



Financial Sustainability Program

Information Paper 5

Efficiency & Economy Audits

August, 2006



Introduction

This information paper is one of a number being developed as a part of the LGA's Financial Sustainability Program. It is designed as a thought starter. Manuals, codes, guidelines, technical definitions, standards and similar documents are also being prepared to provide practical assistance to Councils.

The subject of this information paper is efficiency and economy audits. Recent amendments to the Local Government Act have introduced three relatively new concepts – a mandated requirement to have an audit committee, specific criteria regarding the appointment of auditors and a specific provision regarding the capacity for Councils to conduct efficiency and economy audits. These are in addition to statutory responsibilities which Councils have for annual independent auditing of financial statements. This paper is aimed at ensuring a clear understanding of the role of efficiency and economy audits.

It should be noted that Councils are also subject to a range of external legislative requirements and powers in parallel with those applying to other governments including under the Criminal Law Consolidation, Freedom of Information, State Records and Ombudsman Acts.

This paper should be read in conjunction with the information papers on Financial Sustainability which highlight the increasing demands on Councils and the importance of efficiently managing the delivery of services. Information papers have been, or will soon be, prepared on the following topics:

- Financial Sustainability
- An Overview of Audit Mechanisms
- Audit Committees
- Scope of External Audits - Audit Specification
- Efficiency & Economy Audits
- Infrastructure and Asset Management (Policy and Planning)
- Service Delivery Framework including the Role of Shared Services
- Long-term Financial Plans
- Governance in Local Government
- Financial Governance and Management
- Revenue and Funding Policies
- A New Approach to Standards in Local Government
- A New Approach to State-Local Resourcing
- Depreciation
- Local Government Financial Indicators
- Debt Management
- An Approach to Assessing Financial Sustainability for Local Government

A number of manuals, guidelines, templates, technical definitions, codes, standards and similar documents supporting this series of information papers are also being prepared by the LGA to provide practical assistance to Councils.

For an update on which information papers have now been completed or information about other documents and activities, including briefing and training sessions, please visit our website at: www.lga.sa.gov.au/goto/fsp.

What is an Efficiency & Economy Audit?

An efficiency and economy audit provides both policy makers and management with the auditor's opinion on the efficiency and economy of the conduct of a particular program or activity of Council. The parameters of the audit will be determined by the nature of the program or activity being audited.

The efficiency and economy audit is quite different to the audit of the annual financial statements in that the information gathered and examined will be related only to the program or activity being audited and go beyond relevant financial data. The primary interest in an efficiency and economy audit is resource use, rather than program or activity effectiveness. It is a thorough, rigorous and independent audit of the acquisition and use of resources in a Council program or activity.

The audit should provide both policy makers and management with an opinion on the efficiency and economy of the program or activity under review so as to ensure that the policy outcome sought is being achieved. In particular it will provide guidance on whether the delivery of the service is providing an outcome commensurate with the resources a Council has committed. The audit may include recommendations for future action and identify issues that may require further investigation or consideration.

An efficiency and economy audit is not, and is not intended to be, a means by which the separate but complementary roles of the administration and the elected body become confused.

Some of the key questions that may be explored during an efficiency and economy audit might be:

- Have alternative means of service provision been considered?
- Are sound and valid procurement procedures in place and being followed?
- Is the Council employing the appropriate amount of resources at the appropriate time to ensure efficiency?
- Are property resources being adequately maintained and protected?
- Is there no (or minimal) duplication of work or unnecessary wasted effort?
- Have optimum resource levels been adequately identified?
- Are internal measures of efficiency and economy valid and appropriate?

Efficiency and economy audits should be undertaken by the Council's auditor or an independent, suitably qualified person. The person identified to undertake the examination, and to produce the report, must do so without undue influence from any individual Council Member or the Chief Executive Officer or other staff of the Council.

When commissioning the audit, the auditor should be advised of the program area and required to develop an understanding of the policy that drives the program and once fully understood, adopt the appropriate audit procedure.

What does the Act allow for?

The Local Government Act (as amended) requires that an efficiency and economy report must be provided to the Principal Member of the Council (who must ensure that a copy is immediately provided to the Chief Executive Officer). A copy of the report is also to be provided to the Council's audit committee.

The Act also requires that Council Members formally receive the auditor's report at the next ordinary meeting of the Council, or special meeting called in accordance with the requirements of the Act. After management has commented and recommendations either accepted or rejected, the report should be released as a public document.

Refer to Attachment 1 for a copy of section 130A of the Act, which is likely to come into operation in January 2007.

It should also be noted that the Local Government Act already requires that Council Members "*keep the Council's resource allocation, expenditure and activities and the efficiency and effectiveness of its service delivery, under review*" (Section 59 of the Act).

The role of the Council Members is not to become involved in the detailed management of the Council but to concentrate on policy development, strategic planning and monitoring of resource use. The efficiency and economy audit of a Council activity or program should therefore only be undertaken where necessary to properly assist Council Members in the discharge of their obligations by providing comfort that the activity is being managed in an efficient and economical manner and without impinging on matters that are lawfully the domain of management.

Among other obligations, the Chief Executive Officer is responsible (Section 99 of the Act):

- for the day-to-day operations and affairs of the Council;
- to provide information to the Council to assist the Council to assess performance against its strategic management plans;
- to ensure that the assets and resources of the Council are properly managed and maintained; and
- to ensure that records required under this or another Act are properly kept and maintained.

Chief Executive Officers and their management teams will have various programs for the review of the services provided in various departments of their Councils. The implementation of an efficiency and economy audit should be considered in the context of the administration's role and performance in continuously monitoring and evaluating all aspects of Councils' administration and functions.

What are the issues for Councils?

The provisions of the new Section 130A will enable Councils to call for the conduct of an efficiency and economy audit where they form an opinion that it is a matter of such significance as to justify an examination under this section.

The Local Government Act places an obligation on both Council Members and their Chief Executive Officers to continuously review the efficiency and effectiveness of their service delivery and operations.

This paper suggests that efficiency and economy audits should be used only to support, or address failings in, a Council's ongoing monitoring and evaluation of strategic functions where clarification is required on whether a program or activity is achieving its policy outcomes in an efficient and effective manner. A well functioning audit committee and an appropriate program of internal audits will reduce the likelihood of the need for one-off efficiency and economy audits. In this context ad hoc efficiency and economy audits should not be commissioned by Councils unless there are exceptional circumstances.

This document is designed to assist in promoting a common basic understanding of a subject important to the financial sustainability of Councils. Other checklists and documents are being prepared to assist Councils with their next steps.

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Attachment 1: Local Government Act Provisions Relating to Efficiency and Economy Audits

Section 130A provides that:

- (1) A council may, as it thinks fit, request its auditor, or some other person determined by the council to be suitably qualified in the circumstances, to examine and report on any matter relating to financial management, or the efficiency and economy with which the council manages or uses its resources to achieve its objectives, that would not otherwise be addressed or included as part of an annual audit under Division 4 and that is considered by the council to be of such significance as to justify an examination under this section.
- (2) An examination and report under subsection (1) may be requested—
 - (a) if appropriate, on the basis that it will be conducted in conjunction with an annual audit; or
 - (b) on the basis that it will be conducted as a separate examination and report.
- (3) An examination under this section—
 - (a) is not to operate or apply so as to limit the role or functions of a council under this or any other Act, or the lawful role or functions of any member of a council; and
 - (b) is to be undertaken in such manner as the person conducting the examination thinks fit and without undue influence from a member of the council or the chief executive of the council.
- (4) The chief executive officer must, at the request of a person conducting an examination under subsection (1) —
 - (a) produce to the person for inspection any documents relevant to the examination;
 - (b) provide to the person explanations or information required by the person.Maximum penalty: \$10 000.
- (5) The report on an examination must be provided—
 - (a) to the principal member of the council (who must ensure that a copy is immediately provided to the chief executive officer, and that copies are provided to the other members of council for their consideration at the relevant meeting under subsection (6) or (7)); and
 - (b) to the council's audit committee.
- (6) Unless subsection (7) applies, the report must be placed on the agenda for consideration—
 - (a) unless paragraph (b) applies—at the next ordinary meeting of the council;

- (b) if the agenda for the next ordinary meeting of the council has already been sent to members of the council at the time that the report is provided to the principal member of the council - at the ordinary meeting of the council next following the meeting for which the agenda has already been sent, subject to the qualification that this paragraph will not apply if the principal member of the council determines, after consultation with the chief executive officer, that the report should be considered at the next meeting of the council as a late item on the agenda.
- (7) The report may be the subject of a special meeting of the council called in accordance with the requirements of this Act (and held before the ordinary meeting of the council that would otherwise apply under subsection (6)).
- (8) The report on an examination must be kept confidential until it is received at the relevant meeting of the council held under subsection (6) or (7) or, if the council so resolves at that meeting, until a later date specified by the council (being not later than 60 days after the date of the meeting).