

September 14, 2020

To: **Hon. David Templeman**, MLA, Minister for Local Government, Sport and Cultural Industries,

And **Mr. Duncan Ord** OAM, Director-General Department of Local Government, Sport and Cultural Industries

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Submission by the Institute of Internal Auditors - Australia to the Office of Local Government, Sport and Cultural Industries on the review of the Local Government Act for Western Australia

The Institute of Internal Auditors – Australia (IIA–Australia) is making this submission in relation to the Local Government Review Panel’s Final Report, Recommendations for a new Local Government Act for Western Australia

1. Introduction

The reform of the local government sector is vital for the community. Its elected representatives and council employees, service providers, and regulators must strive to implement policies that will see improved and affordable outcomes for local communities.

To do this, local governments should implement governance structures that will contribute to better outcomes for its constituents.

A key component of good governance is having a strong and effective Audit and Risk Committee, and the Committee requires a charter that includes internal and external audit functions, both of which will deliver effective outcomes for local government.

Attention to regular monitoring and revision of agency governance is encouraged. Having an effective and appropriately resourced internal audit function will achieve these outcomes, which the panel to its credit has identified.

The Institute of Internal Auditors-Australia welcomes the Local Government Review Panel’s recommendations particularly recommendations 53 & 54 where the role of Audit, Risk and Improvement Committees includes mandatory internal audit, which will increase better governance practices at local government level.

These are:

Recommendation 53. The Panel recommends the role of audit committees be expanded to become Internal Audit, Risk and Improvement Committees and:

a. The majority of Committee members, including the Chair, should be independent of the local government and should be drawn from a suitably qualified panel.

b. To address the impost on small local governments, the committee could be established on a regional basis.

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Recommendation 54. The Panel recommends the main roles of the Audit, Risk and Improvement Committee should include:

- a. Developing an audit plan which focuses on compliance, risk (including procurement), financial management, fraud control, governance and delivery of the Council Plans;
- b. Identifying continuous improvement opportunities and monitoring programs and projects in this area;
- c. Conducting the mandatory internal audits as outlined in the audit plan; and
- d. Providing advice to council in relation to these matters.

While this is commendable, the IIA-Australia believes that accompanying guidance materials must be informative and instructive, and sourced from the Institute's materials, to assist councils administer the internal audit function effectively.

For example, it's important to highlight that the inclusion of an internal audit function, can only be successful if its undertaken by "suitably qualified" internal audit practitioners, who must follow the International Standards for the Professional Practice of Internal Auditing, the only applicable standards available for practitioners in Australia.

The Western Australian Treasury Instructions TI 1201, also to their credit, includes Audit Committees and the requirement for an internal audit function that follows the International Standards for the Professional Practice of Internal Auditing contained in the International Professional Practices Framework (IPPF).

The role of the internal audit function is largely determined by the effectiveness of the corporate governance structures and processes in place. Internal audit evaluates and contributes to the improvement of risk management, internal controls, compliance and governance processes.

The role is defined in accordance with the International Professional Practices Framework of The Institute of Internal Auditors, stated in TI 1201, as modified by the Act and Treasurer's instructions, and takes into consideration the type of audit activity, subject matter, elements of the internal control structure, and nature of the audit activity undertaken.

However, while Treasury should be commended for mandating the internal audit function and requiring practitioners to follow International Professional Practices Framework (IPPF), which contains the International Standards for the Professional Practice of Internal Auditing, their definition of 'suitably qualified' contains some incorrect interpretations.

For example, sub-paragraphs (3) and 4 (ii) of the Instructions, describes qualifications for the chair of the audit committee and Head of Internal Audit to include current membership of CPA Australia, Chartered Accountants ANZ or IPA and then whether they are a member of IIA-Australia and so on.

Having an accountancy qualification does not in itself provide a practitioner with 'suitable qualifications' to practice as the Head of Internal Audit. Membership of these other bodies, such as CPA Australia, Chartered Accountants ANZ or IPA are only suitable for external audit, which generally reviews historical financial information.

IIA-Australia recommends that all supporting regulations and guidance state that the Heads of Internal Audit should have a qualification such as Certified Internal Auditor® (CIA®) designation, or the Graduate Certificate in Internal Auditing qualification, or be admitted as a Professional Member of the Institute Internal Auditors – Australia (PMIIA).

2. Local Government Reforms in other States

We note that the Review Panel considered reforms in other States, and South Australia and Victoria have reviewed their legislation and have either passed it, or as is the case of SA, it's in the upper house awaiting approval.

Most States have now included the requirement for audit committees in local government legislation, and the roles and mandated functions which must be followed. Some States have the bare minimum required of the audit committee in legislation and rely on regulations and guidance materials to fill in the gaps (Tasmania). While other States are more prescriptive in their legislation.

New South Wales has been at the forefront of governance and risk management reform at State and now Local Government level. They were the first State to mandate the internal audit function in legislation.

As a first step, in 2008, the New South Wales government released guidelines to assist councils to establish an internal audit function. These guidelines were updated in 2010. The benefits realized by councils who had introduced internal audit into their business led to calls for internal audit to be made mandatory for every council in NSW.

New South Wales set the pace for local government reform, and in 2016, the NSW Government made it a requirement under the Local Government Act 1993 that each Council have an Audit, Risk and Improvement Committee (ARIC) in place.

The Audit Risk and Improvement Committee, among a range of activities, must undertake internal audit. This is outlined in section 428A Part 4A. The Committee must keep under review a range of functions including the council's governance function. This requirement will take effect from March 2021, and Councils are also required to proactively manage any risks they face under the new guiding principles of the Act.

Reviews by the NSW Auditor-General found that by 2012 over 75 councils had some sort of internal audit function, and by 2016 about 60 councils (out of 152 councils) or 39% had or shared an Audit, Risk and Improvement Committee. IIA-Australia has assisted many councils with audit committee training.

Internal audit's unique position is that it is independent from management and the responsibilities of management. Because of this independence, it's able to provide objective assurance and advice.

It is not possible to be both independent of management and assume management responsibilities. Where internal audit has these roles, independent assurance on such activity must be drawn from other sources.

Coordination and alignment are essential to ensure organizational coherence and avoid silos.

Independent assurance is provided to the Audit, Risk and Improvement Committee by the internal audit function.

The requirement for each council to establish an Audit, Risk and Improvement Committee is seen as added assurance, to continuously review and provide independent advice on Council's compliance and risk functions. The Local Government Act also envisages the establishment of an internal audit function in each council to support the work of the Committee.

The government has since been working to develop the regulatory framework that will support the operation of these committees, and the establishment of a risk management framework and internal audit function in each council. They have released a discussion paper "A Risk Management and Internal Audit Framework for local councils in NSW" (September 2019), which details the regulatory requirements and operational framework being proposed.

There will be nine core requirements that councils will be required to comply with when establishing their Audit, Risk and Improvement Committee, risk management framework and internal audit function

These requirements are based on international standards (AS/NZS ISO 31000:2018 and International Standards for the Professional Practice of Internal Auditing) and the experience of Australian and NSW Government public sector agencies that have implemented risk management and internal audit.

Most importantly, they reflect the unique needs, structure and resources of the NSW Local Government.

Some of the core requirements include appointment of an independent Audit, Risk & Improvement Committee, establish a risk management framework aligned to Australian & New Zealand standards, appoint suitably qualified internal audit practitioners and establish reporting lines, agree to an internal audit work program, performing and reporting and ongoing monitoring, and having a quality assurance program.

In **NSW** (as is now occurring in other States) councils may share Audit, Risk and Improvement Committees and internal audit functions (see section 428 B). This is usually effective for smaller and regional councils that do not have the necessary resources or where the level of expertise may be wanting.

The operation of sections 428A and 428B will be supported by 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 ARIC under section 428A (2) (i) of the Local Government Act. Importantly, the Office of Local Government recommends that Audit, Risk and Improvement Committee meetings should not be open to the public.

The Local Government Regulation will also prescribe a Model Internal Audit Charter and Model Terms of Reference for Audit, Risk and Improvement Committees, which all Councils must adopt and comply with when operating their internal audit function. The discussion paper “A New Risk management and Internal Audit Framework” describes the key requirements that will ultimately be prescribed by the Local Government Regulation.

To support compliance with the Local Government Act and regulation and guidelines will be issued under section 23A of the Local Government Act that outline the core requirements that each Council’s risk management framework and internal audit function must have.

A key aim of the guidelines will be to create a strong and effective risk management framework and internal audit function in all Councils by establishing minimum standards that reflect accepted international standards.

In **Victoria**, the revised the Local Government Act (2019) mandates that Council must have an Audit and Risk Committee (section 52) and under its charter must oversee internal and external audit functions (section 53 d).

Regulations and Guidance materials for Councils are yet to be published but after consultations with IIA-Australia, it is expected to include reference to the International Standards for the Professional Practice of Internal Auditing and guidance on ‘suitable qualifications’ for internal auditors.

Under Victorian Treasurer’s Standing Directions 3.2.2.1 (d) the internal audit function has to have “suitably experienced and qualified” internal auditors. Guidance documents supporting the Standing Directions issued by Treasury state that internal auditors recommend having a professional designation such as membership of IIA-Australia, which is not mandatory, but a “relevant qualification”.

Guidance supporting the Standing Directions include reference to following the International Standards for the Professional Practice of Internal Auditing, International Professional Practices Framework (IPPF), issued by the International Internal Audit Standards Board, and IIA-Australia Practice Guides.

In **Tasmania**, the Local Government Act 1993 requires Councils to establish Audit Panels with at least two independent members and must have respect to corporate governance and risk management.

However, the Local Government Act does not mandate the internal audit function in legislation (Section 85, 85A and 85B of the Local Government Act 1993 or the Local Government Panels Order 2014).

Department of Premier and Cabinet Guidance on Audit Panels – A Practice Guide (Revised 2018) outlines the functions of audit panels. In section 2.2 the outline of governance activities includes “effective internal audit policies” and a “risk management framework”. However, this is not mandatory, only voluntary. But Tasmanian Government is expected to legislate eight key governance principles councils are expected to follow.

Councils are also permitted to share Audit Panels and independent members and resources.

Audit Panels must have 4-5 members of whom two must be independent.

The Guide also states that internal auditors should follow the ‘International Standards for the Professional Practice of Internal Auditing’, and references ‘Audit Committees – A Guide to Good Practice (Third Edition 2017) a joint publication by AICD, the AUASB and IIA-Australia.

However, this Guide is also voluntary.

The Chair of the Audit Panel has the power to elect to hold meetings in private.

The Department of Premier and Cabinet is currently reviewing its Local Government Act and its governance framework is also under review.

In **Queensland**, only large councils are required to have an audit committee, but all Councils are required to have an internal audit function that complies with the International Professional Practices Framework (IPPF).

The Local Government Act 1993 requires Local Councils to establish an Audit Committee, which prepares an internal audit plan, assesses the compliance with the internal audit plan, and then oversee out the ‘effective internal audit function’.

Guidance material in the form of Local Government Bulletin 08/15 recommends internal auditors follow the ‘International Standards for the Professional Practice of Internal Auditing’. The Bulletin also outlines the appropriate qualifications required of an internal auditor.

Local Government Bulletins, and particularly 08/15 on Internal Audit and Audit Committees, state that all Local Governments are required to ‘establish an efficient and effective internal audit function and establish an audit committee’ (supported by the revised Local Government Act 2009, Local Government Regulations 2012, City of Brisbane Act 2010, and City of Brisbane Regulations 2012).

The Bulletin provides guidance on internal audit, charters and the plan itself. Importantly, the Bulletin also explains compliance with the International Professional Practices Framework, which includes the International Standards for the Professional Practice of Internal Auditing issued by the International Internal Auditing Standards Board. Both Local Government Regulations and City of Brisbane Regulations 2012 outline what must be in the internal audit statement.

The Bulletin also references Treasury Information Sheet 2.9 and the ANAO's best practice guide Public Sector Internal Audit 2012, which is now out of print. It is replaced by IIA-Australia's publication Effective Internal Audit in the Public Sector – A Best Practice Guide, which was released in early 2020.

Queensland Treasury also provides guidance not only for State Government departments but also to Local Government on requirements of the Head of Internal Audit (See Queensland Treasury Information Sheet 2.6).

Mandated minimum qualifications as prescribed by the Regulation, the person assuming the responsibilities of HIA must, as a minimum, hold a level of professional membership outlined below:

Professional membership or above (Institute of Internal Auditors in Australia) – noting that the Financial Accountability Handbook Fiscal Management 44 (Last Updated: January 2017) states that a Professional Member carries the post-nominal designation PMIIA, which stands for Professional Member, Institute of Internal Auditors – Australia, or CPA or above (CPA Australia), or CA or above (Institute of Chartered Accountants in Australia), or MIPA or above (Institute of Public Accountants), or qualifications from an overseas accounting body that are recognized by at least two of the above bodies as having equivalent membership.

Again, it should be noted that membership of an accountancy body will not qualify the practitioner as an internal auditor.

In **South Australia**, current legislation requires establishment of an audit committee under section 126 of the Local Government Act under section 126—Audit committee; and in (4) The functions of an audit committee include section (c) reviewing the adequacy of the accounting, internal control, reporting and other financial management systems and practices of the council on a regular basis.

In the current reform process, section 126 will be amended to expand the role of audit committees to “audit and risk committees” consisting of a majority of independent members. Under clause 83 (6) the expanded functions include (g) (1) an internal audit function.

Recently, only public corporations were required to have an audit committee and an internal audit function (Section 31 Public Corporations Act 1993 SA). But this is under review at State Government level. At local council level, audit committees are open to the public, which is not the current practice in other jurisdictions, but this may change.

Most States include the internal and external audit functions as required activities of the audit committee, and guidance material particularly references the International Professional Practices Framework (IPPF), which includes the International Standards for the Professional Practice of Internal Auditing, and references to 'suitable qualifications' for internal Auditors..

3. Recommendations

Internal audit should be structurally independent and free from coercion by management to be effective in its role. Functional reporting to the Chair of an appropriately constituted Audit, Risk and Improvement Committee on key issues ensures that the Head of Internal Audit is able to report objectively without fear or favour.

IIA-Australia believes that safeguards are necessary to protect the internal audit function and that these should include:

- a. That the hiring and firing of the head of internal audit should be a decision on recommendation of the Audit, Risk and Improvement Committee.

- b. That the remuneration of the head of internal audit should be a decision reviewed and endorsed by the Audit, Risk and Improvement Committee of the Council (and not by senior management).
- c. That the scope for internal audit should be a decision reserved by the Audit, Risk and Improvement Committee on the recommendation by the head of internal audit, and the budget be reviewed and endorsed by the Committee.
- d. That all internal audit work should be reported to the Audit, Risk and Improvement Committee, and the Committee should periodically request confirmation that all reports have been tabled.
- e. That throughout the year the Chair of the Audit, Risk and Improvement Committee and annually the Committee as a whole should meet privately with the head of internal audit without management present.
- f. That at least annually, the Audit, Risk and Improvement Committee should have satisfied themselves that the internal auditor is appropriately positioned and adequately resourced; that the work of the internal auditor is being conducted in conformance with the International Standards for the Professional Practice of Internal Auditing; that they have satisfied themselves that the internal auditor has not been impeded in their work; and, that management has responded appropriately to internal and external auditor representations.

Recommendations for inclusion in regulations and guidance documents:

- The Council's internal auditor must follow the International Professional Practices Framework (IPPF) containing the International Standards for the Professional Practice of Internal Auditing.
- The head of the internal audit function should be 'suitably qualified' and ideally have a direct reporting line to the Chair of the Audit, Risk and Improvement Committee in order to bring the requisite degree of independence and objectivity to the role.
- Importantly, that Audit, Risk and Improvement Committee meetings should be held in private, and not be open to the public.
- Qualifications and suitable experience for an internal auditor includes either the Certified Internal Auditor® (CIA®) designation, or the Graduate Certificate in Internal Auditing qualification, or be admitted as an ordinary member or Professional Member of the Institute Internal Auditors – Australia (PMIIA).

4. About the Institute

The Institute of Internal Auditors (The IIA) is the global professional association for internal audit practitioners, with global headquarters in the USA, and with Institutes throughout the world including Australia (IIA–Australia). The IIA was established in 1941, and now has more than 200,000 members from 190 countries throughout the world, including 3,000 members in Australia.

As the chief advocate of the internal audit profession, The IIA serves as the profession's international standard-setter, sole provider of globally accepted internal auditing certifications, and principal researcher and educator.

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The IIA sets the bar for internal audit integrity and professionalism around the world with its International Professional Practices Framework (IPPF®), a collection of guidance that includes The International Standards for the Professional Practice of Internal Auditing, and the Code of Ethics for internal auditors.

The Code of Ethics states the principles and expectations governing the behaviour of individuals and organizations in the conduct of internal auditing. It describes the minimum requirements for conduct and behavioural expectations, rather than specific activities.

The International Standards for the Professional Practice of Internal Auditing issued by the International Internal Auditing Standards Board of The IIA are “the Standards” governing internal auditing worldwide.

Members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security.



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