



Financial Sustainability Program

Information Paper 14

Model Work Program for Council Audit Committees

April 2007



Introduction

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 an explicit capacity for a Council to conduct an efficiency and economy audit. These are in addition to statutory responsibilities which Councils have for annual independent auditing of financial statements. LGA Financial Sustainability Information Papers 2 – 5 discuss these issues. In particular paper number 3 deals with Council audit committees and includes a model terms of reference.

The Act sets out the principal functions and extent of authority for Council audit committees. While the terms of reference for audit committees should meet the minimum requirements in the Act they should be tailored also to meet specific needs of individual Councils. The work program of each Council's audit committee should not only address a common core of activities aimed at addressing its statutory responsibilities but should also take account of local circumstances and priorities.

The purpose of this information paper is to provide guidance to Councils on the establishment of the work program for their audit committees. The paper includes, as an attachment, a model initial work program.

This paper should be read in conjunction with other information papers which highlight the increasing demands on Councils and the importance of efficiently managing the delivery of services, and in particular in conjunction with those on:

- Audit Committees
- Scope of External Audit – Audit Specification
- Efficiency & Economy Audits

Other information papers have been, or will soon be, prepared on the following topics:

- Financial Sustainability
- An Overview of Audit Mechanisms
- 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
- Model Framework for Council Annual Business Plans
- Targets for Local Government Financial Indicators.

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 does the Act now require?

The change to the Local Government Act to require Councils to establish audit committees was supported by Local Government and also included as a recommendation in the LGA's Independent Inquiry into the Financial Sustainability of Local Government in South Australia.

Audit committees play a critical role in the financial reporting framework of Councils by overseeing and monitoring the contributions of management and external auditors in the financial reporting process. They will also review issues such as the approach being adopted by Councils and their management teams to address business risks, corporate and financial governance responsibilities and legal compliance. Councils may also refer issues of a strategic nature to their audit committees.

The principal functions and extent of authority for an audit committee are set out in Section 126 (4) of the Local Government Act as follows:

- (a) reviewing annual financial statements to ensure that they present fairly the state of affairs of the council; and*
- (ab) proposing, and providing information relevant to, a review of the council's strategic management plans or annual business plan; and*
- (ac) proposing, and reviewing, the exercise of powers under section 130A; and*
- (ad) if the council has exempted a subsidiary from the requirement to have an audit committee, the functions that would, apart from the exemption, have been performed by the subsidiary's audit committee; and*
- (b) liaising with the council's auditor; and*
- (c) reviewing the adequacy of the accounting, internal control, reporting and other financial management systems and practices of the council on a regular basis.'*

Audit committee role and work program

Some Councils traditionally have used finance committees or similar, to oversee lower-level or more routine financial activities such as monitoring budget variance reports, noting bank account reconciliations, assisting with preliminary budget planning etc. With the introduction of audit committees it is appropriate that Councils review the use and role of finance committees. Councils may choose to replace their finance committee with an audit committee or to have both committees in operation. Where the latter occurs the respective roles of the two committees need to be clear and understood by the membership of each to ensure they compliment each other and that all required activities are undertaken without duplication or confusion. For example will the finance committee focus on monitoring Council's financial activities or pro-actively and strategically drive financial performance improvement, including any relevant matters identified in the Financial Sustainability Inquiry? If the finance committee's focus is the latter, then the audit committee's focus will be more one of commenting on the finance committee's proposals and achievements rather than driving such a program itself.

The composition and charter of the audit committee should be determined by Council with regard to legislative requirements and available guidance material (eg see LGA *Financial Sustainability Information Paper 3: Audit Committees*).

The audit committee should however develop its own work program, but in consultation with the Council and its chief executive officer (who is likely to seek input from the chief finance officer and

other senior staff where their responsibilities fall within the domain of the audit committee's focus of interest). This work program (including any sitting fees for audit committee members) will be resourced by Council and needs to be budgeted accordingly. The consultation between the audit committee and Council and its chief executive should balance the needs identified in the work program against the level of resources required.

Prior to developing its work program the audit committee should receive a sound induction. This should include ensuring that all members clearly understand the audit committee's charter and the relationship with other relevant committees of Council. The audit committee should also be given a briefing on the Council's suite of strategic management plans (SMPs), annual business plan (ABP), operating environment and financial performance and position (particularly in the context of the key findings of the Financial Sustainability Inquiry).

This should include an emphasis on understanding the meaning of, and rationale for, the rating the Council was awarded in the context of the Financial Sustainability Inquiry and its financial performance and position using the sector-endorsed financial indicators (see *LGA Information Paper 9: Local Government Financial Indicators* and *Information Paper 12: Targets for Local Government Financial Indicators*). Where the Council has a long-term financial plan (LTFP) this same data should be provided for the projected future.

An audit committee should address issues which fall within the activity areas determined by its terms of reference. Some issues may be addressed on a once-off basis and others on a regular basis. Information Paper 3 describes the following activity areas as being appropriate for an audit committee:

Financial Reporting

The audit committee needs to be satisfied that practices adopted by the Council and supported by its external auditor (unless otherwise indicated by a qualification to the audit or commented on in the accompanying management letter) are appropriate having regard to its circumstances and practices elsewhere and are reflected in formal Council policies as appropriate.

Internal Controls and Risk Management Systems

The Local Government Act (Section 125) requires Councils to maintain effective internal controls. The audit committee needs to ensure that the Council and its management team have in place locally appropriate plans, policies and arrangements to manage and mitigate the organisation's business risks.

Whistle Blowing

The audit committee should ensure the Council has in place locally appropriate and legislatively compliant arrangements for its employees to raise concerns in confidence, about possible wrongdoing in financial reporting or other matters. The committee should ensure that these arrangements allow independent investigation of such matters and appropriate follow-up action.

Internal Audit

In the context of the Council's overall risk management system, the audit committee needs to monitor and review the effectiveness of the Council's internal audit function. This should include monitoring its independence and any restrictions placed thereon and the adequacy of its resources by, for example, reviewing summaries of reports on the Council's operations from its internal auditor and management's responses. If the Council does not have, and decides not to develop, a formal internal audit function then the audit committee needs to take this into account in determining its role and annual work program.

External Audit

The audit committee needs to;

- meet as necessary, and monitor the Council's relationship, with its external auditor;
- consider and make recommendations to Council in relation to all aspects of the appointment, re-appointment, remuneration, and removal or resignation of Council's external auditor;
- assess the effectiveness of the external audit process and outputs relative to the scope of the engagement; and,
- review management's response to the external auditor's findings and recommendations.

Reporting

In addition to receiving minutes of audit committee meetings, the Council also needs to have promptly brought to its attention significant, urgent findings of the audit committee. The audit committee should also review its charter and performance annually (either by self assessment or through an external reviewer) and report these conclusions and its overall activity outputs to, and invite comment from, the Council.

Other Matters

A key role of Council audit committees, recognised in the Local Government Act and arguably warranting special emphasis based on the findings of the Financial Sustainability Inquiry, is to identify areas where the Council's financial governance policies and practices can be improved. In particular audit committees have a role in ensuring that the Council's strategic management and annual business plan development, management and reporting processes take account of, and support, the Council's future financial sustainability.

Attached is a model initial work program for a Council's audit committee that is intended to provide general guidance. The suggested list of activities is comprehensive and should be modified to take account of local circumstances, including both resource availability and specific local needs to ensure the work of the audit committee adds value relative to costs. The model work program identifies likely areas for initial focus for the audit committee and other areas that might become a subsequent focus once the committee has been in operation for a period of time. Initial focus should be on key local priority issues.

It is not suggested that the model initial work program would be achieved in a specific time period e.g. in the first year. All Councils are different and the rate at which their audit committees address the issues identified will differ. Rather the model initial work program presents guidance for a starting point for audit committees and subsequently should be reviewed and updated at least annually taking account of achievements and developments.

Acknowledgements

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Attachment: Model Initial Work Program for a Council's Audit Committee

[Italicised notes and comments enclosed in square brackets '[]' have been included to assist Councils' interpretation and use of the model initial work program. These notes should be deleted as the work plan is prepared.]

***[City of xxx / xxx District Council] Audit Committee Work Program [200x-0x]
 Updated [dd Month 200x]***

Activity	Timeframe <i>[Record start and end month.]</i>	Current Status / Outcomes / Benefits Achieved <i>[Update for each meeting of the audit committee.]</i>	Date Completed <i>[Record month completed.]</i>	Follow-up Action <i>[Identify activities to be added to subsequent work program.]</i>
1 Financial Reporting				
<i>Initial Focus</i>				
1.1 Identify areas of accounting treatment that are open to discretion, and in particular have material impact on reported financial performance and position (e.g. assumed asset lives, depreciation methodology, asset revaluation frequency and techniques, capitalisation policies and overhead accounting treatments all can have material affect on the operating result and net asset values).		<i>[Include details of any relevant outputs generated as a result of this activity.]</i>		<i>[Include details of any recommended reviews.]</i>
1.2 Ensure that financial information included in publications for external audiences (eg annual report, Council newspaper, brochure to all ratepayers etc) accurately reflects key accrual based financial information and where appropriate sector-endorsed financial indicators.		<i>[Include details of review of Council's targets for these financial indicators.]</i>		<i>[Ongoing monitoring of performance against targets for these financial indicators.]</i>

<i>Subsequent Focus</i>				
1.3	Ensure that asset values and depreciation rates are up to date and soundly based, including that they have particular regard to local conditions and do not just reflect common practice elsewhere e.g. <ul style="list-style-type: none"> • whether land values reflect the current local market; • whether infrastructure asset values reflect local replacement costs and the condition of existing assets; • whether an infrastructure asset condition audit been undertaken recently to assist in making this judgement. 			
2 Internal controls and risk management systems				
<i>Initial Focus</i>				
2.1	Identify whether weaknesses in internal controls have been previously identified, e.g. by management or Council's external auditor, and if so whether action has been taken to have them addressed.		<i>[Include details of recommended remedial activity.]</i>	<i>[Review progress in addressing weaknesses.]</i>
2.2	Establish whether locally appropriate strategies exist to minimise the likelihood of occurrence and adverse consequence for obvious and major internal control and other risks e.g: <ul style="list-style-type: none"> • consider the range of documented internal control policies and procedures; • whether they are being followed; • whether an assessment has been undertaken to identify foreseeable events with potentially catastrophic consequences and actions established to minimise their likelihood and effect e.g. 		<i>[Include details of</i> <ul style="list-style-type: none"> • <i>documented internal control policies and procedures examined;</i> • <i>recommendations arising.]</i> 	<i>[Review progress in addressing recommendations made.]</i>

<ul style="list-style-type: none"> ○ whether a business continuity plan has been developed in case of major damage to key Council properties or other, eg computer, assets; ○ whether there are significant risks that have been identified by Council's insurers that have not been reasonably addressed and therefore could jeopardise insurance cover in this regard. 				
<i>Subsequent Focus</i>				
<p>2.3 Ensure a thorough review is undertaken to identify locally appropriate internal control and risk management policies and procedures using formal tools and processes such as the <i>Internal Financial Controls – Best Practice Manual, 2002</i> (produced by the SA Local Government Financial Management Group, with funding from the Local Government Research and Development Scheme) and/or other locally appropriate reference tools. Ensure that identified improvement opportunities can be appropriately addressed. <i>[Note – this could be undertaken progressively in stages with the locally most important and highest risk areas tackled first.]</i></p>		<p><i>[Include details of any recommendations arising.]</i></p>		<p><i>[Review progress in addressing recommendations made.]</i></p>
3 Whistle blowing				
<i>Initial focus</i>				
<p>3.1 Identify whether the Council has in place simple, readily accessible arrangements for employees to confidentially raise concerns of alleged malpractice in accord with legislative provisions.</p>		<p><i>[Include details of any recommendations arising.]</i></p>		<p><i>[Review progress in addressing recommendations made.]</i></p>

<i>Subsequent focus</i>				
3.2	Examine whether Council's whistleblower arrangements are well known to employees and effective having regard to local circumstances.		<i>[Include details of any recommendations arising.]</i>	<i>[Review progress in addressing recommendations made.]</i>
4 Internal audit				
<i>Initial focus</i>				
4.1	Where Council has an internal audit function: <ul style="list-style-type: none"> • undertake a review of its charter and annual work plan and outcomes from its past work. Examine whether identified matters have been appropriately addressed; • if no formal internal audit function exists then explore whether such a service could be cost-effectively provided (eg through an external service provider, possibly in conjunction with other Councils). 		<i>[Include details of any recommendations arising.]</i>	<i>[Review progress in addressing recommendations made.]</i>
4.2	Examine whether the Council has developed a formal policy and associated arrangements for exercising its powers regarding initiating and undertaking efficiency and economy audits e.g. <ul style="list-style-type: none"> • whether there is an objectively developed and strategically prioritised schedule of efficiency and economy audits; • whether it is the responsibility of the Internal Audit function to manage, or some other management arrangements are in place; • whether the audit committee itself should manage or just provide comment. The audit committee should provide advice to Council on this issue.		<i>[Include details of recommendations for management of efficiency and economy audits.]</i>	

<i>Subsequent Focus</i>				
4.3	The audit committee should: <ul style="list-style-type: none"> • keep the operations of the internal audit function (where it exists) under review including approving its annual work program, and monitoring of its independence and performance and provide feedback as appropriate; • take internal audit plans and work outcomes into account in own decision-making and work program updates. 		<i>[Include details of any recommendations arising.]</i>	<i>[Review progress in addressing recommendations made.]</i>
4.4	Having regard to results of its own work program and the Council's available resources, risks and anticipated benefits and costs, the audit committee should identify whether there are key functions where it might recommend that an efficiency and economy audit be performed.		<i>[Include details of recommended efficiency and economy audits.]</i>	<i>[Review outcomes of efficiency and economy audits undertaken.]</i>
5 External audit				
<i>Initial Focus</i>				
5.1	Meet with the Council's external auditor to: <ul style="list-style-type: none"> • invite presentation of his/her audit methodology and risk assessments within the audit plan; • discuss any qualifications raised in the most recent audit or comments made in the accompanying management letter; • assess the appropriateness of the Council's response to matters so raised; and, • invite comment on the financial systems and affairs of the Council having regard to comparable benchmarks. 		<i>[Include details of any recommendations arising.]</i>	<i>[Review progress in addressing recommendations made.]</i>
5.2	Ensure that appointment arrangements for the external auditor conform with legislative provisions.		<i>[Include details of any recommendations arising.]</i>	<i>[Review progress in addressing recommendations made.]</i>

<p>5.3 Ensure compliance with new regulation 16A of the Local Government (Financial Management) Regulations 1999 which prevent a Council from engaging its auditor to provide any services to the Council outside the scope of the auditor's functions under the Local Government Act.</p>		<p><i>[Include details of any recommendations arising.]</i></p>		<p><i>[Review progress in addressing recommendations made.]</i></p>
<p><i>Subsequent Focus</i></p>				
<p>5.4 Keep oversight of the Council's relationship with its external auditor and develop an appropriate timeframe to address all matters requiring consideration in the appointment/re-appointment of the external auditor and manage this process when it falls due <i>[note: amendments to section 128 provide that the Council's auditor must be rotated after no more than five years].</i></p>		<p><i>[Include details of any recommendations arising.]</i></p>		<p><i>[Review progress in addressing recommendations made.]</i></p>
<p>6 Reporting</p>				
<p><i>Initial and Ongoing Focus</i></p>				
<p>6.1 Ensure that significant, urgent matters identified through the work program are formally and promptly reported to Council.</p>		<p><i>[Include details of matters reported to Council.]</i></p>		<p><i>[Review Council's response to matters reported.]</i></p>
<p>6.2 Report annually to Council;</p> <ul style="list-style-type: none"> • outlining outputs relative to the audit committee's work program and the results of a self-assessment of performance for the preceding period including whether it believes any changes to its charter are appropriate; • outlining any identified training needs; • advising future work program proposals; and, • invite comment from the Council on all of the above. 		<p><i>[Include details of report.]</i></p>		<p><i>[Review Council's response to report.]</i></p>

7 Other matters				
<i>Initial Focus</i>				
<p>7.1 Review, and where warranted suggest improvements in, the formats of budget and actual financial performance information reported to the Council to ensure they:</p> <ul style="list-style-type: none"> • are succinct, easy to follow and pitched with a strategic focus; • are based on accrual accounting information and include the material required by Regulation 5B and Regulation 7(3) of the Local Government (Financial Management) Regulations 1999; and, • incorporate key financial sustainability information including comparison of actual and budgeted performance against targets, where they have been set by Council, for sector-endorsed financial indicators. 		<p><i>[Include details of any recommendations arising.]</i></p>		<p><i>[Review progress in addressing recommendations made.]</i></p>
<p>7.2 Review the Council's financial governance arrangements and their effectiveness including:</p> <ul style="list-style-type: none"> • the processes in place to ensure; <ul style="list-style-type: none"> ○ all Council Members and the executive team have appropriate knowledge of key financial governance principles, issues and reporting tools in the context of Local Government financial sustainability; and, ○ where warranted, existing knowledge and skills are augmented with locally appropriate training and support; • the appropriateness of existing strategic financial decision-making models and processes underpinning Council's long-term financial plan (or assist with its development if necessary) and annual business plan; 		<p><i>[Include details of any recommendations arising.]</i></p>		<p><i>[Review progress in addressing recommendations made.]</i></p>

<ul style="list-style-type: none"> the appropriateness of targets established by Council for sector-endorsed Local Government Financial Indicators having regard to <i>Financial Sustainability Information Paper 12: Targets for Local Government Financial Indicators</i> (or assist with the development of these as necessary); and, the appropriateness of the range and content of Council's financial policies and practices (and in particular in regard to treasury management having regard to <i>Local Government Financial Sustainability Information Paper 10: Debt Management</i>). 				
<i>Subsequent Focus</i>				
<p>7.3 Comment on the draft annual business plan prior to its formal consideration for adoption by Council, particularly in terms of consistency with Council's strategic management plans, recognising that Council is responsible and accountable for policy positions and service level decisions but mindful also that the audit committee has responsibilities to ensure Council is aware of the impact on ongoing financial sustainability of its proposals.</p>		<p><i>[Include details of comments made.]</i></p>		<p><i>[Review Council's response to comments made.]</i></p>
<p>7.4 The audit committee should satisfy itself regarding the:</p> <ul style="list-style-type: none"> consistency of Council's strategic plan with its long-term financial plan; consistency of Council's long-term financial plan with its infrastructure and asset management plan (I&AMP); soundness of the I&AMP; e.g. Is it supported by engineering and other professional assessments regarding the condition of Council's infrastructure assets? 		<p><i>[Include details of any recommendations arising.]</i></p>		<p><i>[Review progress in addressing recommendations made.]</i></p>

<ul style="list-style-type: none">likely impact on Council's ongoing financial sustainability of implementation of its suite of strategic management plans.				
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