenance of the ARICs and associated Internal Audit and Risk management processes. As noted above, this includes sitting fees, superannuation, insurance, travelling and accommodation costs where face to face meetings are held, the cost of administrative support, demands on council staff time and the costs of any external advice that may be commissioned by the ARIC. The costs associated with the requirement to comply with Risk Management Standard ISO31000/2018, particularly in relation to human resources, technology and professional development, are also considered prohibitive for rural councils and should be relaxed. A more simplified approach would help avoid some of these costs, an example is discussed under Alternative Models below.

**Potential Conflicts:** Concerns have been expressed about the potential conflicts inherent in the new relationships between ARICs, general managers, council staff and the elected Governing Body. The Framework provides numerous trigger points. These include:

- Dual reporting lines for Internal Audit function which reports to the general manager administratively but functionally reports to the ARIC.
- Internal Audit Professionals also express concern that provision has been made to allow the Head of Internal Audit function to report to another senior officer other than the General Manager. The concern is that this will compromise independence.

- Dual reporting lines for administrative staff who also act as the Secretariat for the ARIC.
- ARIC reporting to council/governing body and subject to performance review by council/governing Body.
- Council/Governing Bodies power to dismiss Chair or other Committee members.
- ARIC capacity to raise matters with the Secretary DPIE, without consultation with the General Manager or council.

**ARIC Membership Terms:** There appears to be a conflict in the draft Guidelines in relation to the objective of staggering terms of ARIC membership so that there is continuity and the proposed alignment of ARICs with council terms. This needs to be clarified. The Guidelines also need to include more detail in relation to performance reviews of the ARIC by the council and the process for dismissing the Chair or other Committee members.

**Joint Organisations:** While the draft Guidelines now place JOs in the newly created Tier 1 with rural councils and county councils, as well as providing for JOs to also share ARICs with member councils, some JOs still maintain that they are too small to warrant the imposition of the new Framework. JOs are mainly very small organisations, often with only one staff member and a focus largely on advocacy and strategy. Core budgets are very small often barely covering staff costs and basic overheads. It is argued that the additional compliance burden would stifle the operations of the JO, diverting resources from their primary functions.

Further, given their small size, administrative and compliance functions such as HR, IT and finance are commonly outsourced to a member council, meaning that audit and risk management functions are in practical terms covered by the supporting council.

Taking these factors into account, LGNSW recommends that the OLG consider the proposal from a number of JOs to establish an exemption threshold for compliance of \$1-\$1.5 million in core funding. Core funding being defined income that does not include tied grants from the State or Federal Governments.

This would be a simple solution that recognises the practical realities of JOs.

**Alternative Models:** Some rural and regional councils have suggested alternative models that would be less onerous for rural councils than the Tier 1 requirements and better recognise their resource constraints and isolation. LGNSW recommends that the OLG give serious consideration to the model proposed by Hay Shire Council in their submission. This presents an alternative model that would help overcome the key problems of high costs and securing ARIC members.

The model presents an option where ARIC membership would be drawn from other councils with General Managers as Chairs and other expert council staff such as Chief Financial Officers as members. This would be in addition to Councillor membership and community representative membership proposed under the draft Guidelines.

## 5. Conclusion

LGNSW has supported the phased introduction of robust internal audit and risk management practices over the past decade and it should be acknowledged that councils have substantially improved their performance in these areas over that time. LGNSW commends the OLG for responding positively to the issues raised by local government in response to the draft Framework released in 2019 and welcomes the numerous amendments made in the draft Guidelines.

However, councils still have a number of legitimate concerns about the draft Guidelines and we strongly urge the OLG to give serious consideration to the issues and recommendations presented above.

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