



PERFORMANCE AUDIT

23 MAY 2023

Regulation and monitoring of local government

NEW SOUTH WALES AUDITOR-GENERAL'S REPORT

THE ROLE OF THE AUDITOR-GENERAL

The roles and responsibilities of the Auditor-General, and hence the Audit Office, are set out in the *Government Sector Audit Act 1983* and the *Local Government Act 1993*.

We conduct financial or 'attest' audits of state public sector and local government entities' financial statements. We also audit the Consolidated State Financial Statements, a consolidation of all state public sector agencies' financial statements.

Financial audits are designed to give reasonable assurance that financial statements are true and fair, enhancing their value to end users. Also, the existence of such audits provides a constant stimulus to entities to ensure sound financial management.

Following a financial audit the Audit Office issues a variety of reports to entities and reports periodically to Parliament. In combination, these reports give opinions on the truth and fairness of financial statements, and comment on entity internal controls and governance, and compliance with certain laws, regulations and government directives. They may comment on financial prudence, probity and waste, and recommend operational improvements.

We also conduct performance audits. These assess whether the activities of government entities are being carried out effectively, economically, efficiently and in compliance with relevant laws. Audits may cover all or parts of an entity's operations, or consider particular issues across a number of entities. Our performance audits may also extend to activities of non-government entities that receive money or resources, whether directly or indirectly, from or on behalf of government entities for a particular purpose.

As well as financial and performance audits, the Auditor-General carries out special reviews, compliance engagements and audits requested under section 27B(3) of the *Government Sector Audit Act 1983*, and section 421E of the *Local Government Act 1993*.

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GPO Box 12
Sydney NSW 2001

The Legislative Assembly
Parliament House
Sydney NSW 2000

The Legislative Council
Parliament House
Sydney NSW 2000

In accordance with section 38EC of the *Government Sector Audit Act 1983*, I present a report titled '**Regulation and monitoring of local government**'.

A handwritten signature in black ink, appearing to read 'Margaret Crawford'.

Margaret Crawford PSM
Auditor-General for New South Wales
23 May 2023



RECONCILIATION COMMITMENT STATEMENT

The Audit Office of New South Wales pay our respect and recognise Aboriginal people as the traditional custodians of the land in NSW.

We recognise that Aboriginal people, as custodians, have a spiritual, social and cultural connection with their lands and waters, and have made and continue to make a rich, unique and lasting contribution to the State. We are committed to continue learning about Aboriginal and Torres Strait Islander peoples' history and culture.

We honour and thank the traditional owners of the land on which our office is located, the Gadigal people of the Eora nation, and the traditional owners of the lands on which our staff live and work. We pay our respects to their Elders past and present, and to the next generation of leaders.

contents

Regulation and monitoring of local government

Section one – Regulation and monitoring of local government

Executive summary	1
Introduction	7
Oversight and enabling arrangements for the OLG	12
Monitoring and responding to sector risks and issues	16

Section two – Appendices

Appendix one – Response from agency	27
Appendix two – Statutory powers relevant to council accountability under the Local Government Act	28
Appendix three – About the audit	30
Appendix four – Performance auditing	32

Section one

Regulation and monitoring
of local government

Executive summary

The *Local Government Act 1993* (the LG Act) provides the legal framework for the system of local government in New South Wales. The LG Act describes the functions of councils, county councils and joint organisations which should be exercised consistent with the guiding principles and requirements of the LG Act. Councils also have functions and responsibilities under other Acts.

There are 128 local councils, nine county councils and 13 joint organisations of councils in the New South Wales local government sector. Each council is unique in size and location, owns and manages assets, and delivers services for their communities. According to 2021–22 data provided by the Department of Planning and Environment (the department), local councils managed \$175.2 billion in infrastructure, property plant and equipment, held \$16.8 billion of cash and investments, collected \$7.8 billion in rates and charges and entered into \$3.7 billion of borrowings. Councils' decision-making responsibilities directly impact the communities they serve, including responsibilities relevant to financial management, economic development, environmental sustainability and community wellbeing.

Under the LG Act, each elected council is accountable to the community they serve. In addition to Auditor-General reports, issues relating to council performance and compliance have been identified in public inquiries commissioned by the Minister for Local Government and investigations by the Independent Commission Against Corruption, NSW Ombudsman and Office of Local Government (OLG). Challenges and opportunities related to the operations and sustainability of the local government sector have also been reported by the sector and identified in reports by NSW government agencies such as the Independent Pricing and Regulatory Tribunal.

The department is the primary state government agency with responsibility for policy, legislative, regulatory and program functions for local government matters. The Office of Local Government (OLG) is a business unit within the department that advises the Minister for Local Government and exercises delegated functions of the Secretary of the Department of Planning and Environment under the LG Act.

Key departmental planning documents state that the OLG is responsible for strengthening the sustainability, performance, integrity, transparency and accountability of the local government sector. As the state regulator of the local government sector, the OLG aims to promote voluntary compliance, build councils' capacity for high performance, and intervene only when 'warranted and appropriate'. Relevant regulatory activities include issuing guidelines, investigating councils and councillors, and supporting the Minister for Local Government's discretionary intervention powers. The OLG's other functions include developing policy, administering grants and programs, supporting local government election processes, and issuing certain approvals.

The objective of this audit was to assess whether the OLG is effectively monitoring and regulating the local government sector under the LG Act. The assessment included:

- the effectiveness of departmental arrangements for the OLG to undertake its regulatory functions
- whether the OLG has effective mechanisms to monitor and respond to risks and issues relating to council compliance and performance.

This report focuses on the OLG's activities relevant to powers under Chapter 13 of the LG Act, and related regulatory activities, such as monitoring risks, issuing guidance and engaging with councils. It also examines strategic and operational planning for these activities in the context of the OLG's other activities, and departmental arrangements to oversee and enable the OLG's regulatory effectiveness.

Other OLG activities were not in scope of the audit but are commented on in this report where contextually relevant. This includes the OLG's responsibilities under the LG Act with respect to councillor misconduct, and the 2022 review of the councillor misconduct framework commissioned by the former Minister for Local Government.

Conclusion

The Office of Local Government (OLG) in the Department of Planning and Environment (the department) does not conduct effective, proactive monitoring to enable timely risk-based responses to council performance and compliance issues. Council performance and compliance varies and a range of issues continue across the local government sector – some significant – that can impact on councils' operations and sustainability.

The department recognises that an effective and efficient sector is 'crucial to the economic and social wellbeing of communities across the State,' but the OLG does not routinely review the results of its regulatory activities to improve its approaches. The OLG has also not clearly defined and communicated its regulatory role to ensure that its priorities are well understood.

Inadequate performance measurement and reporting on its regulatory activities is a significant transparency and accountability issue, and the OLG cannot demonstrate that it is effectively regulating the local government sector.

The department lacks an adequate framework to define, measure and report on the OLG's performance as the state regulator of the sector under the *Local Government Act 1993* (the LG Act). The OLG's various council engagement activities are not well structured and coordinated towards delivering on a clearly defined regulatory role and its regulatory priorities are not well understood. In 2022, the OLG identified, in its new strategic plan, that there is a need for it to define its role in the sector. It would be expected that a clearly defined role already underpins its aim to 'strike the right mix of monitoring, intervention, capability improvement and engagement activities'.

The OLG collects various sources of information about council compliance and performance but its systems and processes do not enable structured, proactive sector monitoring to enable timely, risk-based responses. Ineffective sector monitoring is a particular issue in the context of compliance, financial management and governance risks that have been identified in inquiries and reviews by other government agencies including integrity bodies and reported by the sector. Audit Office data for 2021–22 shows that 62 councils did not have or regularly update key corporate governance policies, and 63 do not have basic controls to manage cyber security risks. Further, 31 councils or joint organisations did not meet the statutory requirement to have an audit, risk and improvement committee by 30 June 2022.¹

Overall, the OLG has made limited progress on projects that have been identified since 2019 to improve its sector monitoring, such as updating its performance measurement framework for councils. These factors limit its capacity to identify and act on issues early. In early 2023, the OLG started to implement a new council risk assessment tool.

The OLG's two main frameworks to guide its sector improvement and intervention activities were last updated in 2014 and 2017. The OLG considered relevant statutory criteria when advising the Minister on the use of powers to issue performance improvement and suspension orders under the LG Act. But the OLG lacks complete and approved procedures to guide staff when preparing advice and recommendations related to interventions, and other response options. This creates risks to the consistency and transparency of relevant processes.

The department and the OLG have identified that resourcing issues present a risk to the OLG's regulatory functions. Projects since 2021 to review the OLG's budget did not progress. The OLG does not routinely review the costs or evaluate the effectiveness of its regulatory activities.

The OLG's 2022–2026 strategic plan sets out a vision to be, 'A trusted regulator and capability builder enabling councils to better serve their communities'. Implementing the strategic plan presents an opportunity for the OLG to better define, communicate, and deliver on its regulatory objectives towards strengthening the sector. The OLG advises that a delivery plan and performance indicators for its new strategy are being developed, alongside work resulting from the 2022 review of the councillor misconduct framework.

¹ This data has been sourced through the Audit Office's financial audits of councils. The Local Government 2022 report, which compiles results from the local government sector financial statement audits for the year ended 30 June 2022, will include this and additional data, and related information. This report is expected to be tabled in June 2023.

1. Key findings

The OLG is responsible for strengthening the local government sector but inadequate performance measurement and reporting limits its transparency and accountability

The Department of Planning and Environment (the department)'s key planning documents identify the Office of Local Government (OLG) as responsible for improving council performance and governance, and strengthening the system of local government. The department lacks an adequate framework to define, measure and report on the OLG's performance, and to assess the contribution of its regulatory activities to its strategic objectives as well as departmental and state outcomes.

Departmental annual reporting since 2019–20 has not included specific information about the OLG's role in regulating the sector, or its outputs and outcomes. As a business unit within the department, the OLG is not required to produce an annual report, and the OLG does not otherwise routinely publicly report on its performance as a regulator. Doing so would be good regulatory practice to support transparency and accountability.

Defining measurable outcomes and reporting performance are also core to ensuring the effective and economical use of resources. The OLG does not routinely review the costs or evaluate the efficiency and effectiveness of its regulatory activities towards continuous improvement. Its processes and systems do not readily support analysis of whether resources are being effectively prioritised.

The OLG finalised its new strategic plan for 2022–26 in December 2022 and is developing a delivery program and performance measures to support its delivery.

The OLG has not adequately defined and communicated its regulatory role in the sector creating risks to its regulatory effectiveness

The OLG is the state regulator of the local government sector, alongside other responsibilities. But the scope and intent of the OLG's various activities and points of engagement with councils have not been well defined. The OLG's 2022–2026 strategic plan sets a new goal to build strong state, local government and stakeholder relationships, including by defining the role OLG plays in the local government sector. It would be expected that a clearly defined role would already underpin the OLG's strategic planning process to enable it to develop its vision, goals and objectives for the future consistent with its role.

The OLG's publicly available 2017 Improvement and Intervention Framework in relation to NSW Councils describes the OLG's regulatory approach, stating that the OLG will encourage voluntary compliance and good practice before taking steps to 'persuade' or 'enforce' compliance. The OLG delivers a range of activities that aim to support and strengthen sector performance and compliance. But the OLG was slow to finalise guidance for the sector on key issues such as cyber security, risk management and internal audit. It has also not developed and implemented a clear sector engagement strategy to ensure its regulatory approach is well understood and coordinated, including in view of its other activities.

An inadequately defined and communicated role in the sector presents risk and challenges to the OLG's regulatory effectiveness. For example, Audit Office reports to Parliament since 2017 have recommended that the department and OLG communicate the State's view and address different practices across the sector in councils' accounting for rural firefighting equipment. But rather than proactively adopting a clear regulatory position that addresses the issue of continued council non-compliance with the Australian Accounting Standards, the OLG has attempted to broker between levels of government. This has not resolved the issue, and has caused confusion about its role as the state regulator of the local government sector. Forty-three councils received qualified audit opinions on their 2021–22 financial statements due to non-compliance on this matter.²

² This data has been sourced through the Audit Office's financial audits of councils. The Local Government 2022 report, which compiles results from the local government sector financial statement audits for the year ended 30 June 2022, will include this and additional data, and related information. This report is expected to be tabled in June 2023.

The OLG's 2022–2026 strategic plan, which includes reference to a 'council engagement strategy' (to be developed), presents an opportunity for the OLG to improve how it develops and implements sector-wide and council-specific engagement activities.

The OLG lacks a structured approach and effective systems to support sector monitoring, limiting its capacity to identify risks and implement timely responses

Targeted, intelligence-led sector monitoring is important so that the OLG can identify trends, risks and issues early. The OLG has various sources of information about sector-wide and council-specific compliance and performance, but lacks adequate processes to ensure the most relevant information is gathered and used in a structured and coordinated way.

Information about the sector and councils is used by different OLG teams for regulatory and non-regulatory functions, and it is analysed and handled manually across a number of systems that are not integrated. The OLG does not have a data management framework that defines the roles and responsibilities of teams and key staff for managing data, including for regulatory purposes. The OLG also lacks a structured, risk-based approach to using the information available to it to proactively develop responses to known and emerging issues in the sector.

The OLG's main mechanism for routinely reviewing sector performance is an annual benchmarking of financial and other data that it requires councils to submit after each financial year. But this process does not provide timely information about councils' financial sustainability or other performance indicators. As such, it is of limited relevance to sector monitoring for the purpose of the OLG identifying and acting on risks and issues early.

Opportunities for the OLG to improve its digital systems and better use information for sector monitoring (such as data on complaints about councils and councillors) were identified in an internal audit, two consultant reviews and departmental projects since 2019, but have not resulted in substantive changes.

The OLG's operational planning documents since 2019–20 have also identified various actions to improve its approach to sector monitoring, including ways to be more proactive, but there has been limited progress. Some projects are identified as subject to resourcing.

The OLG is procuring a case management system for its investigation and intervention functions.

The OLG's processes to consider performance and compliance issues have lacked a clear and consistent risk assessment framework, but a new tool is being implemented in 2023

There are regular meetings of OLG managers and directors that act as a forum to share information and discuss risks relevant to councils and the sector. Risk levels have been applied to councils during these meetings, but the rationale for these assessments is not clearly or consistently documented.

The Audit Office's 2012 performance audit on '[Monitoring local government](#)' recommended that the OLG establish a risk-based framework for assessing council performance and determining how to respond to issues. In 2019, the OLG identified that the timeliness of its interventions could be negatively impacted by not implementing effective risk profiling. In November 2022, the OLG commenced a project to develop a council risk assessment tool. The OLG started implementing the tool in March 2023.

The OLG has frameworks to guide its regulatory responses but relevant aspects are out of date and there are gaps in procedures to support their application

The OLG's regulatory responses are guided by frameworks developed in 2014 and 2017, and relevant criteria under the LG Act. The OLG has not updated these frameworks to reflect changes to (or the most current) business operations, regulatory strategies, and legislative provisions.

These frameworks are also not supported by complete and approved procedures, and related templates are not consistently used. For example, quality assurance and control mechanisms are not adequately reflected in the OLG's procedures, and the OLG has not provided staff with clear guidance on the implementation of departmental conflict of interest considerations specific to staff undertaking regulatory activities. The OLG also lacks approved procedures to guide staff when preparing and reviewing advice and recommendations related to interventions, and other regulatory responses.

Our review of documentation related to advice on the use of ministerial intervention powers to issue performance improvement orders and suspension orders since 1 July 2019 found that the OLG's advice to the Minister for Local Government considered the relevant legislative criteria: we did not identify inconsistencies with procedural requirements under the LG Act. But gaps in the OLG's procedures are significant because they create risks to the consistency and transparency of processes for ministerial and departmental executive decisions and other regulatory responses.

Projects to review the OLG's resourcing did not progress, but resourcing is under consideration as the OLG implements its new strategic plan

Resourcing has been identified in OLG operational planning documents and risk registers as limiting the progress of actions to deliver on its (previous) 2018–2022 strategic plan. A September 2021 departmental document describes adequate resourcing and systems as an 'issue' for the OLG's regulatory activities. Projects since 2021 to review the OLG's resourcing, and consider increases, did not progress.

The OLG advises that it intends to review resources as part of finalising the delivery program for its new 2022–2026 strategic plan, and in view of recommendations made in the 2022 review of the councillor misconduct framework.

Recommendations from the review of the councillor misconduct framework

A 2022 review of the councillor misconduct framework made 49 recommendations, including to develop a new accountability framework for dealing with councillor misconduct. It was outside the scope of this audit to assess the framework or the 2022 review. It is the responsibility of the department to consider the relevance of findings and recommendations from the review, and any relevant reform activities, when implementing recommendations made in this Audit Office report.

2. Recommendations

By December 2023, the Department of Planning and Environment's Office of Local Government should:

1. Publish a council risk assessment tool to support councils to self-assess and report on performance and compliance issues, including to their audit, risk and improvement committee.
2. Ensure that its sector engagement strategy incorporates a clear articulation of the OLG's regulatory approach, and that activities under this strategy are consistent with and support its regulatory approach.
3. Implement enhanced processes for regularly tracking and internally reporting on operational activities, including their status, risks and relevant impacts on the delivery of the OLG's regulatory activities.

By July 2024, the Department of Planning and Environment's Office of Local Government should:

4. Publish a report on its regulatory activities and performance that is underpinned by:
 - a performance measurement framework for the OLG's activities that is linked to its regulatory objectives, as well as departmental and state outcomes
 - a review and analysis of recent and emerging sector-wide issues and trends.
5. Establish a program of yearly reporting on its regulatory performance, informed by analysis of sector-wide issues and trends.
6. Publish an annual calendar of key sector support and monitoring activities, to promote transparency and communicate the OLG's regulatory priorities to the sector.
7. Develop and maintain a data management framework that supports efficient, coordinated and controlled data gathering, sharing and use across OLG teams.
8. Review and update frameworks and procedures for regulatory responses to ensure they are current and support transparent advice and decision-making, including through:
 - consistent approaches to documenting key considerations when identifying appropriate regulatory responses
 - guidance on identifying and managing conflicts of interest specific to the OLG's regulatory activities
 - routine processes to review the costs, effectiveness and impact of regulatory activities.

1. Introduction

1.1 The system of local government

In New South Wales, the *Local Government Act 1993* (the LG Act) and Local Government (General) Regulation 2021 (the Regulation) provide the legal framework for the system of local government.

Exhibit 1: Purposes of the *Local Government Act 1993*

Section 7 Purposes of the Act

- a) to provide the legal framework for the system of local government for New South Wales
- b) to set out the responsibilities and powers of councils, councillors and other persons and bodies that constitute the system of local government
- c) to provide for governing bodies of councils that are democratically elected
- d) to facilitate engagement with the local community by councils, councillors and other persons and bodies that constitute the system of local government
- e) to provide for a system of local government that is accountable to the community and that is sustainable, flexible and effective.

Source: Section 7, LG Act.

The Minister for Local Government is responsible for administering the LG Act and has various powers and responsibilities.

The LG Act also confers powers and responsibilities on the 'Departmental Chief Executive', currently the Secretary of the Department of Planning and Environment (the department).

Chapter 3 of the LG Act sets out principles that provide guidance to enable councils to carry out their functions in a way that facilitates local communities that are 'strong, healthy and prosperous'. These include principles for exercising functions, for decision-making and community participation, for sound financial management, and for integrated planning and reporting.

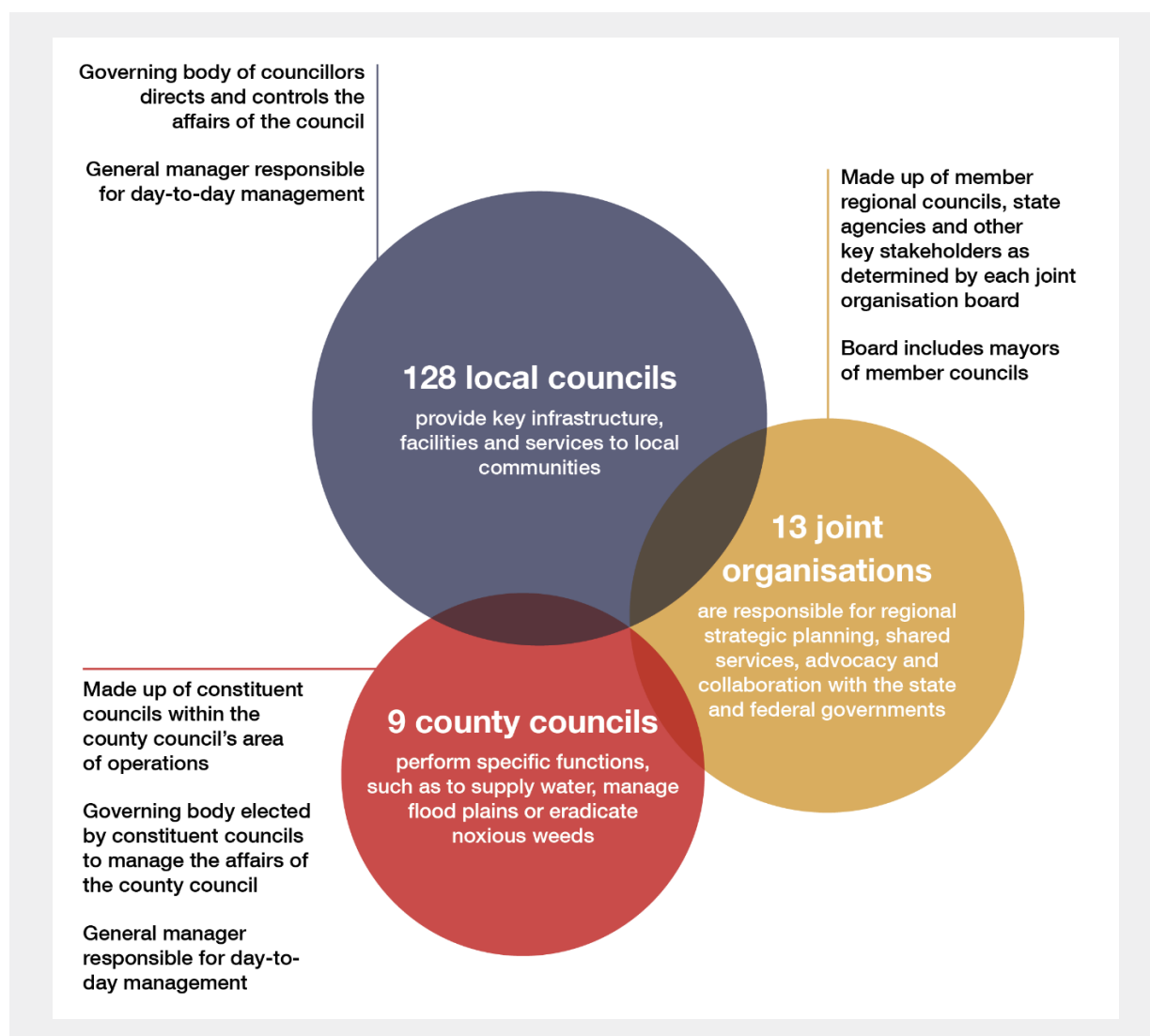
The LG Act has been amended in the last decade, including as part of the NSW Government's local government reform which started in 2014 when the government released its 'Fit for the Future' program. Amendments to the Act include:

- the introduction of new powers for the Minister for Local Government to issue performance improvement orders and to temporarily suspend councils
- the inclusion of principles for councils; expanded role descriptions for councils, mayors, councillors and general managers; financial and performance auditing of councils by the Auditor-General; and requirements for councils to have audit, risk and improvement committees
- introduction of joint organisations of councils
- amendments to requirements relating to councils charging rates to their communities.

The local government sector

The local government sector in New South Wales is made up of 128 local councils, nine county councils and 13 joint organisations of councils. According to data published by the department, taken together the 128 local councils employ over 48,000 staff. In 2021–22, local councils managed \$175.2 billion in infrastructure, property plant and equipment, held \$16.8 billion of cash and investments, collected \$7.8 billion in rates and charges and entered into \$3.7 billion of borrowings.

Exhibit 2: Overview of the local government sector in New South Wales



Source: Audit Office analysis of LG Act and publicly available information.

The role of the governing body of a council includes to direct and control the affairs of the council in accordance with the LG Act, ensure as far as possible the financial sustainability of the council and that the council acts in accordance with the principles set out in Chapter 3 of the LG Act. The governing body also determines the process for the appointment of the general manager and monitors their performance.

Accountability-related requirements on councils

Chapter 13 of the LG Act, titled 'How are councils made accountable for their actions?', sets out requirements for councils, including:

- integrated planning and reporting requirements for councils to prepare a community strategic plan, community engagement strategy, resourcing strategy, delivery program and operational plan
- requirements relating to financial management, reporting and accounting, including that a council's financial statements are audited by the Auditor-General
- annual reporting requirements relating to the council's achievements and effectiveness
- the requirement to have an audit, risk and improvement committee.

Chapter 13 also includes discretionary powers for the Minister for Local Government to respond to council performance issues. These include powers to:

- issue a performance improvement order with the option to appoint a financial controller and/or temporary adviser
- issue a suspension order to temporarily suspend a council and appoint an interim administrator
- appoint a commissioner to hold a public inquiry into a council, which may lead to appointment of an administrator.

The Secretary of the department also has powers and responsibilities under the LG Act. These include issuing guidelines relating to the exercise of council functions that councils must take into consideration, making preliminary enquiries, investigating any aspect of a council or of its work or activities, reviewing councillor misconduct and pecuniary interest complaints, considering requests for an extension of time for a council to prepare and audit its financial reports, and investigating public interest disclosures.

Councils have functions and requirements under other legislation. These include, for example, building and development controls under the *Environmental Planning and Assessment Act 1979* and animal control under the *Companion Animals Act 1993*.

Other parts of government oversee and regulate aspects of councils' activities and the local government sector. These include the Environment Protection Agency, the Information and Privacy Commission and the Independent Commission Against Corruption.

Councillor conduct

Elected councillors are accountable to the local community for the performance of the council.

Chapter 14 of the LG Act sets out a framework for managing councillor misconduct, serious corrupt conduct and complaints concerning failure to disclose pecuniary interests. In 2021, the former Minister for Local Government requested the OLG to commission a review of this framework. The review reported in October 2022 and made 49 recommendations, including to develop a new accountability framework for dealing with councillor misconduct and to establish an independent Councillor Conduct Commission to oversee independent Councillor Conduct Review Panels. It was outside of the audit scope to assess the councillor misconduct framework or the review (see Chapter 1.3).

1.2 Department of Planning and Environment

The department is the primary state government agency with responsibility for policy, legislative and program functions for local government matters, including activities to monitor and regulate the local government sector. It identifies the OLG as responsible for a priority to 'Improve council performance and governance and strengthen the system of local government', relevant to the state outcome to 'Create a strong and liveable NSW'. The department has stated that:

Effective and efficient local government is crucial to the economic and social wellbeing of communities across the state. OLG ensures councils and council officials are held accountable for performance and integrity through a combination of communication, monitoring, risk-profiling and intervention.

... OLG works with the local government sector to strengthen the sustainability, performance, integrity, transparency and accountability of local councils across the state.

The Office of Local Government

The OLG is a business unit within the department that advises the Minister for Local Government and exercises delegated functions of the Secretary of the Department of Planning and Environment under the LG Act. A deputy secretary oversees the OLG and reports to the Secretary.

The functions of the OLG have been differently positioned within government over time. The Department of Local Government was established in 1995 and abolished in 2009 when its functions were transferred to a Division of Local Government within the Department of Premier and Cabinet. The OLG was created as a separate public service agency in February 2014 until it was abolished in July 2019 and its functions were transferred to a newly established department, the Department of Planning, Industry and Environment (DPIE). The Department of Planning and Environment was created in December 2021 and has maintained the OLG's functions and branding since that time.

A 2021 Audit Office performance audit on '[Machinery of government changes](#)' found that 'specific reasons for establishing DPIE were not documented at the time of the change and anticipated benefits were not defined'.

The OLG's 2018–2022 strategic plan set a vision for 'Local and state governments working together to better serve communities'. The OLG's new strategic plan for 2022–2026 was finalised in December 2022.

The OLG's regulatory approach

The OLG's 2017 Improvement and Intervention Framework in relation to NSW Councils outlines what type of response may be appropriate where council compliance or performance risks and issues are identified. The framework states that the purpose of any intervention is to encourage councils and individuals to voluntarily act appropriately.

According to the framework, where councils are not performing as expected the OLG will:

- respect the democratic mandate of councils and importance of self-improvement
- intervene early to strengthen a council's capacity to meet its obligations
- escalate action appropriately, promptly and proportionally
- consider the broader implications of any intervention on the local government sector
- commit to maintaining strong and constructive relationships.

The OLG's Performance team and Investigations team are primarily responsible for implementing the framework, and for monitoring and responding to sector risks and issues, but other teams also undertake relevant activities.

The OLG also supports the administration of the councillor misconduct framework under the LG Act.

The OLG's other functions and activities

The OLG has other functions which form part of its core activities including developing policy, supporting local government election processes, grants administration, promoting responsible pet ownership, managing the NSW Pet Registry, and providing advice to the state government and Minister for Local Government on local government matters.

The OLG has delivered and coordinated supports to councils impacted by recent emergency events, including bushfires, floods and the COVID-19 pandemic, including through grants administration, membership of NSW government emergency working groups and issuing guidance and updates to the sector.

These other functions are primarily undertaken by the OLG's Program Delivery, Council Engagement, Council Governance and Policy teams, as well as the Emergency Recovery & Strategy directorate.

1.3 About the audit

The objective of the audit was to assess whether the OLG, as part of the department, is effectively monitoring and regulating the local government sector under the LG Act. It focused on:

- the effectiveness of departmental arrangements for the OLG to undertake its regulatory functions
- whether the OLG has effective mechanisms to monitor and respond to risks and issues relating to council compliance and performance.

The audit scope covers administrative arrangements and processes since 1 July 2019 that support the Secretary of the department and the Minister for Local Government to hold councils to account using the powers available under Chapter 13 of the LG Act, and related activities to monitor and strengthen compliance and performance in the sector (see Appendix two).

The audit did not examine the OLG's broader functions and activities or regulatory activities relating to the councillor misconduct framework, which were out of scope.

The performance or compliance of individual councils and the merits or impact of decisions about the use of investigation and intervention powers in relation to councils were also not in scope.

For further detail on our audit procedures see Appendix three.

2. Oversight and enabling arrangements for the OLG

This chapter considers the effectiveness of departmental arrangements for the OLG to undertake its regulatory functions.

2.1 Accountability for effective sector regulation

The OLG is responsible for strengthening the local government sector but lacks an adequate framework to measure its regulatory performance

The department identifies the OLG as being responsible for improving council performance and governance, and strengthening the system of local government. The OLG has stated that it is responsible for strengthening the sustainability, performance, integrity, transparency and accountability of the local government sector. But the department lacks an adequate framework to define, measure and report on the OLG's performance as the state's regulator of the local government sector. This limits departmental accountability for effective sector regulation.

The department's business planning documents identify the OLG as responsible for improving council performance and governance and strengthening the system of local government, relevant to a state outcome to 'Create a strong and liveable NSW'. These documents reference the OLG's regulatory functions and goals, and include performance measures. These measures have been in place since at least September 2021 but do not provide meaningful performance information about the OLG's regulatory activities and their contribution to departmental and state outcomes. These measures are discussed below:

- **Number of councils assessed for financial performance (measured annually, target 100% per annum).** This measures outputs only, that is the number of councils assessed by the OLG each year. A link between this output and the OLG's contribution towards strengthening sector performance is not well defined, for example performance is not defined in view of the quality, relevance or timeliness of the assessment (see also Chapter 3.1).
- **Whether all councils had adopted the audit, risk and improvement committee (ARIC) framework (measured quarterly).** It is unclear whether this indicator aims to measure compliance with the statutory requirement for councils to have an ARIC by 4 June 2022, or councils' implementation of related policy requirements and expectations, such as those set out in the Guidelines for Risk Management and Internal Audit which were not approved until December 2022. The OLG has advised that it does not collect data on council compliance with the requirement to have an ARIC. Its current target is 100% adoption by June 2023.

The only other departmental performance measure for the OLG relates to the number of cat and dog registrations, relevant to the OLG's role to maintain the NSW Pet Registry.

The OLG's 2018–2022 strategic plan did not include performance measures for its goals.

In December 2022, the OLG finalised a new strategic plan for 2022–26, with the vision to be 'A trusted regulator and capability builder enabling councils to better serve their communities'. The department has advised that delivery plans and performance metrics for the new strategic plan are being developed.

Defining measurable outcomes, tracking and reporting performance are core to ensuring the effective and economical use of resources. Inadequate performance measures create a risk that the OLG is not able to demonstrate its regulatory effectiveness, and participate effectively in outcome-based budgeting processes.

The lack of public reporting on OLG's regulatory activities and performance limits transparency and accountability

Departmental annual reporting since 2019–20 has not included specific information about the OLG's role in regulating the local government sector, or the outputs and outcomes of the OLG's regulatory activities. This limits transparency and accountability around the OLG's activities and priorities, and whether it is achieving its regulatory objectives.

The OLG publishes some information about its regulatory activities on its website, such as lists of current and previous interventions, public inquiries, completed investigations, and information on the number of complaints it has received about councils or councillors. But this reporting is limited in detail does not provide visibility around the OLG's operational and regulatory priorities or communicate the extent to which OLG's regulatory activities have contributed to sector outcomes.

When the OLG was a separate agency it was required to prepare and publish an annual report with information about its performance, management, activities, risks and financial position. This requirement does not apply to the OLG as a business unit with the department, but routine reporting on regulatory activities and outcomes is good practice. Some other regulators in New South Wales, and at the Commonwealth level, publish reports or statements (other than annual reports) that aim to provide assurance around the performance of their regulatory activities towards objectives.

The OLG does publish council data on its Your Council website. This aims to enable councils and members of the public to see how their council is performing in comparison to other councils against OLG financial benchmarks and a range of other indicators.

Departmental arrangements for the OLG have changed multiple times impacting the continuity of governance arrangements and key projects

The positioning and executive reporting lines for the OLG business unit have changed four times since the OLG's functions were transferred to the department in July 2019. Changes to arrangements for the OLG within the department have impacted the progress and continuity of governance arrangements including for risk management, and key projects relevant to the OLG's operations.

Since December 2022, the OLG has been part of the 'Local Government Group' with a dedicated deputy secretary. Prior, the OLG was part of three other departmental groups with broader portfolio responsibilities.

Exhibit 3: Positioning of the OLG business unit within the department



Source: Audit Office analysis of departmental information.

The OLG's risk register was not fully reviewed and updated according to departmental risk management procedures until September 2022. The risk register was reviewed in January 2023 and is to be reviewed quarterly.

The department developed a more structured process for tracking risks and audit recommendations and reporting progress to the Crown Lands and Local Government Group executive in 2022. However, this process no longer applies to the OLG as part of the newly established Local Government Group.

Compliance gaps in OLG's code of conduct and conflict of interest declarations were identified during this audit. Steps have been taken to improve the level of compliance, but gaps remain.

2.2 Strategic and operational planning

The OLG has not adequately defined its role in the sector, creating risks to its effectiveness

The OLG is the state regulator of the local government sector under the LG Act, alongside other responsibilities. But the scope and intent of the OLG's various activities and points of engagement with councils have not been well defined. The OLG's 2022–2026 strategic plan includes a strategy to 'define the role OLG plays in the local government sector' towards building strong state and local government and stakeholder relationships. It would be expected that a clearly defined role in the sector already underpins the OLG's strategic planning processes to enable it to develop its vision, goals and objectives for the future consistent with its role. Its core activities and legislative responsibilities are varied but have not undergone substantial reforms since at least 2018, and the purpose of the LG Act has not changed.

The OLG's 2017 Improvement and Intervention Framework sets out features of the OLG's regulatory approach, but the publicly available framework is not current in relevant aspects (see Chapter 3.2). The lack of clarity with respect to the OLG's regulatory role is also consistent with findings from consultations with other agency and local government sector representatives.

An inadequately defined regulatory role contributes to challenges and risks to the OLG's effectiveness, including:

- challenges to defining what key data/information about councils and the sector is needed for the efficient, intelligence-led monitoring of performance and compliance risks and issues (see Chapter 3.1)
- operational challenges for the OLG when it receives high volumes of correspondence and requests that fall outside of its remit, such as enquiries related to development or planning decisions made by councils
- strategic challenges for the OLG in responding to ministerial or departmental priorities and operational demands, such as defining the appropriate scope of OLG support to the sector in relation to emergency events
- coordination challenges with other regulators and agencies when engaging with councils on operational or policy issues, and when referring issues or responding to information, for example around the referral of complaints about councils/councillors
- reputational risks for the department being able to demonstrate that the OLG's activities are contributing to clearly defined outcomes (see Chapter 2.1), and where there is a perceived lack of alignment with public or sector expectations of the OLG, or with state government priorities or requirements.

Councils are required under the LG Act to maintain proper accounting and prepare financial statements in accordance with the Australian Accounting Standards. The State Government, through NSW Treasury (and in agreement with the department), has concluded that under the Australian Accounting Standards rural firefighting equipment vested to councils is not controlled by the State, and that on balance councils control this equipment. The non-recording of rural firefighting equipment within councils' financial statements increases the risk that these assets are not subject to at least an annual stocktake, not properly maintained and managed, and that councils' financial statements do not comply with the Australian Accounting Standards.

Audit Office reports to Parliament since 2017 have recommended that the department and OLG should communicate the State's view and address different practices across the sector in accounting for rural firefighting equipment. Rather than proactively adopting a clear regulatory position to address the issue of continued council non-compliance with the Australian Accounting Standards, the OLG has attempted to broker between levels of government. This has not resolved the issue and has caused confusion about its role as the state regulator of the local government sector. Forty-three councils received qualified audit opinions on their 2021–22 financial statements due to their failure to either perform a stocktake of this equipment and/or recognise this equipment.

The OLG has not developed and implemented a sector engagement strategy to ensure the scope and intent of its various activities and points of engagement with councils is well-defined, and that its regulatory approach and activities are well understood. Its sector engagement activities are not clearly coordinated, and it lacks clear procedures setting out expectations for its various engagement activities.

The department determined that a risk relating to the OLG ineffectively communicating its role and powers was no longer relevant to monitor and manage, archiving it in September 2022. In January 2023, the department reinstated this risk as relevant to monitor.

Projects in 2021 to review the OLG's resourcing did not progress, but resourcing is under consideration as the OLG implements its new strategic plan

The department determines the OLG's budget, consistent with NSW Treasury requirements for outcome-based budgeting. Resourcing has been identified in OLG operational planning documents and risk registers as limiting progress on delivering its 2018–2022 strategic plan. Projects in 2021 to review the OLG's resourcing, and consider increases, did not progress.

As at February 2023, there are 21 positions within the OLG's Performance and Investigations teams, which is around a quarter of the OLG's total positions. Departmental information shows that \$241.6 million of the OLG's \$255.7 million total latest approved budget for 2022–23 is committed to specific programs or activities, such as grants programs for floods and companion animals, pensioner council rate concessions, maintaining the NSW Pet Registry, and depreciation. The remaining \$14.1 million is available for the OLG's labour and other operational costs, including for activities relevant to the delivery of its regulatory functions. The department anticipates a decrease in the OLG's overall budget in the coming years, consistent with cost-saving measures across the department.

A September 2021 departmental document describes adequate resourcing and systems as an 'issue' for the OLG's regulatory activities. In late 2021, the department agreed to projects to consider resourcing and investment in the OLG's regulatory effectiveness:

- In November 2021, a review identified opportunities for operational changes and increased investment in systems and technology to improve the OLG's sector performance and intervention activities. Recommendations from that review were not progressed. Departmental documents in 2022 identified enhancing the OLG's digital capability as a priority.
- In December 2021, the department endorsed a project to develop a budget strategy to identify the resources required to enable the OLG to operate at 'full functionality' (including to proactively build the capability of the local government sector). Ministerial and departmental administrative changes occurred later that month. The project did not progress.

The OLG advises it is reviewing its resources as part of finalising the delivery program for its new 2022–2026 strategic plan, and in view of reforms resulting from the review of the councillor misconduct framework. That review comments on resourcing levels and the OLG's remit, and notes limitations that affect delivery of investigation and intervention functions. The OLG's resourcing has also been a consistent theme in consultations with the department and stakeholders in this audit.

The Audit Office's '[Audit Insights 2018–2022](#)' report states that adequate resourcing levels should be defined in resourcing models to ensure delivery can reach expected performance levels, meet complex needs, be responsive to changing environments, and coordinate requirements. The OLG's operational plans to support the delivery of its 2018–2022 strategic plan were not consistently approved, updated or reported against since 2019. There are opportunities for the OLG to implement clearer mechanisms for regular reporting to senior management on milestones, budget, and key risks in delivering its new strategic plan.

3. Monitoring and responding to sector risks and issues

This chapter assesses whether the OLG has effective mechanisms to monitor and respond to risks and issues relating to council compliance and performance.

The OLG's 2017 Improvement and Intervention Framework is intended to guide appropriate responses to council compliance or performance risks and issues. The publicly available framework states that generally, the OLG will encourage councils to meet their obligations before a more formal intervention will be considered. It also states that any intervention or improvement response will be proportionate to the circumstances.

Exhibit 4: OLG's intended improvement and intervention approach



Source: Audit Office diagram citing text from the OLG's 2017 Improvement and Intervention Framework.

3.1 Monitoring sector risks and issues

The OLG does not have fit-for-purpose information management systems to support effective sector monitoring

The OLG does not have fit-for-purpose systems or coordinated processes to effectively use information about the sector and councils to inform its sector monitoring and regulatory responses. The OLG also does not have a data management framework that defines the roles and responsibilities of its teams and key staff for managing data.

The OLG's main record keeping system enables it to categorise documents and manage correspondence, but it lacks adequate search and reporting functionalities for sector monitoring. OLG teams also use other systems and manual processes when handling information and analysing data about councils. This results in a range of uncoordinated data sets, and a high reliance on key personnel to share relevant, timely information without the support of controlled systems and processes. This includes information from the Council Engagement team that has access to, but does not routinely use, a customer relationship management system. In March 2023, the OLG advised that a data management framework is being developed.

Opportunities for the OLG to better use information for sector monitoring were identified in an internal audit and two consultant reviews since 2019. These included opportunities related to using complaints data about councils and councillors. In 2020–21, it received 1,543 complaints about 123 councils, of which 43% related to financial management, management/maladministration, or council governance. The OLG has not implemented an improved approach for analysing complaints data and using it for sector monitoring purposes.

Projects in 2022 to consider the efficiency and productivity of the OLG's digital systems have not resulted in substantive changes.

The OLG lacks a structured approach to proactive sector monitoring, limiting its capacity to identify risks and implement timely, proportionate responses

The OLG collects various sources of information about council compliance and performance, but does not have adequate processes to ensure the most relevant information is gathered and used in a structured, coordinated way to proactively develop responses to known and emerging issues in the sector. This limits its capacity for targeted, intelligence-led sector monitoring to identify sector trends and council-specific risks and issues early.

The OLG sets out standards and expectations for councils, including in its guidelines and handbook on the integrated planning and reporting (IP&R) framework, annual Code of Accounting Practice and Financial Reporting, a Calendar of Compliance, and model codes of conduct and meeting practice. However, the OLG has not clearly defined its approach to sector monitoring in view of these or other relevant requirements under the LG Act, or other policy expectations. For example, the OLG does not have a structured approach to monitoring compliance with the IP&R framework under the LG Act.

The lack of structured monitoring is a particular issue in the context of compliance, financial management and governance issues that have been identified in reviews and inquiries by State government agencies and integrity bodies and reported by the sector. Audit Office data for 2021–22 identified the following deficiencies relevant to governance and internal controls:

- 63 councils did not have basic governance and internal controls to manage cyber security
- 62 councils did not have or did not regularly update key corporate governance policies such as for risk management, contract management and business continuity
- 31 councils did not have an audit, risk and improvement committee
- 20 councils reported deficiencies in fraud control processes
- 21 councils did not have a sufficient legislative compliance policy or register.

The OLG has not routinely implement targeted monitoring activities based on these or similar indicators, and taking into account the diversity of the sector. For example, considering differences between rural and metropolitan councils, or for local and county councils.

However, there is evidence of some targeted monitoring starting recently. For example, in August 2022, the OLG announced that it would audit compliance with Model Code of Conduct requirements for certain council officials, including councillors, to lodge a written declaration of their personal interests. This proactive project could provide useful intelligence on compliance and potential governance risks.

Financial management and sustainability risks

Under the LG Act, councils are expected to apply sound financial management principles that require responsible and sustainable spending and investment, and consideration of intergenerational equity.

The OLG reviews financial data submitted by councils on an annual basis to assess and benchmark their financial performance. This data does not provide timely information about councils' financial sustainability or other performance risks and issues. As such, it is of limited relevance to sector monitoring for the purpose of identifying and acting on risks and issues early. In addition, the timeliness of the OLG's review is impacted by whether councils seek an extension to submit their financial statements.

For the 2021–22 financial year, the number of councils and joint organisations applying for an extension of time to submit their audited financial statements increased from 41 in 2020–21 to 57 in 2021–22.³

³ This data, and the data on deficiencies in governance and controls (above), has been sourced through the Audit Office's financial audits of councils. The Local Government 2022 report, which compiles results from the local government sector financial statement audits for the year ended 30 June 2022, will include this and additional data, and related information. This report is expected to be tabled in June 2023.

Councils are required under the Local Government (General) Regulation 2021 to prepare quarterly budget reviews setting out a revised estimate of their income and expenditure for the year. The OLG is developing a process to review these budget statements to inform its monitoring activities.

The OLG has identified projects that could improve its sector monitoring, but relevant progress has been limited

The OLG's operational planning documents since 2019–20 have identified various actions or projects relevant to improving its sector monitoring approach, and making it more proactive, but its progress on these has been limited (Exhibit 5).

Exhibit 5: Overview of the status of OLG's sector monitoring projects

Action identified in OLG planning documents	Status recorded by OLG			
	2019–20	2020–21	2021–22	2022–23
Review/delivery of the performance measurement framework for councils	High priority, subject to resourcing	Inactive, subject to resourcing	High priority, subject to resourcing	High priority, subject to resourcing
Council risk profiling project	(Not listed)	On track	On hold	High priority, status unclear [^]
Review and refresh of Promoting Better Practice Review program	On track with work 'well underway'	(Not listed)	Medium priority, subject to resourcing	Medium priority, subject to resourcing

[^] Note: The OLG started implementing a new risk assessment tool in March 2023 (see below).

Source: Audit Office analysis of OLG documentation.

Audit Office performance audits in 2018 and 2019 recommended that the OLG progress the development of a performance measurement framework and associated performance indicators, for use by councils and the government in sector-wide performance reporting. The OLG has identified delivering such a framework as a high priority for councils since 2019–20. The lack of progress on this is significant considering the OLG reports it has been reviewing the framework since 2013, and the OLG's guidelines for staff conducting financial reviews have not been updated since 2012. An April 2022 consultant report also recommended that the OLG update its performance indicators for councils, but the OLG has not yet done this.

The OLG advises that it has started to implement recommendations from a 2021 review of its framework for joint organisations of councils which included a recommendation to develop a performance measurement framework for joint organisations.

The OLG has made limited progress on its refresh of the Promoting Better Practice Review program which ran from 2004 to 2014. According to the OLG's website, this program was designed to act as a 'health check' and aimed to assist in strengthening the local government sector by providing councils with the opportunity to reflect on the systems, policies and procedures contributing to their overall performance. The program involved the OLG working with councils to recommend improvements following a council self-assessment to consider whether it has appropriate arrangements across the following key areas: strategic planning, governance, planning and regulation, asset and finance, community and consultation and workforce relations. Sector peak organisations and stakeholders informed the audit that this was generally a useful and proactive program, and some councils advised that they still use the checklist that was developed for the program as a guide.

Regular meetings support the OLG's consideration of sector risks and issues, but has lacked a clear and consistent risk assessment framework

Regular meetings of OLG team managers and directors provide a forum for discussing risks and issues relevant to councils and the sector. These meetings aim to maximise the value of internal expertise and information across teams to support coordinated and consistent regulatory responses. The Audit Office's 2012 performance audit report on '[Monitoring local government](#)' recognised that similar meetings occurring at that time were an appropriate way to respond to high-risk councils.

But the OLG has lacked a clear and consistent framework for assessing council risks during these meetings, or for related monitoring and regulatory purposes. The 2012 performance audit included a recommendation that the OLG establish a risk-based framework for assessing council performance and determining how to respond to performance issues. The OLG applied risk levels (high, medium and low) to a selection of councils as part of meetings between February 2019 and October 2022 without a clear framework. This limits transparency around the rationale and evidence used. It also makes it difficult for the OLG to demonstrate that it is prioritising resources and activities towards the greatest risks.

In 2019 the OLG identified that the timeliness of its interventions could be negatively impacted by a failure to implement an effective risk profiling strategy, and identified that a 'council risk profile framework' would be developed.

In November 2022, the OLG commenced a project to develop a risk assessment tool. The OLG started implementing the tool in March 2023.

3.2 Responding to council risks and issues

The OLG has frameworks to guide its regulatory responses, but relevant aspects are out of date

The OLG aims to take early action on poor performance and intervene in councils when warranted and appropriate. The OLG advises that its 2017 Improvement and Intervention Framework and its 2014 Framework for Implementing Early Intervention Orders guide advice and decision-making around regulatory responses. But these frameworks have not been reviewed to ensure that they reflect the OLG's current operating model and regulatory approach.

The OLG's 2017 framework outlines strategies available to the OLG, such as providing advice, issuing warning letters, delivering training, issuing guidance, visiting councils and using statutory powers to investigate or intervene. It also includes relevant considerations to assist identification of the appropriate strategy, such as purpose, context, risks and resources. The OLG's 2014 framework was developed to guide the implementation of performance improvement and suspension orders.

But the OLG has not reviewed these frameworks to ensure that they reflect current business activities, regulatory strategies, and legislative provisions. For example, the 2014 framework does not reflect legislative provisions relating to the appointment of financial controllers, whose functions can be specified in a performance improvement order. One financial controller has been appointed since 1 July 2019. The 2017 framework does not reflect roles and responsibilities of staff managing relationships with councils, including in the context of the creation of the Council Engagement team in 2018. Neither the frameworks nor other internal documents incorporate current control mechanisms, and departmental requirements such as conflict of interest or duty considerations. For example, the OLG does not provide guidance on when its staff involved in regulatory activities should make activity or project-specific declarations.

In addition, the OLG's procedures for handling complaints about councils and councillors have not been updated since 2013. A review of these commenced in 2021 but was not completed.

The OLG lacks complete and approved procedures to guide decision-making with respect to regulatory responses

The OLG lacks complete and approved procedures to support the application of its 2014 and 2017 regulatory frameworks. This creates risks to the consistency and transparency of advice and recommendations relating to regulatory responses, including on the use of statutory powers to issue guidance, to investigate councils, and intervene. Appendix two provides an overview of these powers.

There are also key gaps in guidance available to staff for developing and implementing regulatory responses. Staff expertise and knowledge-sharing is important for regulatory decision-making, but neither the frameworks nor other internal documents provide sufficient guidance on:

- how to assess the seriousness of behaviour or actions, for example, through the application of risk assessments to consider instances of non-compliance
- provide guidance on coordinating interactions with councils, such in relation to council visits
- referring relevant matters to other sector regulators and oversight agencies, such as the NSW Ombudsman, the Independent Commission Against Corruption, or the Audit Office
- approaches to different types of entities in the local government sector, such as county councils and joint organisations
- the type and level of support provided by the OLG during the public inquiry process and when a council is under administration, such as with respect to reviewing and responding to administrators' reports.

OLG planning documents for 2022–23 include actions to identify and maintain a comprehensive suite of investigation tools and resources, and review and update the frameworks. The broader OLG delivery program and related resourcing are not finalised.

The OLG considered relevant statutory criteria when advising the Minister on the use of intervention powers

The OLG provides advice and assistance to the Minister for Local Government in relation to the exercise of powers under the LG Act relating to performance improvement orders, suspension orders and public inquiries. The Act and Regulation specify criteria which must be considered, and procedural steps which must be taken by the Minister before issuing a performance improvement order or suspension order. The Minister has not delegated these powers.

Exhibit 6: Overview of use of ministerial intervention powers since 1 July 2019

Since 1 July 2019, the Minister's statutory intervention powers have been used in relation to six councils to address issues such as financial and asset management, governance and councillor misconduct. These consist of:

- 6 performance improvement orders, including:
 - 4 where a temporary adviser was appointed
 - 1 where both a temporary adviser and financial controller were appointed
- 3 suspension orders, each involving the appointment of an interim administrator.

There have also been three public inquiries, each of which led to the dismissal of the relevant council and the appointment of an administrator.

Source: Audit Office analysis of OLG records.

Our review of the key documentation relevant to the above interventions, and three other councils where an intervention was proposed but did not proceed, found that OLG advice to the Minister for Local Government considered relevant legislative criteria and did not identify inconsistencies with procedural requirements under the LG Act.

The OLG's 2017 Improvement and Intervention Framework includes a template to support the identification of appropriate regulatory response strategies based on considerations such as purpose, context, risks and resources. However, the OLG advises this template is not used, and these factors were not always clearly considered in our review of the key documentation relevant to interventions.

The OLG lacks but is procuring a system to manage information for its regulatory responses

The record keeping system used across the OLG does not support effective and efficient information handling for its regulatory responses.

In particular, the OLG does not have a case management system (or similar) to track progress and support the timely management of investigations and interventions. The OLG's systems also do not enable its staff to efficiently extract information about previous engagements with councils. This information could be relevant when advising the Minister for Local Government on considering statutory criteria for certain interventions, such as whether previous intervention attempts (such as telephone advice, warning letters) have had the intended effect.

The OLG's 'investigation plan' template in its 2017 Improvement and Intervention Framework is intended to track the progress of investigations, but it is not being effectively used for this purpose.

The OLG is procuring a case management system. This process has been ongoing since at least mid-2021 and there is no set timeframe for its implementation. The OLG has identified that potential benefits of this system would include improved visibility and searchability of information relevant to particular cases.

The OLG does not routinely review the costs or efficacy, or evaluate the impact, of its regulatory responses to ensure continuous improvement

Post-implementation evaluation to assess whether regulatory activities are contributing to intended outcomes can enable continuous improvement. But the OLG does not have processes to routinely evaluate how it could strengthen the design and delivery of its regulatory responses.

The OLG's 2017 Improvement and Intervention Framework includes a template that can be used to analyse the desired outcome and impact of a particular intervention, as well as for considering whether the intervention process could be improved. The OLG advises this template is not used in practice, and we did not see evidence of its use, or an alternative review mechanism, in the interventions assessed for this audit.

The absence of meaningful performance measures for the OLG's regulatory activities (see Chapter 2.1) presents a challenge to the OLG evaluating the impacts of its activities and developing strategies for continuous improvement.

The OLG has not routinely collected and analysed data on the time, resources or other costs involved in its regulatory activities. This limits its ability to understand or assess the efficacy of its regulatory responses, and may present a barrier to the OLG using provisions under the LG Act that enable it to recover reasonable expenses incurred in investigations and public inquiries from the relevant council. The OLG has undertaken some activities to collate costs information relevant to public inquiries.

The OLG has provided a range of supports to build sector capacity

The OLG undertakes a range of sector support activities consistent with the 2017 Improvement and Intervention Framework and its role in strengthening sector performance and compliance. Key examples of activities delivered since 1 July 2019 include:

- developing or updating guidelines and codes that councils must have regard to in exercising their functions under section 23A of the LG Act, such as guidelines on the integrated planning and reporting framework and on council elections
- developing or updating other guidance on requirements and best practice, such as a guideline on the use and management of credit cards following an Audit Office recommendation in September 2020
- issuing regular newsletters and circulars to provide updates or guidance to councils (145 circulars were issued between 1 July 2019 and 1 March 2023)
- providing information in response to enquiries, such as on council governance matters (OLG has reported that it received 9,787 pieces of incoming correspondence in 2021–22)
- delivering training, including training webinars for new councillors following the December 2021 local government elections
- undertaking sector engagement activities such as attending sector conferences or visiting councils and joint organisations.

The OLG's sector support activities lack a structured and well-communicated approach to their delivery, and the OLG has been slow to finalise some key guidance

A range of factors impact the OLG's priorities in delivering sector support, but the OLG lacks a structured and well-communicated approach to delivering these supports. This limits transparency and accountability around these activities.

Factors that can impact the OLG's priorities in delivering its sector support activities include ministerial priorities, legislative amendments or reforms and emerging issues. Information and recommendations from other NSW government agencies are also relevant, including reports by other oversight bodies such as the NSW Ombudsman and the Independent Commission Against Corruption, in addition to the Audit Office.

The OLG has used its operational plans to track some of its sector support activities since at least 2019, but the OLG also lacks an effective process for documenting decisions about what is (or is not) progressed or prioritised, and why. This limits the OLG's capacity to demonstrate that its sector support activities are delivered to achieve intended objectives or address emerging issues, and that challenges to delivery are being appropriately managed. The OLG has been slow to finalise guidance for the sector on key issues such as cyber security, risk management and internal audit.

Exhibit 7: Examples of slow progress on delivering sector guidance

Cyber security guidelines

The Audit Office's '[Report on Local Government 2019](#)' recommended that the OLG develop a cybersecurity policy by 30 June 2021 to ensure cybersecurity risks over key data and IT assets are appropriately managed across councils, and key data is safeguarded. The Audit Office's '[Local Government 2021](#)' report, published in June 2022, repeated this recommendation, noting it should be a high priority for the OLG in the context of a finding that cybersecurity frameworks and related controls were not in place at 65 councils.

The OLG's 2020–21 operational plan did identify the development of this policy as a high priority. But the OLG did not release 'Cyber Security Guidelines – Local Government' until about 18 months later, on 19 December 2022. These were not issued under section 23A of the LG Act as guidelines that councils must take into consideration.

Risk management and internal audit guidelines

Internal audit provides assurance over council's governance practices and internal control environment, and identifies where performance can improve. Audit, risk and improvement committees (ARICs) help councils to understand strategic risks and how they can mitigate them. The OLG's development of a risk management and internal audit framework for councils to guide the operations of ARICs and to require councils to have a risk management framework and internal audit function has been a high priority since 2019, but timelines for its completion have been repeatedly extended. The OLG has advised that the development of guidelines has been challenging and involved extensive consultation.

On 19 December 2022, the OLG issued a circular to inform the sector that draft guidelines have been approved but remain in draft until amendments to the supporting regulation come into force in 2023.

Source: Audit Office analysis of OLG documentation and Auditor-General reports.

Local government sector peak organisations and other stakeholders have informed the audit that the OLG's support activities can be useful, but their approach to prioritising activities and reasons for delays in finalising particular resources is unclear. This is consistent with our assessment of the OLG's processes and documentation. There are also concerns about the OLG's timeframes to deliver resources, and currency and accessibility of information on its website.

The OLG's 2022–2026 strategic plan, which includes reference to a 'council engagement strategy' (to be developed), presents an opportunity for the OLG to improve how it develops and implements sector-wide and council-specific engagement activities.

Section two

Appendices

Appendix one – Response from agency

Department of Planning and Environment



Our Reference: A861932
Your Reference: D2305651/PA6698
Contact: Karin Bishop
Phone:

Ms Margaret Crawford
NSW Auditor General

Via email: mail@audit.nsw.gov.au

Dear Ms Crawford

Response to Audit Office Report – Performance Audit on the Regulation and Monitoring of Local Government

Thank you for the opportunity to respond to the NSW Auditor General's Report of the Performance Audit on the Regulation and Monitoring of Local Government within the Department of Planning and Environment.

The Office of Local Government (OLG) notes the comments made in relation to its role as a regulator of the local government sector and welcomes the opportunity to identify ways to strengthen our effectiveness in this area.

Many of the points raised by the report highlight long standing legacy issues that are already being addressed by the OLG through the introduction of new proactive and risk-based monitoring and assessment activities, a renewed focus on compliance and improved data gathering and analysis. Much work, however, remains.

This is a critical time for the local government sector, and OLG's regulatory role will also be guided by major sector-wide reforms currently underway such as the IPART rate peg review, the review of the councillor misconduct framework and a review of councils' performance benchmarking and financial modelling.

We will carefully review the recommendations from the report and implement further improvements over the next 12 months. The report and its recommendations will also assist in the implementation of OLG's new Strategic Plan and provide useful guidance as we review and refocus our operations to align with the priorities of the new Government.

I would be most happy to further discuss our ongoing program of work. I can be contacted on [REDACTED].

Yours sincerely

A handwritten signature in black ink, appearing to read "Kiersten Fishburn".

Kiersten Fishburn
A/Secretary, Department of Planning and Environment

19 May 2023

Appendix two – Statutory powers relevant to council accountability under the Local Government Act

This table provides an overview of the main discretionary powers relevant to council accountability that are available to the Minister for Local Government and Departmental Chief Executive under the *Local Government Act 1993* (NSW) (LG Act). It also includes the 'Key purpose' of the relevant power as stated in the OLG's 2017 Improvement and Intervention Framework in relation to NSW Councils.

Note on delegations: During the audit period, the Departmental Chief Executive position has been held by the Secretary of the Department of Planning and Environment. The Secretary had delegated their powers under the LG Act to the deputy secretary and executive director level. The Minister for Local Government had not delegated their powers.

Power	Responsible officer	Key purpose(s) stated in the OLG's 2017 framework
Issue guidance to councils relating to council functions		
Issue guidance that councils must take into consideration before exercising functions (s. 23A)	Departmental Chief Executive	To provide guidance To provide expected standard
Order provision of documents or information		
Order provision of documents or information concerning the council, its operations or activities (s. 429)	Minister for Local Government or Departmental Chief Executive	To require council to provide information and documents to determine whether or not to exercise any other investigative function To warn council that its performance is being monitored
Investigating councils		
Preliminary enquiries to determine whether to investigate (s 734A)	Departmental Chief Executive	To make enquiries to determine whether or not to exercise the power of investigation To warn council that its performance is being monitored
Investigate any aspect of a council or its work and activities (s 430)	Departmental Chief Executive	To investigate serious issues relating to the operations of a council
Order compliance with investigation recommendations (s 434)	Minister for Local Government	To enforce s 430 recommendations if required To enforce compliance using an established sanction
Recovery of expenses of investigation from council (s 434B)	Departmental Chief Executive	n/a

Power	Responsible officer	Key purpose(s) stated in the OLG's 2017 framework
Performance improvement orders, temporary advisers and financial controllers		
Criteria to be considered are in Part 13, Division 14 of the 'Local Government (General) Regulation 2021'		
Issue an order in respect of a council if the Minister reasonably considers that action must be taken to improve the council's performance (a 'performance improvement order') (s 438A)	Minister for Local Government	To provide a mechanism to act early in order to provide guidance as to how a council can remedy an emerging issue
Appoint a temporary advisor (s 438G)	Minister for Local Government	To provide advice and assistance to a council for the purpose of ensuring that it complies with a performance improvement order To monitor a council's compliance with a performance improvement order
Enforcement of performance improvement order against councillor (s 438HA)	Minister for Local Government	To enforce action required of individual councillors when a performance improvement order is issued to a council
Appoint a financial controller (s 438HB)	Minister for Local Government	To improve financial controls and other functions relating to council finances as specified in any order To authorise payments from council funds
Suspension orders and interim administrators		
Criteria to be considered are in Part 13, Division 14 of the 'Local Government (General) Regulation 2021'		
Issue an order to temporarily suspend a council if the Minister reasonably believes that the appointment of an interim administrator is necessary to restore the proper and effective functioning of the council (ss 438I and 438M) or during a public inquiry (s 438W)	Minister for Local Government	To enable prompt action to be taken to correct a problem, provide time out to build or restore relationships, allow effective business to resume and/or remedy a failure by a council to do something that is required of it
Public inquiry		
Appoint a commissioner to conduct a public inquiry (s 438U)	Minister for Local Government	To examine council dysfunction in a public and independent process To enforce compliance
Recover the reasonable expenses of a public inquiry from council (s 438V)	Departmental Chief Executive	n/a
Dismissal of council and appoint an administrator		
Declare all civic offices in a council to be vacant on the recommendation of the Minister following a public inquiry (s 255)	Governor of New South Wales	n/a

Appendix three – About the audit

Audit objective

This audit assessed whether the Office of Local Government (OLG), as part of the Department of Planning and Environment (the department), is effectively monitoring and regulating the NSW local government sector under the *Local Government Act 1993* (NSW) (the LG Act).

Audit criteria

We addressed the audit objective by assessing whether:

1. The department has effective arrangements for the OLG to undertake its regulatory functions, including:
 - a) appropriate governance arrangements for the OLG to manage the operation and performance of its regulatory functions
 - b) strategic planning that establishes clear objectives and adequate resources for the OLG's regulatory functions
 - c) monitoring and reporting on the performance of the OLG's regulatory activities.
2. The OLG has effective mechanisms to monitor and respond to compliance and performance risks and issues, including:
 - a) robust policies and procedures for monitoring, identifying and responding to compliance and performance risks and issues
 - b) that staff have clear roles and responsibilities and have access to sufficient training
 - c) strategies to strengthen sector compliance and performance
 - d) monitoring and reporting on the performance of its regulatory activities
 - e) mechanisms to identify and respond to opportunities to improve its regulatory activities and approach.

Audit scope and focus

This audit focused on the administrative arrangements and processes that support the Secretary of the Department of Planning and Environment and Minister for Local Government to hold councils to account using the statutory powers available under Chapter 13, Parts 5 to 8, and related activities to monitor and strengthen compliance and performance in the sector.

This audit focused on activities from 1 July 2019. This covers the time from when the OLG's functions were transferred to the department following the 2019 Machinery of Government changes.

Audit exclusions

The audit did not assess:

- the OLG's broader functions and activities, or regulatory activities relating to the councillor misconduct framework under Chapter 14 of the LG Act
- the performance or compliance of individual councils
- the merits or impact of decisions to about the use of investigation and intervention powers in relation to councils.

Audit approach

Our procedures included:

1. Interviewing:

- relevant departmental officers, including from the OLG
 - officers from other State entities
 - sector stakeholders, groups and experts.
2. Examining a range of documents held by the department, including:
 - strategic plans
 - operational plans and reports
 - risk registers and risk management information
 - documents about governance and reporting arrangements
 - records of executive and operational meetings, for example terms of reference, agendas and minutes
 - performance reporting information
 - policies and procedures for regulatory activities, including intervention frameworks
 - internal controls relevant to regulatory activities
 - records relating to interventions and investigations, including briefing notes.
 3. Analysing website submissions.
 4. Analysing literature on good practice regulation and local government regulatory approaches in other jurisdictions.

The audit approach was complemented by quality assurance processes within the Audit Office to ensure compliance with professional standards.

Audit methodology

Our performance audit methodology is designed to satisfy Australian Audit Standard ASAE 3500 Performance Engagements and other professional standards. The standards require the audit team to comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance and draw a conclusion on the audit objective. Our processes have also been designed to comply with requirements specified in the *Government Sector Audit Act 1983* and the *Local Government Act 1993*.

Acknowledgements

We gratefully acknowledge the cooperation and assistance provided by the Department of Planning and Environment. In particular, we would like to thank our liaison officers from the OLG who participated in interviews and provided evidence for the audit.

Audit cost

The estimated cost of this audit including disbursements is \$555,000.

Appendix four – Performance auditing

What are performance audits?

Performance audits determine whether State or local government entities carry out their activities effectively and do so economically and efficiently and in compliance with all relevant laws.

The activities examined by a performance audit may include a government program, all or part of an audited entity, or more than one entity. They can also consider particular issues which affect the whole public sector and/or the whole local government sector. They cannot question the merits of government policy objectives.

The Auditor-General's mandate to undertake performance audits is set out in section 38B of the *Government Sector Audit Act 1983* for State government entities, and in section 421B of the *Local Government Act 1993* for local government entities.

Why do we conduct performance audits?

Performance audits provide independent assurance to the NSW Parliament and the public.

Through their recommendations, performance audits seek to improve the value for money the community receives from government services.

Performance audits are selected at the discretion of the Auditor-General who seeks input from parliamentarians, State and local government entities, other interested stakeholders and Audit Office research.

How are performance audits selected?

When selecting and scoping topics, we aim to choose topics that reflect the interests of parliament in holding the government to account. Performance audits are selected at the discretion of the Auditor-General based on our own research, suggestions from the public, and consultation with parliamentarians, agency heads and key government stakeholders. Our three-year performance audit program is published on the website and is reviewed annually to ensure it continues to address significant issues of interest to parliament, aligns with government priorities, and reflects contemporary thinking on public sector management. Our program is sufficiently flexible to allow us to respond readily to any emerging issues.

What happens during the phases of a performance audit?

Performance audits have three key phases: planning, fieldwork and report writing.

During the planning phase, the audit team develops an understanding of the audit topic and responsible entities and defines the objective and scope of the audit.

The planning phase also identifies the audit criteria. These are standards of performance against which the audited entity, program or activities are assessed. Criteria may be based on relevant legislation, internal policies and procedures, industry standards, best practice, government targets, benchmarks or published guidelines.

At the completion of fieldwork, the audit team meets with management representatives to discuss all significant matters arising out of the audit. Following this, a draft performance audit report is prepared.

The audit team then meets with management representatives to check that facts presented in the draft report are accurate and to seek input in developing practical recommendations on areas of improvement.

A final report is then provided to the head of the audited entity who is invited to formally respond to the report. The report presented to the NSW Parliament includes any response from the head of the audited entity. The relevant minister and the Treasurer are also provided with a copy of the final report. In performance audits that involve multiple entities, there may be responses from more than one audited entity or from a nominated coordinating entity.

Who checks to see if recommendations have been implemented?

After the report is presented to the NSW Parliament, it is usual for the entity's Audit and Risk Committee/Audit Risk and Improvement Committee to monitor progress with the implementation of recommendations.

In addition, it is the practice of NSW Parliament's Public Accounts Committee to conduct reviews or hold inquiries into matters raised in performance audit reports. The reviews and inquiries are usually held 12 months after the report received by the NSW Parliament. These reports are available on the NSW Parliament website.

Who audits the auditors?

Our performance audits are subject to internal and external quality reviews against relevant Australian standards.

The Public Accounts Committee appoints an independent reviewer to report on compliance with auditing practices and standards every four years. The reviewer's report is presented to the NSW Parliament and available on its website.

Periodic peer reviews by other Audit Offices test our activities against relevant standards and better practice.

Each audit is subject to internal review prior to its release.

Who pays for performance audits?

No fee is charged to entities for performance audits. Our performance audit services are funded by the NSW Parliament.

Further information and copies of reports

For further information, including copies of performance audit reports and a list of audits currently in-progress, please see our website www.audit.nsw.gov.au or contact us on 9275 7100.

OUR VISION

Our insights inform and challenge government to improve outcomes for citizens.

OUR PURPOSE

To help Parliament hold government accountable for its use of public resources.

OUR VALUES

Pride in purpose

Curious and open-minded

Valuing people

Contagious integrity

Courage (even when it's uncomfortable)

Level 19, Darling Park Tower 2
201 Sussex Street
Sydney NSW 2000 Australia

PHONE +61 2 9275 7100

mail@audit.nsw.gov.au

Office hours: 8.30am-5.00pm
Monday to Friday.