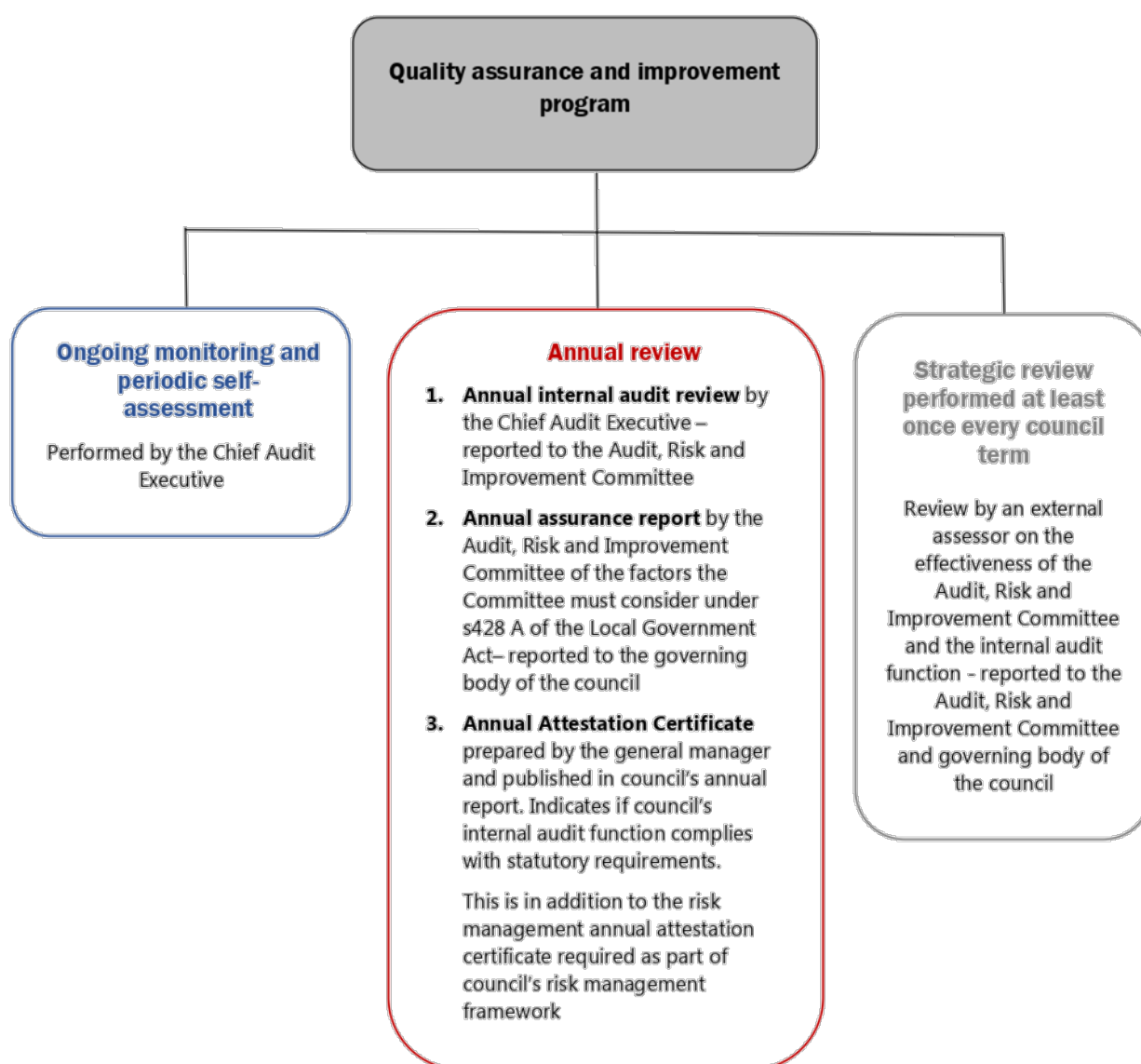


Core requirement 8: **Establish a quality assurance and improvement program**

Proposal

It is proposed that:

- (a) the Chief Audit Executive is to establish a quality assurance and improvement program which includes ongoing monitoring and periodic self-assessments, an annual review and strategic external review at least once every council term, and
- (b) the general manager is to publish in the council's annual report an annual attestation certificate indicating whether the council has complied with the core requirements for the Audit, Risk and Improvement Committee and the internal audit function.



Description

(a) The Chief Audit Executive is to establish a quality assurance and improvement program which includes ongoing monitoring and periodic self-assessments, an annual review and strategic external review at least once each council term

The Chief Audit Executive is to ensure that there is a documented and operational quality assurance and improvement program for assurance activities that is reported to the governing body of the council. The quality assurance and improvement program is to consist of three key elements:

1. **Ongoing monitoring and periodic self-assessments** by the Chief Audit Executive
2. **An annual review** at the end of each financial year by the:
 - Chief Audit Executive on the performance of the internal audit function for the Audit, Risk and Improvement Committee, and
 - Audit, Risk and Improvement Committee on its responsibilities under section 428A of the Local Government Act for the governing body of the council,
3. **A strategic external review at least once every council term** (i.e. four years) by an external party which is reported to the Audit, Risk and Improvement Committee and the governing body of the council.

These are described in greater detail below.

Ongoing monitoring and periodic self-assessments

The Chief Audit Executive is to undertake ongoing monitoring and periodic self-assessments of the internal audit function throughout the year to validate that it is operating effectively and delivering quality and value.

Monitoring and self-assessments could consider, for example:

- compliance with regulatory requirements and the IPPF
- the quality and supervision of audit work performed
- standardised work practices
- communication practices
- timeliness of audit activities
- any professional development or training required
- client satisfaction and the degree to which stakeholder expectations are being met
- the adequacy of internal audit policies
- progress towards key performance indicators, and
- any weaknesses or areas that need improvement.

The Chief Audit Executive is to implement any changes necessary to address deficiencies identified through ongoing monitoring and periodic self-assessment.

Annual performance review

The annual review (performed at the end of each financial year) is to assess the assurance activities that occurred over the preceding financial year. It is to consist of the following two elements, which together will ensure that the council's assurance activities are comprehensively assessed and any issues identified.

1. An annual internal audit review by the Chief Audit Executive for the Audit, Risk and Improvement Committee which assesses:

- how effectively council has implemented the internal audit function (for example, that findings are communicated and implemented appropriately, resourcing is sufficient, the Internal Audit Charter remains appropriate etc.)
- how the internal audit function has performed against the annual work plan and performance targets, and
- how the internal audit function and activities comply with statutory requirements and the IPPF and
- the independence of the internal audit function.

This will ensure that the Audit, Risk and Improvement Committee receives the Chief Audit Executive's advice on the effectiveness of the internal audit function each year. It will also enable the general manager to complete the council's annual attestation certificate (see below).

2. An annual assurance review by the Audit, Risk and Improvement Committee for the governing body of the council which includes:

- a summary of the work the Committee performed to discharge its responsibilities during the preceding year
- advice on the appropriateness of the Committee's terms of reference (where they contain additional clauses that are not included in the Model Terms of Reference)
- an overall assessment of the following aspects of the council's operations in accordance with section 428A of the Local Government Act:
 - compliance
 - risk management
 - fraud control
 - financial management
 - governance
 - implementation of the strategic plan, delivery program and strategies
 - service reviews
 - collection of performance measurement data by the council, and
 - any other matters prescribed by the regulation (i.e. internal audit), and
- information to help the council improve the performance of its functions.

This will ensure that the governing body of council receives the Audit, Risk and Improvement Committee's independent assurance about these matters in accordance with legislative requirements each year. This will support the governing body in the exercise of its oversight role under the Local Government Act.

The general manager and senior managers are to be advised of the findings and outcomes of the annual review and the Chief Audit Executive is to develop an action plan for the Audit, Risk and Improvement Committee, governing body of the council and general manager to address any issues identified in the annual review.

Strategic external review

An external assessment of council's assurance activities is to be conducted at least once every council term (i.e. four years) by a qualified, independent assessor according to the IPPF quality assessment framework. Requiring compliance with the IPPF will ensure that each council can have confidence in the findings and that councils are assessed consistently across the sector.

The strategic review is to be commissioned by the governing body of the council and reported to the Audit, Risk and Improvement Committee, governing body and the general manager. The Chief Audit Executive is to develop an action plan for the Committee, governing body of the council and general manager to address any issues identified in the external review.

The external review is to include the following two components:

- **the effectiveness of the Audit, Risk and Improvement Committee**, including:
 - whether the Committee has fulfilled its terms of reference
 - the appropriateness of the Committee's terms of reference (where the Committee's terms of reference contain additional provisions not contained in the Model Terms of Reference)
 - the performance of Committee members
 - the way the Committee, external auditor, council and internal audit function work together to manage risk and support the council and how effective this is, and
 - whether the Committee has contributed to the improvement of the factors identified in section 428A of the Local Government Act.

The external review is to address the collective performance of the Audit, Risk and Improvement Committee and the individual performance of each member and the Chair. The review is to consider feedback on each member's performance by the Chair of the Committee, mayor and general manager.

This component of the four-yearly external review will provide accountability and ensure that the governing body of the council can assess how the Audit, Risk and Improvement Committee is functioning and whether any changes to the Committee's terms of reference or membership are required.

In considering the outcomes of the external strategic review, the governing body of the council will be able to request the Chair of the Committee to address the council and answer any questions about the operation of the Committee.

- **the effectiveness of the internal audit function**, including:
 - the independence of the internal audit function
 - whether resourcing is sufficient
 - whether the internal audit function complies with statutory requirements and the IPPF
 - the appropriateness of annual work plans and strategic plans based on the risks facing the council
 - whether the internal audit function adds value and delivers outcomes for the council, and
 - the appropriateness of the Internal Audit Charter (where it includes additional provisions not contained in the Model Internal Audit Charter).

This component of the strategic external review will ensure that the governing body of the council is able to assess whether the internal audit function is effective and adding value to the council and whether any changes are required. The governing body of the council will be able to request the Chair of the Audit, Risk and Improvement Committee and/or the Chief Audit Executive to address the council and answer any questions about the internal audit function.

External assessor

The governing body will be able to commission the strategic external review by either engaging an external assessor to undertake the assessment, or by undertaking a self-assessment and engaging a qualified external reviewer to conduct an independent evaluation of that self-assessment.

The external assessor must have, at a minimum:

- no real or perceived conflicts of interest
- certification as an internal auditor
- knowledge of internal audit and external assessment practices, and
- sufficient recent experience in internal audit at a management level which demonstrates a working knowledge of statutory requirements and the IPPF.

The strategic review report is to outline the qualifications of the assessor and any potential conflicts of interest.

(b) The general manager is to publish in the council's annual report an annual attestation certificate indicating whether the council has complied with the core requirements for the Audit, Risk and Improvement Committee and internal audit function

The general manager will be required to annually publish an attestation statement in the council's annual report indicating whether, during the prior financial year, the council was 'compliant', 'non-compliant' or 'in transition' against each of the core requirements of the Audit, Risk and Improvement Committee and council's internal audit framework. The certificate can be combined with the risk management attestation certificate required as part of the council's risk management framework.

Compliance status is to be self-assessed based on the results of the annual performance review. The following table lists the proposed compliance categories and follow-up action that will be required.

Councils that are 'non-compliant' can apply to the Chief Executive Officer of the Office of Local Government for an exemption from statutory requirements. The Chief Executive Officer will be able to grant exemptions to any or all statutory requirements and will be able to impose conditions on the exemption given.

An exemption will only be granted where:

- a council cannot comply because of temporary extenuating circumstances, substantial structural constraints or resourcing constraints that will materially impact the council's operating budget
- the council is not able to enter into a shared arrangement with another council/s in order to comply (for internal audit only), and
- current or proposed alternative arrangements will achieve outcomes equivalent to the requirements.

The maximum period an exemption can apply will be 24 months (two reporting periods). Any further exemption must be reapplied for.

The council's application for an exemption must:

- be in writing
- be made prior to the reporting period in which full compliance with statutory requirements cannot be achieved or as soon as circumstances arise during the reporting period that will make full compliance throughout the reporting period impossible
- provide the reasons why the council cannot comply with statutory requirements, and
- describe and demonstrate the council's efforts to implement alternative arrangements and how these will achieve an outcome equivalent to the requirements.

The general manager is to ensure that a copy of the attestation statement and the exception approval from the Chief Executive Officer of the Office of Local Government (if applicable) is published in the council's annual report. A copy of the attestation statement is to also be provided to the Office of Local Government.

The Chair of the Audit, Risk and Improvement Committee is to also sign the attestation statement where they agree that it is a true and accurate reflection of the council's compliance status against statutory requirements.

Proposed compliance status for attestation certificates

Definition	Further requirements
COMPLIANT	
The council is 'compliant' if it has implemented and maintained practices consistent with statutory requirements for the whole of the financial year	The council is to provide a copy of its attestation statement to the Office of Local Government and publish the attestation certificate in the council's annual report.
NON-COMPLIANT	
<p>The council is 'non-compliant' if:</p> <ul style="list-style-type: none"> it has not implemented and maintained a risk management framework or internal audit practices consistent with statutory requirements for the whole of the financial year, or the council's Audit, Risk and Improvement Committee and internal audit function has been in place for more than five years but has not been externally assessed (for internal audit only) 	<p>The general manager will be required to apply to the Chief Executive Officer of the Office of Local Government for an exemption from statutory requirements</p> <p>The council's application for an exemption must:</p> <ul style="list-style-type: none"> be in writing be made prior to the reporting period in which full compliance with statutory requirements cannot be achieved or as soon as circumstances arise during the reporting period that will make full compliance throughout the reporting period impossible provide the reasons why the council cannot comply with statutory requirements, and describe and demonstrate the council's efforts to implement alternative arrangements and how these will achieve an outcome equivalent to the requirements. <p>The general manager must ensure a copy of the attestation statement and the Chief Executive Officer's exemption approval (if applicable) is published in the council's annual report. A copy of the council's attestation statement is also to be sent to the Office of Local Government.</p> <p>The council will also have to explain on the attestation statement why it is not compliant and if it has received an exemption from the Chief Executive Officer.</p>
IN TRANSITION	
<p>The council is 'in transition' if it is transitioning its operations to the statutory requirements during the financial year because:</p> <ul style="list-style-type: none"> it is a newly constituted council established after the risk management and internal audit requirements of the Local Government Act and Regulation came into force (a two-year transition period will be granted in this instance), or the requirements that are not complied with have been newly prescribed within the last two years and the council is in the process of implementing them. 	<p>Councils taking advantage of the transitional arrangements will not be required to apply for approval from the Chief Executive Officer of the Office of Local Government. However, councils must be actively taking steps during the two-year (for internal audit) and five-year (for risk management) transitional period to commence implementation and detail how the council plans to achieve compliance within this period.</p> <p>The council is to provide a copy of its attestation statement to the Office of Local Government.</p>

Core requirement 9:

Councils can establish shared internal audit arrangements

Proposal

It is proposed that:

- (a) a council can share all or part of its internal audit function with another council/s by either establishing an independent shared arrangement with another council/s of its choosing, or utilising an internal audit function established by a joint or regional organisation of councils that is shared by member councils
- (b) the core requirements that apply to stand-alone internal audit functions will also apply to shared internal audit functions, with specified exceptions that reflect the unique structure of shared arrangements, and
- (c) the general manager of each council in any shared arrangement must sign a 'Shared Internal Audit Arrangement' that describes the agreed arrangements.

Description

(a) A council can share all or part of its internal audit function with another council/s by either establishing an independent shared arrangement with another council/s of its choosing, or utilising an internal audit function established by a joint or regional organisation of councils that is shared by member councils

Councils that do not want to establish a stand-alone internal audit function will be able to:

- share all or part of their internal audit function with another council/s of their choosing as part of an independent shared arrangement, or
- utilise a joint internal audit function established by their joint or regional organisation of councils that is shared with other member councils.

These options will:

- assist smaller councils to implement their internal audit function in a more cost-effective way where:
 - a full-time committee, Chief Audit Executive or internal audit function is not necessary
 - the council's risk profile does not warrant stand-alone arrangements, and/or
 - the cost of having a stand-alone arrangements will significantly and unacceptably impact the council's operating budget
- assist councils in remote locations that may find it difficult to employ or appoint the suitably qualified personnel that are necessary to support a stand-alone internal audit function
- allow councils to access a larger resource pool than would be available to a single council
- create efficiencies through common systems, shared knowledge and internal audit tools, and
- potentially lower audit costs.

When deciding the most appropriate way to establish a council's internal audit function, the general manager should consider the viability and capacity of a shared Audit, Risk and Improvement Committee, Chief Audit Executive or internal audit function to meet their responsibilities given the:

- size of the council in terms of both staffing levels and budget
- geographical and functional distribution of the council's operations
- complexity of the council's core business

- risk profile of the council's operations
- expectations of stakeholders, and
- likely demands placed on the committee, Chief Audit Executive or internal audit function by other councils in the shared arrangement.

A shared arrangement should only be established where the shared internal audit function can maintain a high level of understanding and oversight of each council's operations and internal audit function, as well as effective working and reporting relationships with the general manager and governing bodies of each council.

(b) The core requirements that apply to stand-alone internal audit functions will also apply to shared internal audit functions, with specified exceptions that reflect the unique structure of shared arrangements

The majority of the core requirements outlined in this discussion paper that apply to stand-alone internal audit functions will also apply to shared internal audit arrangements.

This means that any shared internal audit function must operate as an individual resource for each council that meets each council's unique internal audit needs. In terms of roles and responsibilities:

- the **Audit, Risk and Improvement Committee** is to operate as an individual committee for each council in any shared arrangement⁶⁵. This includes the committee:
 - providing independent assurance and oversight for each council
 - endorsing each council's Internal Audit Charter, annual work plan and four-year strategic plan
 - holding individual meetings for each council that are separately minuted⁶⁶ and observers being invited to only attend that part of the committee meeting that relates to their council
 - liaising with the respective governing bodies and general managers of each council in relation to that council's internal audit issues
 - approving individual performance indicators for each council based on that council's needs and operations
 - fulfilling the requirements of each council's quality assurance and improvement program and conducting a separate annual review for each individual council based on that council's internal audit activities which is reported to the governing body of that council
 - maintaining separate and confidential information for each council
- the **Chief Audit Executive** (who may be employed by one of the participating councils or by a joint or regional organisation of councils) is to work separately with each council in any shared arrangement to implement the internal audit function for that council. This includes the Chief Audit Executive:
 - liaising with the governing body and general manager of each separate council about that council's internal audit activities
 - individually developing and implementing the annual work plan and four-year strategic plan for each council, based on each council's individual requirements and in consultation with that council's general manager
 - developing and maintaining internal audit policies and procedures for each council based on that council's needs and operations

⁶⁵ Under the NSW Government's prequalification scheme, membership on any shared Audit, Risk and Improvement Committee will count as one towards the limit of five memberships allowed for a committee member

⁶⁶ Individual meetings for each council can be held sequentially but joint or shared meetings discussing multiple councils must not be held (apart from common agenda items, for example, the Audit, Risk and Improvement Committee's terms of reference, Internal Audit Charter etc.)

- conducting the individual audits of each council
- confirming the implementation by the council of corrective actions that arise from the findings on internal audit activities
- submitting to each respective council an individual report after each internal audit and liaising with the general manager of each respective council (and governing body where necessary) on that council's internal audit issues
- managing any contractual arrangements for externally provided internal audit personnel on behalf of each council in the shared arrangement
- fulfilling the requirements of each council's quality assurance and improvement program and conducting a separate annual review for each individual council based on that council's internal audit activities which is reported separately to the Audit, Risk and Improvement Committee
- attending the Audit, Risk and Improvement Committee meetings of each respective council on behalf of that council
- maintaining separate and confidential information for each council
- providing independent assurance and oversight for each council, and
- **internal audit personnel** (who may be employed by one of the participating councils or by a joint or regional organisation of councils or supplied through an external provider) are to operate as an individual internal auditor/internal audit team for each council in any shared arrangement. This includes internal audit personnel conducting the individual internal audits of each council.

Given there are multiple councils and therefore multiple decision-making bodies involved, shared arrangements will have a number of unique requirements that will be different to those that apply to a stand-alone internal audit function. These are described below.

Unique requirements for independent shared arrangements

Decision-making body

The governing body and general manager of a council are the key decision-makers in a council in relation to internal audit. However, given that any shared arrangement will have more than one governing body and general manager, decision-making in relation to a shared internal audit function is likely to be administratively complex.

To simplify and streamline decision making, councils in an independent shared arrangement will be required to establish a committee comprising of councillors from each of the participating councils under section 355 of the Local Government Act. This committee will make the following decisions (where applicable) about the Audit, Risk and Improvement Committee, Chief Audit Executive or internal audit function that would otherwise be made by the governing body of each council, and each council will be required to delegate these decisions to the committee:

- approving the Internal Audit Charter (after endorsement by the Audit, Risk and Improvement Committee), so it can then be adopted by each individual council
- determining the size of the shared Audit, Risk and Improvement Committee
- appointing and dismissing members and the Chair of the shared Audit, Risk and Improvement Committee
- approving the terms of reference of the Audit, Risk and Improvement Committee (after endorsement by the Committee), so it can then be adopted by each individual council, and
- approving internal audit policies and procedures (in consultation with the Audit, Risk and Improvement Committee and the general managers of each participating council), so they can then be adopted and implemented by each individual council.

Where an Audit, Risk and Improvement Committee is shared, each council in the shared arrangement will still be required to adopt and implement their own Internal Audit Charter, terms of reference for the Audit, Risk and Improvement Committee, and internal audit policies and procedures.

Committee members will be required to consult with other members of the governing body of their council on any decisions made. All other functions assigned to the governing body of a council in core requirements 1-8 will remain with each individual council.

Auspecting body

Where the Chief Audit Executive and other internal audit personnel are shared by councils, these positions must be employed by one of the participating councils in the shared arrangement and located together to work effectively. The Chief Audit Executive must also report administratively to the general manager of the council that employs them.

This will create greater administrative efficiency by reducing reporting and communication lines. It will also ensure that:

- the Chief Audit Executive reports administratively to one general manager on behalf of all councils in the independent shared arrangement
- the Chief Audit Executive, in-house internal audit staff and secretariat staff will be employees of, and located at the auspecting council and have access to necessary administrative and HR support, and
- the Chief Audit Executive and internal audit staff will be subject to the Code of Conduct of the auspecting council.

Administrative responsibility and oversight of the shared internal audit function should be exercised by an administrative oversight committee comprising of all general managers of the participating councils.

The administrative oversight committee will have the following responsibilities in relation to the Audit, Risk and Improvement Committee:

- ensuring adequate procedures are in place to protect the independence of the Audit, Risk and Improvement Committee
- overseeing arrangements for secretariat support for the Audit, Risk and Improvement Committee, and
- receiving written declarations from members that they do not have conflicts of interest that may preclude them from serving on the Audit, Risk and Improvement Committee.

The administrative oversight committee will also have the following responsibilities in relation to the Chief Audit Executive and internal audit staff:

- recommending the appointment and dismissal of the Chief Audit Executive (in consultation with the Audit, Risk and Improvement Committee and governing bodies of each council) – the ultimate decision will be made by the employing general manager, and
- recommending any changes impacting the employment of the Chief Audit Executive (in consultation with the Audit, Risk and Improvement Committee) – the ultimate decision will be made by the employing general manager.

Allegations of breaches of the auspecting council's Code of Conduct by the Chief Audit Executive or internal audit staff are to be dealt with by the auspecting general manager, in consultation with the other general managers.

The general managers of each council will be required to attend the Audit, Risk and Improvement Committee meetings related to their council and to undertake all other functions in relation to internal audit referred to general managers in core requirements 1-8.

Unique requirements for joint/regional organisation shared arrangements

Decision-making body

The member councils of a joint or regional organisation are to delegate their decision making authority in relation to internal audit under section 377 of the Local Government Act to the Board of their joint or regional organisation of councils. The Board will make the decisions that would have otherwise been made by the governing body of each council. This includes:

- adopting the Internal Audit Charter on behalf of each member council (after endorsement by the Audit Risk and Improvement Committee)
- appointing and dismissing members and the Chair of the shared Audit, Risk and Improvement Committee
- adopting the terms of reference of the Audit, Risk and Improvement Committee on behalf of each member council (after endorsement by the Audit, Risk and Improvement Committee), and
- adopting internal audit policies and procedures on behalf of each member council (in consultation with the Audit, Risk and Improvement Committee and the general managers of each participating council).

All other functions assigned to the governing body of a council in core requirements 1-8 will remain with each individual council.

Auspicing body

The shared internal audit function is to be undertaken on behalf of member councils by the joint or regional organisation of councils. This will mean that:

- the Chief Audit Executive will report administratively to the executive officer of the joint/regional organisation
- the Chief Audit Executive, in-house internal audit staff and secretariat staff will be employees of the joint or regional organisation. The Chief Audit Executive and in-house internal audit staff may be located at the joint or regional organisation or at one of the member councils and have access to necessary administrative and HR support supplied through the joint or regional organisation or council, and
- the Chief Audit Executive and internal audit staff will be required to comply with the Code of Conduct of the joint or regional organisation⁶⁷.

The executive officer of the joint/regional organisation will also, on behalf of, and in consultation with each general manager in the shared arrangement, take on the administrative responsibility of some aspects of the shared internal audit function.

In relation to the Audit, Risk and Improvement Committee, this includes:

- determining the size of the Audit, Risk and Improvement Committee
- ensuring adequate procedures are in place to protect the independence of the Audit, Risk and Improvement Committee
- arranging secretariat support for the Audit, Risk and Improvement Committee, and
- receiving written declarations from members that they do not have conflicts of interest that may preclude them from serving on the Audit, Risk and Improvement Committee.

⁶⁷ Where the Code of Conduct of the joint or regional organisation differs from the Model Code of Conduct, the Model Code of Conduct will apply.

In relation to the Chief Audit Executive and internal audit staff, this includes:

- appointing and dismissing the Chief Audit Executive (in consultation with the Audit, Risk and Improvement Committee and governing bodies of each council)
- deciding any changes that may impact the employment of the Chief Audit Executive (in consultation with the Audit, Risk and Improvement Committee), and
- dealing with breaches of the joint/regional organisation's code of conduct by the Chief Audit Executive or internal audit staff.

The general manager of each council will be required to attend the Audit, Risk and Improvement Committee meetings that relate to their council and exercise all other functions of the general managers in relation to internal audit described in core requirements 1-8.

Internal audit requirements for joint organisations

It is important to note that, like councils, joint organisations will also be required to appoint an Audit, Risk and Improvement Committee and have an internal audit function.

The Audit, Risk and Improvement Committee appointed by the joint organisation on behalf of member councils is therefore also to operate as the Audit, Risk and Improvement Committee for the joint organisation and the Chief Audit Executive appointed by the joint organisation is also to oversee the internal audit function for the joint organisation in addition to member councils.

Fees for shared Audit, Risk and Improvement Committee members

The following fee structure that currently applies under the NSW Government's prequalification scheme for Audit and Risk Committee Chairs and Members will apply to all shared arrangements, subject to any change.

Shared Audit, Risk and Improvement Committees	Fee category (based on stand-alone internal audit functions)	Chair fee (excluding GST)	Member fee (excluding GST)
Up to and including three small councils	Medium	\$16,213 per annum	\$1,621 per meeting day including preparation time
Two or more medium councils	Large	\$20,920 per annum	\$2,092 per meeting day including preparation time
Any combination of small and medium councils	Large	\$20,920 per annum	\$2,092 per meeting day including preparation time

(c) The general manager of each council in any shared arrangement must sign a 'Shared Internal Audit Arrangement' that describes the agreed arrangements

The general manager of each council in any shared arrangement will be required to sign a 'Shared Internal Audit Resourcing Agreement' with the other councils in the shared arrangement which agrees the following components.

Shared Internal Audit Resourcing Agreement

Issue	Components to be agreed by councils
Audit, Risk and Improvement Committee	<ul style="list-style-type: none"> • Number of committee members • Term of committee membership • Process for appointing and dismissing the Chair and committee members, including skills and capability requirements • Content, approval and review of the committee's terms of reference • Process for reviewing the committee's performance • Secretariat support arrangements for the committee • The committee's meeting schedule, including the sequencing of meetings to cover each council's requirements and when and how emergency committee meetings can be called • Process for the committee to request others to attend committee meetings or provide additional information about internal audit matters • Arrangements for the provision of information by the committee to the Chief Audit Executive and internal audit personnel, as well as the governing body and general manager of each council
Auspicing arrangements	<ul style="list-style-type: none"> • What the auspicing arrangements will be • What the responsibilities of each council will be • Roles, responsibilities and reporting lines of the internal audit function
Chief Audit Executive and internal audit personnel	<ul style="list-style-type: none"> • Whether internal audit personnel are in-house or contracted through an external provider • Chief Audit Executive and internal audit personnel's purpose, scope, authority, delegations, role, responsibilities and reporting lines • HR matters such as recruitment processes, disciplinary matters, employment conditions, HR support, remuneration • Process for reviewing the performance of the Chief Audit Executive and internal audit personnel as part of each council's quality assurance and improvement program
Administrative arrangements	<ul style="list-style-type: none"> • Content of the Internal Audit Charter as well as how it is approved and reviewed • How costs will be determined, administered and shared • How disputes between councils in the shared arrangement will be resolved • How conflicts of interest, disciplinary or performance issues regarding Audit, Risk and Improvement Committee members, the Chief Audit Executive and internal audit personnel are to be dealt with • Information management and record-keeping • What information, if any, will be shared between councils • How much time the internal audit function spends on each council • Composition of the s 355 committee and the process for appointing and removing members (for independent shared arrangements) • Establishment and operation of the general manager's administrative oversight committee (for independent shared arrangements) • Process for agreeing contractual arrangements with external providers • Procedures and safeguards to be put in place to preserve the independence of the internal audit function

NEXT STEPS

Have Your Say

In developing the risk management and internal audit framework proposed in this paper, the Office of Local Government has considered the recommendations of various inquiries conducted by the Local Government Acts Taskforce, the Independent Local Government Review Panel and the Independent Commission Against Corruption, and the internal audit frameworks of other jurisdictions.

The Institute of Internal Auditors, NSW Treasury, the Department of Finance, Services and Innovation, the NSW Audit Office and the Executive of the Local Government Internal Auditors Network have also provided valuable feedback on earlier drafts of this discussion paper.

We now want to hear from you.

Key questions to consider

- Will the proposed internal audit framework achieve the outcomes sought?
- What challenges do you see for your council when implementing the proposed framework?
- Does the proposed framework include all important elements of an effective internal audit and risk framework?
- Is there anything you don't like about the proposed framework?
- Can you suggest any improvements to the proposed framework?

Submissions may be made in writing by **31 December 2019** to the following addresses.

Post

Locked Bag 3015
NOWRA NSW 2541

Email:

olg@olg.nsw.gov.au

Submissions should be marked to the attention of the Council Governance Team.

Next steps

Feedback will be considered when finalising the risk management and internal audit framework.

Once finalised, the Office of Local Government will notify councils of the new requirements and the steps and timeline for implementation.

Further information

For more information, please contact the Council Governance Team on (02) 4428 4100 or via email at olg@olg.nsw.gov.au.

RESOURCES USED

ACT Government (2007) *Internal Audit Framework*

https://apps.treasury.act.gov.au/_data/assets/pdf_file/0007/617920/Internal-Audit-Framework-April-2007.pdf

Alexander, Elizabeth and Thodey, David (2018) Independent Review into the operation of the *Public Governance, Performance and Accountability Act 2013*. September 2018

https://www.finance.gov.au/sites/all/themes/pgpa_independent_review/report/PGPA_Independent_Review_-_Final_Report.pdf

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http://www.auasb.gov.au/admin/file/content102/c3/04-17_AI_6.1-Final_Audit_Committee_Guide.pdf

Audit Office of NSW (2015) *Governance Lighthouse – Strategic Early Warning System*. Better Practice Guide.

<https://www.audit.nsw.gov.au/our-work/resources/governance-lighthouse>

Audit Office of NSW (2017) *NSW Auditor-General Update for Audit, Risk and Improvement Committee Chairs*. Information Session, Friday 3 March 2017

Audit Office of NSW (2017) *The Auditor-General's New Mandate. Working with the Local Government Sector*. Information Session, January 2017

Australian Government, Department of Finance (2018) *Resource Management Guide No. 202. A guide for non-corporate Commonwealth entities on the role of the audit committee*

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APPENDIX 1 – TIMELINE OF KEY INFLUENTIAL EVENTS

When	Who	What
2008	Office of Local Government ⁶⁸	<p>Internal Audit Guidelines for local government in NSW</p> <p>The Office of Local Government issued <i>Internal Audit Guidelines</i> under section 23A of the Local Government Act. The Guidelines sought to assist councils to put into place effective risk management and internal audit processes. This was in recognition that many councils wished to have a risk management framework and internal audit function and wanted guidance on how to achieve this. The Guidelines included:</p> <ul style="list-style-type: none"> • the aims and objectives of risk management and internal audit in councils • how a risk management framework and an internal audit function is to be overseen, structured and operated • the roles, responsibilities and reporting lines of relevant staff • the need for internal audit charters, and • the establishment, structure and function of audit and risk management committees.
2010	Office of Local Government ⁶⁹	<p>Internal Audit Guidelines for local government in NSW - updated⁷⁰</p> <p>A survey of councils conducted by the Office of Local Government to ascertain the progress made towards implementing the 2008 Guidelines found that while more than 50% of councils reported that they had an internal audit function, there were areas where the Guidelines needed to be clarified to improve compliance. The Guidelines were updated to:</p> <ul style="list-style-type: none"> • provide more guidance on the requirements for an independent audit committee • expand the conflicts of interest provisions, and • clarify the role of the general manager in the internal audit function.

⁶⁸ Then the Department of Local Government

⁶⁹ Then the Division of Local Government in the Department of Premier and Cabinet

⁷⁰ Division of Local Government (2010) *Internal Audit Guidelines*

When	Who	What
2011	Independent Commission Against Corruption	<p>Burwood Council Inquiry</p> <p>The Independent Commission Against Corruption found in its <i>Investigation into alleged corrupt conduct involving Burwood Council's General Manager and others</i>⁷¹ that the absence of internal audit at Burwood Council was a significant factor that allowed corruption to occur at that council. The Commission recommended that:</p> <ul style="list-style-type: none"> internal audit be legislatively mandated for local councils in NSW, and in the case of small councils, the possibility of councils sharing an internal audit function should also be provided as an option. <p>The Commission also made a number of specific recommendations regarding internal audit functions in NSW councils:</p> <ul style="list-style-type: none"> it be made a legislative requirement that council's internal audit committee be able to meet without the general manager present as this would preserve its capacity to meet as an independent body it be made a legislative requirement that the general manager of a council report to the governing body any decision to dismiss an internal auditor and the reason for the decision. This will help protect internal auditors from dismissal as a result of conducting an audit involving the conduct of a general manager the Local Government Act be amended to confer powers on internal auditors similar to those conferred on external auditors. These powers should include full and free access to council information in order to carry out the internal audit function and the power to direct general managers, councillors and staff to produce documents and answer questions clause 9.2(d) of the <i>Model Code of Conduct for Local Councils in NSW</i> be amended to permit councillors to provide information directly to internal auditors. This amendment was considered necessary to increase internal auditors' potential sources of information, and the reporting structure for councils' internal audit function include provision for the governing body of the council to receive information about the outcome of audits. <p>Specific to Burwood Council, but relevant to councils state-wide, the Commission also recommended that:</p> <ul style="list-style-type: none"> council's audit and risk committee be chaired by a person independent of council the governing body of the council receive regular updates on the outcome of internal audits council's internal audit function monitor compliance with the Councillor Expenses and Facilities Policy, any policy for the payment of out-of-pocket expenses to the general manager and staff and council's system for allocating work to legal practitioners as part of its oversight role, and council's internal audit function conducts audits of the authorisation certification and approval processes for expenditure that is unusual or infrequent.

⁷¹ Independent Commission Against Corruption (2011) *Investigation into the alleged corrupt conduct involving Burwood Council's general manager and others*

When	Who	What
2012	NSW Auditor-General	<p>Monitoring Local Government report⁷²</p> <p>The NSW Auditor-General found that over 75 councils had some sort of internal audit function and recommended that amendments be made to the Local Government Act (or other suitable alternative measures) that enable the Office of Local Government to make directions to require councils to have an Audit, Risk and Improvement Committee, internal audit function and fraud control procedures. The NSW Auditor-General also recommended that the Office of Local Government use council internal audit reports to identify councils at financial risk and identify matters which warrant attention.</p>
2013	Local Government Acts Taskforce	<p>Review of the Local Government Act 1993</p> <p>The Local Government Acts Taskforce recommended in its report, <i>A new Local Government Act for NSW and Review of the City of Sydney Act 1988</i>⁷³, that the Act be amended to:</p> <ul style="list-style-type: none"> • legislate financial governance principles councils are to abide by • require councils to implement a financial governance framework that includes risk management, audit, internal controls and independent verification of financial reporting • require councils to incorporate risk management, accountability, value for money and probity in procurement, approval, enforcement and capital expenditure processes, and • require all decisions to incorporate considerations of risk management and long-term sustainability. <p>The Taskforce conducted extensive public and sector consultation in formulating its recommendations.</p>
2013	Independent Local Government Review Panel	<p>Independent Local Government Review Panel</p> <p>The Independent Local Government Review Panel found that, as at 2013, 50% of NSW councils had an Audit, Risk and Improvement Committee and/or some form of internal audit process. However, those that did tended to focus primarily on compliance, risk and fraud control and had committees that were strongly embedded within the council and answerable primarily to the general manager. This could generate conflicts of interest.</p> <p>The Panel recommended in its report, <i>Revitalising Local Government</i>⁷⁴, that the 2010 Internal Audit Guidelines issued by the Office of Local Government be made mandatory under the Local Government Act and that each council be required to have an internal audit function. Under the mandatory framework the Panel specifically recommended that:</p> <ul style="list-style-type: none"> • each council's internal audit function focus on adding value and continuous improvement rather than compliance, risk and fraud control • all councils with expenditures over a set amount (e.g. \$20 million per annum) be required to have an Audit, Risk and Improvement Committee and associated internal audit function with broad terms of reference covering financial management, good governance, performance in implementing the community

⁷² NSW Auditor-General (2012) *NSW Auditor-General's Report - Monitoring local government: Department of Premier and Cabinet, Division of Local Government*

⁷³ Local Government Acts Taskforce (2013) *A New Local Act for New South Wales and Review of the City of Sydney Act 1988*

⁷⁴ Independent Local Government Review Panel (2013) *Revitalising Local Government. Final Report of the NSW Independent Local Government Review Panel*

When	Who	What
		<p>strategic plan and delivery program, service reviews, collection of required indicator data, continuous improvement and long-term sustainability</p> <ul style="list-style-type: none"> • each Audit, Risk and Improvement Committee should have a majority of independent members and an independent Chair, and the general manager should be precluded from being a committee member (but not from attending committee meetings) • the Chair be required to report biannually to a council meeting on council's financial management, governance processes and opportunities for continuous improvement • councils be able to share their internal audit functions under the auspices of joint organisations, and • the NSW Auditor-General conduct issue-based performance audits relating to internal audit. <p>The Panel conducted extensive public and sector consultation in formulating its recommendations.</p>
2016	NSW Parliament	<p>Amendments to the Local Government Act 1993</p> <p>In response to the recommendations of the Independent Local Government Review Panel, the Local Government Act was amended⁷⁵ to require all councils to have an Audit, Risk and Improvement Committee to keep under review the following aspects of council's operations:</p> <ul style="list-style-type: none"> • compliance • risk management • fraud control • financial management • governance • implementation of the strategic plan, delivery program and strategies • service reviews • council's performance, and • the collection of performance measurement data by the council. <p>Guiding principles were included in the Act to require councils to have sound policies and processes for risk management and to effectively and proactively manage risks to the local community and council.</p> <p>The roles and responsibilities of the governing body, mayor, councillors were also updated and include the need to comply with the guiding principles and keep the performance of the council under review.</p> <p>The amendments followed an extensive public consultation process.</p>
2017	Independent Commission Against Corruption	<p>Botany Bay Council Inquiry</p> <p>The Independent Commission Against Corruption found, in its <i>Investigation into the conduct of the former City of Botany Bay chief financial officer and others</i>⁷⁶, that whilst Botany Bay Council did have an internal audit function:</p> <ul style="list-style-type: none"> • it lacked independence from council's management and was prevented by the general manager from investigating the key operational areas and financial aspects of the council where corruption was occurring

⁷⁵ The Local Government Act was amended via the *Local Government Amendment (Governance and Planning) Act 2016*

⁷⁶ Independent Commission Against Corruption (2017) *Investigation into the former City of Botany Bay Council Chief Financial Officer and others*. ICAC Report July 2017

When	Who	What
		<ul style="list-style-type: none"> it was never able to directly present information or audit reports to the Audit, Risk and Improvement Committee or meet with the Committee to discuss concerns without the general manager present it did not use risk ratings to determine what audits would be conducted which enabled key areas (where corruption was occurring) to be missed the council's Audit, Risk and Improvement Committee was ineffective and did not properly examine the council, internal audit function or monitor the implementation of corrective actions, or report to the governing body standard controls were frequently ignored, e.g. management letters key financial staff in the council lacked the capabilities to perform their role the governing body thought it was unable to request more information about audit activities the governing body of council did not properly consider external audit reports or implement recommended corrective actions, and corruption and misuse of public money was able to occur unabated. <p>The Commission recommended that the internal audit model to be developed under the 2016 amendments to the Act be comparable to that which applies to state government agencies. The Commission specified in particular that the NSW Government:</p> <ul style="list-style-type: none"> issue mandatory administration and governance directives to local government similar to those that apply to state government agencies require the composition and operation of audit committees to be similar to those that apply to state government agencies (i.e. all independent members), and require the general managers of each council to regularly attest that its audit committee is operating in accordance with requirements. <p>The Commission also noted that had the NSW Auditor-General been conducting council's external audits (as now occurs) the corrupt conduct would have been detected much more quickly than it was.</p> <p>Specific to Botany Bay Council, but relevant to councils state-wide, the Commission also recommended that:</p> <ul style="list-style-type: none"> council ensures that the implementation of both internal and external audit recommendations is considered by the governing body of the council when evaluating the performance of the general manager council undertake a risk assessment (including an assessment of fraud and corruption risks) to inform its internal audit plan council ensures that its internal audit function operates independently from management by reporting functionally to its Audit, Risk and Improvement Committee council ensures that it has a robust system in place to monitor and report on the implementation of internal audit recommendations that is independent from management, and the general manager reviews the Audit, Risk and Improvement Committee's effectiveness and the adequacy of its arrangements to ensure that it fulfils the responsibilities of its charter and provides sufficient assistance to the governing body on governance processes.

When	Who	What
2018	NSW Auditor-General	<p>Report on Local Government 2017</p> <p>The NSW Auditor-General released her first audit of the NSW local government sector⁷⁷ in April 2018 following the 2016 Local Government Act amendments. In relation to internal audit, the NSW Auditor-General found that, out of a combined 128 local councils and 10 county councils:</p> <ul style="list-style-type: none"> 85 councils (62%) have an Audit, Risk and Improvement Committee and 53 (38%) do not. This is further broken down by location: <ul style="list-style-type: none"> 32 metropolitan councils (94%) have a committee and 2 (6%) do not 29 regional councils (78%) have a committee and 8 (22%) do not 23 rural councils (40%) have a committee and 34 (60%) do not 1 county council (10%) has a committee and 9 (90%) do not 86 council have a supporting internal audit function and 52 councils (38%) do not. This is further broken down by location: <ul style="list-style-type: none"> 31 metropolitan councils (91%) have an internal audit function and 3 (9%) do not 29 regional councils (78%) have an internal audit function and 8 (22%) do not 24 rural councils (42%) have an internal audit function and 33 (58%) do not 2 county councils (20%) have an internal audit function and 8 (80%) do not, and 102 councils (74%) have either an Audit, Risk and Improvement Committee or an internal audit function and 36 councils (26%) have neither. <p>The Auditor-General also found that of the councils that did have a risk management framework in place, many of them were outdated and did not have accurate risk registers, risk policies and/or procedures. Many councils also had significant risks that were not being managed appropriately and were consequently affecting the governance, financial sustainability, asset management and legislative compliance of the council. 55% of Committees were also not reviewing the financial statements of councils.</p> <p>The NSW Auditor-General recommended in relation to risk management and internal audit that:</p> <ul style="list-style-type: none"> the Office of Local Government introduce a requirement for all councils to establish internal audit functions the Office of Local Government update its 2010 Internal Audit Guidelines Audit, Risk and Improvement Committees review the financial statements of councils councils could strengthen governance by implementing risk management and/or ensure their existing risk management framework includes IT, and councils should early adopt the proposed requirement to establish an Audit, Risk and Improvement Committee.

⁷⁷ NSW Auditor-General (2018) *Report on Local Government 2017*

When	Who	What
2019	NSW Auditor-General	<p>Report on Local Government 2018</p> <p>The NSW Auditor-General⁷⁸ found in her 2018 report that out of a combined 128 councils and 10 county councils, the number that have an:</p> <ul style="list-style-type: none"> ○ Audit, Risk and Improvement Committee increased from 85 (62%) in 2017 to 97 (70%), and ○ internal audit function increased from 86 (62%) in 2017 to 92 (67%). <p>The NSW Auditor-General attributed these increases to the 2016 amendments to the Local Government Act that mandate Audit, Risk and Improvement Committees and internal audit functions from March 2021.</p> <p>The councils yet to establish an Audit, Risk and Improvement Committee and internal audit function are mainly rural and county councils (50-60% of rural and county councils are non-compliant). Most metropolitan councils have a Committee and all have an internal audit function.</p> <p>For those councils that did have an Audit, Risk and Improvement Committee:</p> <ul style="list-style-type: none"> • 98% of Committees have an Audit, Risk and Improvement Committee Charter • 94% of Committees have an independent Committee Chair • 90% of Committees are advised of significant, complex or contentious financial reporting issues • 87% of Committees monitor progress in addressing internal and external audit recommendations • 83% of Committees have a majority of members who are independent • 81% of Committees review the council's risk register • 48% of Committees perform an annual self-assessment of their performance. <p>For those councils that did have an internal audit function:</p> <ul style="list-style-type: none"> • 95% have a documented internal audit plan • 90% of Audit, Risk and Improvement Committees review the internal audit plan • 85% of internal audit plans align with the council's risk register, and • 61% of Committees assess the performance of the internal audit function. <p>In relation to risk management, the NSW Auditor-General found that:</p> <ul style="list-style-type: none"> • 120 (87%) councils have a risk management policy and 18 (13%) councils do not • 100 (72%) councils have a risk register and 38 (28%) councils do not, and • 126 (91%) councils' risk registers align with their strategic objectives and 12 (9%) do not. <p>The NSW Auditor-General also recommended that councils:</p> <ul style="list-style-type: none"> • strengthen their risk management policies and practices • manage a number of specific high-risks better • implement stronger internal controls • improve fraud control, IT, asset management, procurement and contract management policies and practices, and • implement a legislative compliance framework tailored to the size and risk profile of the council.

⁷⁸ NSW Auditor-General (2019) *Report on Local Government 2018* (see erratum)

