

Public Accounts Committee
Parliament of New South Wales

**Report on the
Auditing of
Local Government**

1990 - 91

Parliament of New South Wales

**Public Accounts Committee
of the
Forty-Ninth Parliament**

Fifty-Third Report

Inquiry pursuant to Section 57(1) of the Public Finance and
Audit Act 1983, concerning the Auditing of Local Government

(Transcripts of Proceedings are printed in a separate volume to this Report)

January 1991

From left:

Phillip Smiles (Chairman), George Souris (Vice Chairman), Allan Walsh, Terry Griffiths, John Murray

Secretariat

Victoria Walker, M.A., Director

Bernadette Gurr, Clerk

Norma Rice, Secretary/Word Processor Operator

Rebecca Turrell, B.A. (Visual Arts)
Secretary/Word Processor Operator

NSW Public Accounts Committee

Parliament House
Macquarie Street
SYDNEY NSW 2000

Telephone: (02) 230 2631

Fax: (02) 230 2831

Members of the Public Accounts Committee

The Members of the Public Accounts Committee of the Forty-Ninth Parliament are:

Mr Phillip Smiles, LL.B., B.Ec., M.B.A., Dip. Ed., M.P., Chairman

Phillip Smiles was elected Member for Mosman in March 1984.

A management and marketing consultant since 1974, Phillip Smiles has been involved with entrepreneurial business activities since his teens. Since entering Parliament he has been actively interested in areas of small business, emergency services, welfare and financial analysis. He was appointed a Member of the Public Accounts Committee in 1984 and was elected Chairman in 1988.

Mr George Souris, B.Ec., Dip. Fin. Mangt., F.A.I.M., F.A.S.A., C.P.A., M.P., Vice Chairman*

George Souris was elected Member for Upper Hunter in 1988.

An accountant in public practice for 12 years, George Souris also served as a Shire Councillor in Singleton for seven years, four of which were as Deputy President. At university he was a Rugby Blue, represented NSW Country, Australian Universities and Australian Colts rugby teams. He is the NSW Parliament's appointed Member of the University of Newcastle Council. George Souris has experience in taxation and business management and an interest in financial analysis. He is a member of Rotary and other community organisations.

Mr John Murray, B.A., M.P.

John Murray, was elected Member for Drummoyne in April, 1982.

Formerly a teacher, John Murray served as an Alderman on Drummoyne Council for three terms, was Mayor of the Council for five years and served four years as Councillor on Sydney County Council. He has served as a member of the Prostitution Committee and the House Committee, and is a former Chairman of the Public Accounts Committee.

Mr Allan Walsh, B.A.(Hons), Dip. Ed., M.P.

Allan Walsh was elected Member for Maitland in September, 1981.

Following eight years as a Mirage fighter pilot with the R.A.A.F., he was involved in business management. Allan Walsh has also taught industrial relations, management and history at technical colleges.

Mr Terry Griffiths, M.P.

Terry Griffiths was elected Member for Georges River in 1988.

Prior to being elected to Parliament he was the Chief Executive of the Scout Association of Australia. Before this he was an Army Officer. He is a graduate of the Officer Cadet School Portsea, a graduate of the School of Military Engineering and a Fellow of the Australian Institute of Management. He has been actively involved in Lions, Rotary and other community organisations.

* Mr George Souris, M.P., Member for Upper Hunter, was appointed to the Committee on 23 February 1989, and elected Vice-Chairman on 2 March 1989. Mr Souris replaced Miss W. Machin, M.P., who was appointed to the position of Chairman of Committees on 23 February 1989.

Report on the Auditing of Local Government

CONTENTS

	Page
Chairman's Foreword	ix
Executive Summary	xi
Summary of Recommendations	xv
1. Background to the Inquiry	1
Introduction	
2. Terms of Reference	7
Introduction	
Method of Investigation	
3. History of Local Government Accounting and Auditing	11
4. The Role of the Auditor in Local Government	19
Expectation Gap	
5. Councils' Needs for Audit Information	29
Views of Ratepayers	
Responses from Bodies Representing Councils	
Summary of Findings on Councils' Need for Audit Information	

	Page
6. Local Government: Auditing the \$3.3 Billion Industry	39
7. Special Features of Local Government Accounting Proposed Changes to Accounting Standards - ED50	61
8. Appointment Procedures Alternative Accounting Approaches The Competitive Market Checks and Balances	67
9. Accreditation Special Requirements for Auditors	85
10. Termination of Audit Contract Present System of Dismissal	95
11. Professional Practices - Review Mechanisms	105
12. Term of Appointment	109
13. Fees	115
14. Scope of Audit Auditing Risk Management	125
15. Internal Audit	137

	Page
16. Reporting to Council	141
Lines of Communication	
Management Letters	
17. Reporting to Ratepayers	149
18. Issues Arising from the Inquiry	155
Professional Indemnity	
A Level Playing Field?	
Corruption	
Conclusion	

List of Appendices

1. Call for Submissions	161
2. Submissions and Correspondence Received	162
3. Witnesses at Public Hearings	168
4. Inspections and Meetings	171
5. List of Councils and Annual Turnover	173
6. Terms of Engagement for Provision of Audit Services	177
7. Local Government Audit Firms	192

Chairman's Foreword

The 1990s must be the decade of significant reform for the Local Government sector in New South Wales. Local Government is now big business with New South Wales councils employing some 41,000 people, controlling assets valued at over \$10 billion and collectively spending approximately \$3.3 billion per annum.

Despite the size of the sector, with the exception of the 1986 provision requiring Local Government to report annually on their operations and financial management to the ratepayers, no meaningful reforms have been introduced for decades.

Local councils are in many ways monopolies and currently there appears to be no comprehensive system in place to keep them honest, efficient and effective in their reporting to both the elected council representatives and the ordinary ratepayer. Consequently, the Public Accounts Committee's report into Local Government auditing provides an opportunity to initiate necessary major financial reforms to address these concerns.

This inquiry has revealed that less than 30 local government auditing firms monitor New South Wales Local Government financial management, many elected councillors are largely ignorant of the realities of their councils' financial position, many councils' annual reports presented to their ratepayers are little more than an excuse for ego tripping and amateurish public relations and that too often a council's auditors have a less than arm's length relationship with senior council officers that has existed for several council terms.

Accreditation, employment, management and payment of council auditors deserve critical attention throughout the State. The overall quality of Local Government financial management in New South Wales is deserving of considerable improvement. It is to be hoped that this report will encourage a significant change in the current system and in consequence provide all the players in the Local Government system with an impetus to embrace long overdue change.

Report on the Auditing of Local Government

In conclusion, I would like to express my gratitude to my fellow Committee members, Committee Researcher Tom Benjamin, and Committee Director Victoria Walker for their very valuable input into this report and the many councils and auditors who most generously and willingly co-operated with this inquiry.

A handwritten signature in black ink, appearing to read 'Phillip Smiles', written in a cursive style.

Phillip Smiles, L.L.B., B.Ec., M.B.A., Dip. Ed., MP
Chairman

Executive Summary

The Local Government Auditor is central to public concerns about the accountability of Councils to their electors and to the State and Federal tiers of Government which fund them. As the business complexity of Councils increases there will be greater demands for auditing which can highlight financial risks while not overlooking the less material transactions which can become sources of complaint.

Councils face rising expectations for service, placing great demands on limited resources. The traditional focus of Local Government auditing has been on the stewardship of these available funds. Today's auditor provides additional resources to Councils by bringing a breadth of outside accounting experiences.

To keep pace with changing necessities will require re-definition of the special accreditation process, terms and conditions of appointment which have been largely determined by the Local Government Act, 1919.

To fulfil this multi-faceted role, the auditor needs some security of tenure to safeguard against arbitrary or retaliatory dismissal. Statutory provisions are also important in allowing the auditor scope to move beyond bare compliance reporting and into financial analyses which could reveal more about a Council's policy than is disclosed under current practice.

Reports need to be adequate to the needs of all decision-makers, whether electors, councillors, or managers. There must be provision for "bad news" to be visible in the audited statements in time for action to be taken.

This Inquiry has been a response to suggestions that the existing legislation was outdated, to the extent that current practices might not detect even major financial problems or a rundown of infrastructure. The focus on minutiae and the movement of monies within funds has been described as complex and arcane.

There were also suggestions that the present system of virtual lifetime appointment for Local Government auditors had led to a "cosy" relationship between auditors and management and to a professional cartel whose fee structure could only be influenced from within.

The Public Accounts Committee investigated these claims as part of its broader terms of reference to examine the overall provisions for Local Government auditing service. The public inquiry involved Local Government participants from throughout rural and metropolitan NSW. It drew upon interstate and overseas experience for perspective and for constructive alternatives to current practice.

The Committee focussed on the "expectation gap" between what ratepayers and funders want to know, what the profession can reasonably be expected to deliver at present, and the changes necessary to close this gap. The profession acknowledges an obligation for the auditor to report on the client's prospects as a going concern. For a Council, this could mean an analysis of all forms of risk as well as its ability to maintain infrastructure and effective services.

The Committee, in making its recommendations, has sought to preserve the autonomy of Local Governments as well as the flexibility to allow auditing to draw on local experience, where desirable. External auditors have served as a source of advice to council staff, through their links with the wider profession. The Committee hopes that this can be harnessed in building up the internal audit function which was found to be in its infancy in Local Government.

The Committee sees as most desirable the continuance of a mixed system of private and public sector auditing alternatives for Local Government. The Department of Local Government has provided the sort of double check that is performed by financial analysts in the private sector. The use of a reporting format common to all Councils has minimized the potential for "creative" accounting and use of reserves. Retention of these resources, together with the enhancement of internal audit, can free the Local Government auditor to engage in more meaningful performance auditing.

The Committee recommends freeing up the accreditation and tendering process for Local Government audit appointments. While high-quality professional service should be the norm, quality should not be the sole factor driving the market price of fees higher than necessary to match Councils' needs. Councils must have the option to choose the level of service commensurate with their resources.

The Committee views the internal audit function as capable of providing the flexibility to answer management questions without compromising the independence of the auditor. It has recommended that statutory links be provided between the internal and external audit functions as well as a mechanism for taking the quality of internal work into account in the tendering process.

The changes which the Committee has recommended which are likely to have the greatest impact are those which bring Local Government auditing more into line with other government and commercial practice. By freeing the external audit from obsolete attest reporting, Local Government can take fuller advantage of modern public sector audit practices.

The Committee has recommended that the accreditation of Local Government auditors be treated as one of many post-graduate specialties within the auditing profession. Together with limited tenure of 4 years for audit appointments, this will allow easier entry and exit from the market and greater cross-fertilization of skills from other audit sectors.

The adoption of a familiar commercial reporting framework will allow financial statements to bring to light processes such as the run-down of infrastructure assets and the impact of depreciation on operating accounts. The Committee seeks to preserve the important role of fund accounting through the use of conventional notes appended to the accounts.

As in the private sector, attention must be paid to the review and appeal procedures for removal and disciplinary action. The Committee has recommended achieving the appropriate balance by limiting tenure and removing the burden of proving auditor unsuitability from the proceedings. A disciplinary review and Appeals Board could become a part of the proposed Local Government Commission.

The Committee is of the belief that auditor independence is more appropriately safeguarded through an appeal process than through a virtual lifetime appointment. Representation on the Appeal Board from the Government, Councils, and the profession will ensure that removal will not be abused and will not unduly call reputations into question.

Cooperation will also be encouraged in the expansion of the scope of auditing and annual reporting. Objectives which are set at open Council meetings can become the subject of performance review. Value for money and risk analysis can also become part of Local Government auditing, once relieved of a portion of the statutory load.

The Committee wants the auditor to become a more public figure in Local Government. The optional practice of attending Annual General Meetings to field ratepayers' questions should become the norm. The quality and understandability of annual statements of account can be much improved by adoption of a more compact commercial reporting framework.

Council involvement in the audit process can be further guaranteed by requiring Councils to pay for a periodic review of auditor performance. This will encourage the formation of audit committees, involving management and internal and external auditors. The Committee's recommendation to provide statutory links between these parties will lessen any inhibitions upon more open communication.

The recommended deregulation of accreditation is seen as enhancing post-graduate opportunities in Local Government auditing rather than lessening them. The current restricted entry practices have resulted in enrollments below an economic level for post-graduate institutions. By making Local Government auditing but one of a range of continuing professional development options, more programmes could be mounted by both the profession and the tertiary institutions. Topics related to the expanded scope of audit would then be available to a greater range of prospective Local Government auditors. The result should be better-rounded professional development.

The Committee hopes that it can play a continuing part in development and formulation of codes of practice and standards for audit practice. The proposed Local Government Commission

Historically, cooperation may have been constrained by a combination of the limitations of the legislation and the ministerial policy not to fully exercise existing powers. The Committee is confident that the recommendations in this report will contribute to the review of Local Government which currently involves a range of participants.

Summary of Recommendations

1. It is recommended that the reporting requirements contained in the Local Government Act be amended to include a requirement that the auditor comment as to the Council's viability and liquidity position.

Chapter 4

2. It is recommended that auditors engaged in auditing Councils' financial and other records be given statutory protection for information provided in accordance with the performance of their duties under the Local Government Act.

Chapter 4

3. It is recommended that the Local Government and Shires Association of NSW assist Councils to provide training programmes for elected members emphasising the role of the auditor and interpretation of financial reports.

Chapter 5

4. It is recommended that the Department of Local Government publish the quarterly information it receives from Council in a format which will enable Councils to evaluate their performance and compare it with industry profiles and trends.

Chapter 6

5. It is recommended that Councils' annual budget estimates be presented in the same format as their annual accounts to allow elected members and ratepayers to readily assess Councils' performance in the year in achieving their budgeted objectives.

Chapter 6

6. It is recommended that the audit standards prescribed under Section 211 and Ordinance 26 of the Local Government Act be re-written in line with current auditing standards and further amended to incorporate changes in accounting standards as they occur.

Chapter 6

12. It is recommended that Councils and the selected auditors sign an audit contract covering the terms of the audit engagement.

Chapter 8

13. It is recommended that both commercial providers and the Auditor-General should be eligible to tender as Council auditors.

Chapter 8

14. It is recommended that the requirement of S. 211 (6) requiring possession of a Local Government Certificate for eligibility to practice as a local government auditor be abolished.

Chapter 8

15. It is recommended that accreditation of local government auditors should become the responsibility of individual Councils. To be eligible for appointment as a local government auditor a person shall have the following minimum qualifications:

- i. tertiary qualifications for admission as an Associate of the Australian Society of Accountants or the Institute of Chartered Accountants in Australia;
- ii. registration as a company auditor under the Corporations (New South Wales) Act 1990 and the Commonwealth Corporations Act 1989 Section 1280;
- iii. maintenance of the continuing professional development requirements for accreditation by the Australian Society of Accountants and for the Institute of Chartered Accountants in Australia.

The Auditor may also offer for consideration (or demonstrate eligibility on the following grounds):

- i. local government auditing experience with a comparable client base;
- ii. demonstrated access to resources and capacity to adequately audit the Council's management, financial and computing procedures;

15. (continued)
iii. local government content in formal qualifications.

The Council may also consider:

- i. the auditor's standing within the profession;
ii. the auditor's access to intermediate and senior advice;
iii. the auditor's capacity to provide additional services in local government management, finance and computing as may be advantageous to the client Council.

Chapter 8

16. It is recommended that the Department of Local Government establish an Appointment Review Committee to investigate and make recommendations on requests by Councils to terminate the appointment of the external auditors.

Chapter 10

17. It is recommended that The Appointment Review Committee comprise representatives of the Department of Local Government, the accounting profession, the Local Government and Shires Association and the Institute of Municipal Management.

Chapter 10

18. It is recommended that a Council's auditor should have the right to be heard by the Appointment Review Committee of the Department of Local Government prior to his/her removal by a Council.

Chapter 10

19. It is recommended that recommendations of the Appointment Review Committee be submitted to the Department of Local Government for ratification prior to the dismissal of the external auditor.

Chapter 10

20. It is recommended that the Auditor-General be engaged to review the working papers of Council auditors as a peer reviewer for the purpose of maintaining audit standards and that Councils are to bear this expense.

Chapter 11

21. It is recommended that, in cases where the Auditor-General is the appointed auditor for a Council, the peer reviewer is to be appointed by the Department of Local Government or its replacement.

Chapter 11

22. It is recommended that the Auditor-General be engaged to review Council audits on a cyclical basis reporting to both the Council and the Department of Local Government, as part of the peer review.

Chapter 11

23. It is recommended that a peer review of a Council's external auditors working papers be conducted by the Auditor-General at least once every eight years (or two Council terms) and be at Council expense.

Chapter 11

24. It is recommended that Council auditors should be appointed for a term of four years.

Chapter 12

25. It is recommended that the tender and appointment of Council auditors be undertaken in the second or third year of the Council term.

Chapter 12

26. It is recommended that the extent of the audit, and any additional consultancy work required by Council, with the hourly rate structure for any such services, be specified in the audit contract and published in the Council's Annual Report.

Chapter 14

27. It is recommended that there be a statutory requirement for each Council to establish an audit committee, consisting of elected members, the chief executive officer, and the finance or treasury officer.

Chapter 14

28. It is recommended that the Local Government Act be amended to provide that Councils have a statutory responsibility to ensure that there is an effective system of internal control over the financial and related operations of the Council, similar to that prescribed in the Public Finance and Audit Act, 1983.

Chapter 15

29. It is recommended that tender specifications for a Council auditor detail existing internal audit arrangements to enable prospective external auditors to review and tender on a fully informed basis.

Chapter 15

30. It is recommended that management letters to Council management by the external auditor become part of the auditor's report to the Council at the end of each financial year.

Chapter 16

31. It is recommended that Councils be required to conduct an Annual General Meeting for presentation of the Annual Auditors' Report. The auditor would be obliged to attend and to be prepared to discuss the Report, so that ratepayers have an opportunity to ask questions of the auditor.

Chapter 17

32. It is recommended that the Annual Report of each Council be provided to every elector, and include a copy of the following material from the audited annual accounts: the Balance Sheet, Income and Expenditure Account, and Notes Accompanying the Accounts. To assure that cost does not inhibit or delay this process, the minimum requirement should be that the Annual Report be inserted in a widely-distributed local newspaper.

Chapter 17

33. It is recommended that the form and content of the Council's Annual Reports be in line with reporting requirements for public companies.

Chapter 17

1. Background to the Inquiry

Introduction

- 1.1 The Public Accounts Committee is empowered under Section 57 of the Public Finance and Audit Act 1983 *"to examine the opinion or any reports of the Auditor-General transmitted ... before the Legislative Assembly with the accounts as an authority of the State."*
- 1.2 In Volume II of his 1988 Report the Auditor-General referred to shortcomings in the auditing of local government:

"Since 1986 there has been a legislative requirement for councils to report annually on their operations and their financial management to the electorate. This has been a positive step towards increasing the accountability of the elected local government representatives and of Council officials to the citizens and ratepayers..."

The financial statements should not only serve accountability purposes but must also be useful in economic decision making. The suitability of the current method of preparing the financial statements needs to be reviewed in the light of the users of the statements and their needs. I believe that the current method of presenting the statements does not satisfy the entire needs of users in the three categories. This, I believe, is because the statements have been designed primarily to meet the needs of the Department of Local Government and the Australian Bureau of Statistics. My concern in this area is twofold.

First, as to the usefulness of the financial statements included within annual reports of local councils: Local Government financial statements, in complying with current legislation are prepared on a separate fund basis.

Report on the Auditing of Local Government

This basis and the proclaimed method of preparing the statements appears to be produced predominantly for the statistical and research purposes of the Local Government and other departments rather than the other external users of the statements. It is my opinion that the statements in their current format would be almost totally incomprehensible to their users.

*Secondly, as to the availability of audited financial information: I am advised that some Councils prepare and make a limited distribution of annual reports to residents and other ratepayers. Other Councils advertise the availability of detailed financial information. In some instances, rather than including the detailed financial statement in circulated reports, a summarised form of the Council's financial statements is distributed with a notation that the balance sheet and revenue accounts for the year including auditor's certificate, are available for inspection at Council's office."*¹

- 1.3 In Volume II of his 1989 Report the Auditor-General drew attention to a specific problem in Councils reporting of financial transactions which had escaped comment by local government auditors:

*"It was recently brought to my attention that some Councils, particularly those making voluntary rate rebates, may have misinterpreted the legislation covering the amount of rebate which may be claimed from the Government. It is still too early to provide an estimate of the total amount of overpayment involved."*²

- 1.4 These payments were made under the program heading "*Rate Rebates for Pensioners*", representing subsidies to Councils for rate concessions granted to certain classes of pensioners. The concessions related to general rates up to a maximum of \$175 for the 1988 rate year (\$150 for 1987 rate year). Concessions could also include voluntary rebates made by Councils.

1 New South Wales Auditor-General's Report for 1988, Volume II, p. 85

2 New South Wales Auditor-General's Report for 1988, Volume II, p. 266

- 1.5 Overpayment to Councils was subsequently found to amount to some \$7.5 million. Mr W. W. Baker, Deputy Auditor-General, told the Inquiry that since publication of Volume II of the Auditor-General's Report 1989 there had been only minor progress made towards resolution of these overpayments. Mr Baker went on:

*"In my opinion, the overpayments arose out of a rate subsidy scheme which was extremely complicated and capable of misinterpretation. As such, auditing the scheme would have been complex. For the same reasons I do not think the overpayments should in any way be used as a yardstick for measuring the overall complexity of local government reporting."*³

- 1.6 Another matter which came to the Committee's attention was a failure among Councils to meet their liability in respect of the Stamp Duties (Financial Institutions Duty) Amendment Act, 1982. The Department of Local Government has notified Councils of the need to segregate bank accounts into those which comprise transactions exempt from duty and those which are dutiable. Between 1982 and 1990 a number of Councils failed to comply with these requirements. This failure resulted in The Sydney Morning Herald headline on 28 July 1990: *"Councils face fines for millions owed in tax."*

- 1.7 Mr Elliott, Secretary of the Department of Local Government, in a letter of 6 June 1990, referred to the important role played by auditors in such financial dealings:

*"The errors occurred over a long period of time with apparent good faith on all sides. Both the Department and the Councils involved relied upon the certificates of Council clerks and auditors as to the correctness of the claims."*⁴

- 1.8 Following the comments made in his 1988 report, the Auditor-General appeared before the Committee at a public hearing on 31 October 1989 and detailed his recommendation *"that a separate Part or Division be created in the*

3 Submission, 6 June 1990

4 Submission, 6 June 1990

Public Finance and Audit Act dealing with local government Councils and that the Auditor-General be responsible for their audit".⁵

- 1.9 The Chairman and Vice-Chairman of the Local Government Auditors' Association of NSW gave evidence at a public hearing into the Committee's Inquiry into the Auditor-General's Office and tabled a discussion paper on the audit provisions of the Local Government Act. Members of the Committee questioned the relevance of this to the terms of reference of the Inquiry into the Auditor-General's Office and the seemingly intense interest being shown by the Local Government Auditors' Association.

"The interest is purely because the submission has been made by the Auditor-General that the Auditor-General should take over local government auditing, and we believe that the local government industry is well served with the existing incumbent local government auditors, and as an association, we represent those people⁶ ... the financial reporting to Councils, the financial management of the Councils is as high as I have seen in private sector instrumentalities⁷ ... Suggestions have been made in the past that some local government auditors have been carrying out substandard audits [by] the Department of Local Government, but they have never been able to name any Councillor auditor. ... We're not very amused by it."⁸

- 1.10 The Committee noted that the Local Government Auditor's Association had a closed membership, a fixed scale of fees, and very few instances of dismissal of members in over 40 years.
- 1.11 The Committee was aware that concerns about local government accountability were being expressed at various levels: by the public through the media, the Ombudsman and the ICAC, by the Department of Local Government, by Councils, by the professional associations, local government auditors and by the Auditor-General.

⁵ Submission, Inquiry into the Auditor-General's Office, 3 November 1989, p. 17

⁶ Mr Thomas, Chairman, Minutes of Evidence, Report on the Auditor-General's Office, 3 November 1990, p. 91

⁷ Mr Spencer, Vice-Chairman, Minutes of Evidence, Report on the Auditor-General's Office, 3 November 1990, p. 91

⁸ Mr Spencer, Vice-Chairman, Minutes of Evidence, Report on the Auditor-General's Office, 3 November 1990, p. 116

- 1.12 The Committee determined to include in its examination the major problems raised which were related to the auditing and financial accountability of local government. These issues included the accreditation, duties, terms, lines of communication and conditions of appointment of auditors. The range of services included in the scope of audit was raised in terms of expanding the current compliance focus, together with the potential this might bring for increased exposure of the auditor to litigation or challenge to renewal of contract.

2. Terms of Reference

Introduction

- 2.1 The Committee received a reference on 11 January 1990, from the Minister for Local Government and Planning, Mr David Hay, who wrote to the Committee that he was

"...concerned with the performance of local Councils and their accountability to the public and the government...", in the context of a wider review of the Local Government Act:

The financial provisions of the Act include those relating to the auditing requirements concerning Councils and a Discussion Paper has been prepared on the appointment of local government auditors.

*I regard the questions of who should be responsible for the audit of local government and how the auditor should be appointed as important ones in view of the very considerable public interest issue involved, and I would like to seek a wide range of opinion before forming a view on these matters."*¹

- 2.2 The Committee resolved under Section 57 (1) of the Public Finance and Audit Act to undertake an Inquiry into Local Government Auditing.
- 2.3 The Terms of Reference for the Inquiry were to examine:
- i. The manner, method, terms and conditions of appointment of local government auditors in New South Wales;
 - ii. the necessary qualifications and experience required of persons or firms suitable as auditors of local government bodies;

¹ Letter, 11 January 1990

- iii. The formulation of standards and code of professional practices for local government auditors;
- iv. The basis of remuneration and contract of appointment;
- v. The duties and rights of auditors and the scope and objectives of the audit assignment;
- vi. The reporting requirements of the auditor;
- vii. Any other matter relating to the auditing and accountability processes of local government.

Method of Investigation

- 2.4 Advertisements requesting submissions, pursuant to Section 57 of the Public Finance and Audit Act 1983, were placed in The Sydney Morning Herald, The Daily Telegraph, The Financial Review, the Public Service Notices, Business Review Weekly and in the Australian Business Magazine.
- 2.5 Letters were sent to Members of Parliament, the Auditor-General, Heads of Departments and to the Department of Local Government and Treasury inviting their input.
- 2.6 The Committee met with a number of Municipal and Shire Councils in metropolitan and rural areas of New South Wales. Eight Councils attended a public meeting in Dubbo. A public hearing was held in Maitland with nine Councils attending. Members of the Committee liaised with the Auditor-Generals of Victoria and South Australia, who have a direct involvement in Local Government auditing. Members obtained comparative information on Local Government auditing practice from Canada, UK, USA and New Zealand.
- 2.7 Analysis of legislation, formal and informal documents, attendance at seminars, including the Annual Conference of the Local Government Auditors Association of NSW, all contributed to an understanding of the relevant issues.

- 2.8 The Department of Local Government and the Treasury provided useful advice and material. The Secretary and senior staff of the Department of Local Government prepared a number of formal submissions and freely contributed briefings, materials and factual information.
- 2.9 The Committee took cognizance of the views of Councils of all types: City, Municipal, Shire and County Councils, and organisations which have dealings with Local Government.
- 2.10 During its deliberations the Committee met with auditors, singly and in groups, during both open discussions and formal hearings. These discussions were in both rural and metropolitan locations.

3. History of Local Government Accounting and Auditing

- 3.1 The current Local Government Act draws heavily on 1906 legislation, which in turn largely rewrote legislation devised in the previous century under a strong British influence:

*"Now 70 years old, the Local Government Act has been heavily amended and has grown in size and complexity. That is now flawed and overdue for revision is undisputed."*¹

- 3.2 The auditor's role under the 1906 Act was broadly defined by the requirements for Councils to keep semi-annual accounts of *"...monies received and paid into or out of every fund, and of the several purposes for which such monies have been received and paid..."* and *"full and accurate accounts of its receipts, disbursements, assets, and liabilities."*²

- 3.3 The 1906 Local Government Act required in Section 180 *"a special fund for each special rate levied"* to which must be carried *"the proceeds of the special rate and the revenues derived from the work or service. ...The fund shall only be applied for the purposes of or incidental to the said work or service."*

- 3.4 Fund accounting is a tool which has served for decades in monitoring of non-profit and government use of entrusted monies. The Committee acknowledges that a great advantage of fund accounting, while it grows in complexity with the number of funds available, is that it makes transparent the movement of monies within funds and reserves.

1 Department of Local Government, White Paper on Phase I of the Local Government Act Review, July 1990

2 Local Government Act, 1906

- 3.5 The broad 1906 requirement to report on the use of monies for the achievement of specific "*purposes*" gave the auditor scope to assess the cost or the benefit of Council expenditure. An auditor concerned that purposes were not being achieved would have been within the guidelines to write a "*long form*" report encompassing many of the issues which would today be referred to as "*value for money*" or "*performance*" auditing.
- 3.6 In 1920 an expert committee of accountants examined a proposed revision of the Accounts and Audit Regulations. The Committee, in recommending what would become Ordinance No. 26 of the Local Government Act in 1922, reported as follows:
- "...in as much as there is no question of distribution of profits the ordinary Profit and Loss Account is not necessarily suitable. Moreover a local council is not responsible to owners for capital. ...The great care taken in the case of an ordinary commercial concern not to over-state asset values may be largely dispensed with. The commercial balance sheet and the point of view of its preparation are not in keeping with a local council's purpose."*³
- 3.7 The 1919 Act, Section 211, together with Ordinance 26, dissected requirements for reporting into specific provisions for the repayment of loans, statement of the value of assets, account of collection, banking, expenditure, plant, stores and material, and misappropriation of moneys or property. The Act requires that the auditor's report is to "*certify whether in his opinion the statements of accounts are full and fair statements properly drawn up, so as to exhibit a full and true view of the Council's affairs.*"
- 3.8 The seemingly broad scope of a "*full and true view*" was to some extent constrained by the requirement to "*certify*" rather than express an opinion or comment. The fact that the powers of Section 214 to "*take evidence upon oath or affirmation*" and, by summons, to require persons to appear personally and to produce books and papers are not matched by statutory protection of the auditor from defamation action, may have served to dampen the auditors enthusiasm for reporting beyond the statutory requirements.

³ Quoted by Professor R. Walker, School of Accountancy, University of New South Wales, *Local Government Under Pressure to Go Commercial, New Accountant*, 22 March 1990

evolved to meet the need for information on company performance. Public sector scrutiny of Councils is performed by the Department of Local Government which has responsibility for scrutinising and evaluating local government performance. This will be dealt with in more detail in Chapter 8.

- 3.12 The current *"tick and flick"* auditing practices evolved to maintain the independence of the auditor and to provide the auditor some protection. Professor R. W. Walker, Head of the School of Accountancy of the University of New South Wales, noted that statutory requirements and professional codes of practice have been responsible for narrowing the focus of audit over the past 100 years and that the *"long form"* of report, containing a fuller appraisal of the financial prospects for the auditee, actually pre-dated the statutory audit common today.⁵
- 3.13 These *"long forms"* of audit, as typified by the broader requirements of the Local Government Act 1906, were commonplace in both private and public sector prior to the 1930's. Attempts to limit auditors' exposure to litigation resulted in the *"standard form"* audit report common in the private sector today, in which vaguer statements about *"general accepted accounting principles"* replaced more extensive disclosures and references to *"truth"* and *"fairness"* and comments on efficiency or effectiveness in the reports.⁶
- 3.14 While there is ample scope for modification of current audit services under the existing Act, it would require commensurate changes in policy and context. the Department of Local Government has stated its preference to review the legislation, stating that *"Any modern legislation should emphasise the corporate nature of Councils rather than reinforce a fragmented approach"*.⁷
- 3.15 In December 1989 the Department of Local Government circulated a Discussion Paper, Appointment of Local Government Auditors, to Councils and interested organisations. It presented seven options for change, with summaries of their potential effects. While not making recommendations in favour of any option, the paper nevertheless conveyed certain views for comment, including the suggestion that the auditor's primary duty is to the

5 Mr J. Guthrie & Professor R. Walker, *Corporate Audit Reporting in Australia*. Accountability Conference, Sydney, May 1988.

6 Ibid

7 Department of Local Government, White Paper, July 1990

public, rather than the Council, which required them to not only be independent, but to be seen to be independent.⁸

- 3.16 The paper posed fundamental questions as to whether the appointment of the auditors by the bodies upon which they were required to report could theoretically compromise the perceived public interest role. It explored alternative arrangements for appointment, accreditation and removal.
- 3.17 It also discussed, as had an earlier paper in 1987, the possibility of opening the appointment to tendering. It contrasted the views which had been put forward by both the Auditor-General and the Local Government Auditors' Association of NSW.⁹
- 3.18 The NSW Government is committed to establishing a Local Government Commission, which would presumably be responsible for improving local government accountability and administrative efficiency. Under the present proposal major responsibilities of the present Department of Local Government would be divided between the proposed Commission and an Office of the Minister. This Report will refer to roles it sees for such a Commission, where different from current practice.
- 3.19 The Committee understands that under the proposed Commission, the Minister would be largely responsible for the development and monitoring of legislative rules for conduct. The Commission would reform many of the functions of administration currently performed by the Department of Local Government. The primary difference between the current and proposed system are that the Commission would be governed by a Board comprised of members with a stake in local government. The Committee was informed that this could better balance the interests of local government and the State and Federal tiers of Government which contribute to funding.¹⁰

8 Mr A. Baldwin, Discussion Paper: *Appointment of Local Government Auditors*, New South Wales Department of Local Government, December 1989

9 Mr C. V. Ellis, Discussion Paper on Auditing in Local Government, NSW Department of Local Government, 1987

10 The proposed membership of the Commission is: A Chairperson, nominated by the Minister, the Director, who will be Deputy Chairperson, two persons nominated by the Local Government Association, two persons nominated by the Shires Association, three persons with local government expertise nominated by the Minister, two persons nominated by the Minister from a panel provided by the local government unions and professional associations.

- 3.20 Other legislative changes will continue what has been a long process of evolution in the role of professionals in local government. The creation of a Local Government Commission would bring about the separation of policy from administration which had been recommended since 1973 for the whole of local government.¹¹
- 3.21 Auditing is by no means the only profession which is being reviewed with an eye to change. At the Commonwealth level, the National Review of Local Government Labour Markets has investigated improving flexibility in local government employment throughout Australia.¹²
- 3.22 The profession of local government auditing has evolved since 1906 to become a discipline separate from other branches of auditing. The main factor in this has been as statutory requirement for accreditation in addition to that for registration as an auditor under the Companies Code. This will be examined in more detail in Chapter 11.
- 3.23 Another factor supporting this separation has been the need for training and experience in the special form of fund accounting currently used in local government. Following an Inquiry in 1978, new reporting procedures were instituted to better account for reserves and to provide a revenue account and balance sheet in modern tabular form. The result brought local government accounts into line with the uniform classification of familiar balance sheets, revenue account and statement of sources and applications of funds. The Australian Accounting Research Foundation has proposed further changes, whose implications will be more fully discussed in Chapter 7.¹³
- 3.24 The Committee noted a trend in legislative changes since 1972 towards freeing up entry into local government auditing. The elimination of statutory examinations in favour of tertiary study, led to the present system. This, in turn, has been recently amended so that persons who are not yet accredited company auditors can, nevertheless, enrol in local government units toward their later registration as local government auditors, upon

11 The Barnett Committee, Report of the Committee of Inquiry into Local Government Areas and Administration in NSW, December 1973

12 Report of the Local Government Commission Task Force, Offices of the Minister and Department of Local Government, 1990

13 The Bain Committee, Report into Local Authority Management in NSW, to the Minister for Local Government, March 1978

completion of the requirements for commercial auditing. The matter of accreditation of local government auditors is discussed in Chapter 9.¹⁴

- 3.25 The relatively small number, some 70 firms, in the local government auditing profession in NSW ensures that current practitioners can come to know each other quite well and would have every incentive to let their professional body, the Local Government Auditors' Association play a role in their regulation, advocacy, professional development and fee-setting, as do most other professions. The issue of term of appointment will be dealt with more fully in Chapter 11.
- 3.26 The biggest areas for change in local government auditing will be to do, not with who does the auditing, but with the scope of these audits. Despite 80 years of gradual change, the demands and responsibilities place upon Councils and their professional advisers have consistently outpaced changes in their information systems. Ratepayers demand greater accountability and objective measurements of Councils' efficiency in terms of service delivery. Changes in the scope of local government audits must develop in concert with developments in management and the accountability of Councils both to their ratepayers and to the State and Federal Governments.

¹⁴ The Barnett Committee, Report of the Committee of Inquiry into Local Government Areas and Administration in NSW, December 1973

4. The Role of the Auditor in Local Government

4.1 The auditing of an entire tier of government is a big task. There are 176 Councils in NSW. Their combined expenditure of \$3.3 billion represents approximately 3% of the GDP of New South Wales. This money is derived from a multiplicity of local, state and federal sources and is accounted for in thousands of special purpose funds across the 176 Councils.¹

4.2 The Auditor's duties are defined under Section 211 (8) and (9) of the Local Government Act 1919 as follows:

"(8) The auditor shall make a full and complete audit of the accounts of the Council, using due care, skill, and diligence, and shall certify whether in his opinion the statements of accounts are full and fair statements properly drawn up so as to exhibit a full and true view of the Council's affairs, and whether they are in accordance with the books of the Council and the provisions of the Act and the ordinances thereunder.

He shall also certify in the prescribed form the amount which the Council may borrow by way of limited overdraft in respect of each fund of the Council in pursuance of section 174.

(9) The auditor shall, in respect of each audit, report to the Council and the Minister -

- i. Whether or not in his opinion -*
 - a. due provision has been made for the repayment of loans; and*
 - b. the value of assets has (so far as the auditor can judge) been in all cases fairly stated; and*

¹ Department of Local Government, Annual Statements for 1989

- c. *due diligence and care have been shown in the collection and banking of income; and*
 - d. *the expenditure incurred has been duly authorised, vouched and supervised; and*
 - e. *proper account has been kept of plant, stores and materials; and*
 - f. *any of the moneys or other property of the Council have been misappropriated or improperly or irregularly dealt with; and*
- ii. *As to any other matters which in his judgment call for special notice or which are prescribed."*

4.3 Accounting and internal control requirements are more fully detailed in Ordinance 26, which spells out the scope and method of reporting.

4.4 In his Submission to the Inquiry, the Auditor-General commented on limitations he saw in the Local Government Act:

"Subsection (i) of the above section [211] in my opinion has also become clearly outdated in terms of the duties and objectives of modern-day auditors. Many statutory bodies had this type of reporting requirement removed from their legislation in 1983.

In particular Subsection 211(9)(i)(f) demonstrates the archaic overall nature of the Section. It is indicative of conducting 'a full and complete audit' when auditors performed a 100% check of transactions. How else could an auditor attest whether "any of the moneys or other property of the Council have been misappropriated or improperly or irregularly dealt with.

The auditor's certification as to the financial statements presenting a "true and fair view" should serve as sufficient evidence to the Minister and the Council that all is in order."²

² Submission, 26 April 1990

- 4.5 The Local Government Auditors' Association of NSW, in their Submission to this Inquiry stated:

"There have been a number of emotive statements (some uninformed) made about the firms currently practising in the field of local government auditing. The suggestion has been put that the current practices are unduly restrictive.

*The current incumbent local government auditors are not themselves responsible for the present position. Those practitioners holding local government appointments do so only because they have completed the government required training. The law as it presently stands has served to ensure the competent, independent audit of local government."*³

- 4.6 The Committee holds that the profession of auditing encompasses more than the mere checking of compliance with statutes and would agree with the Australian Accounting Research Foundation (AARF) that:

"The auditor also evaluates whether audit evidence raises doubt about the ability of the client to continue as a going concern in the foreseeable future.

*Through the audit process, the auditor adds credibility to management's financial statements, which allows owners, investors, bankers and other creditors to use them with greater confidence."*⁴

- 4.7 The Committee became aware whilst undertaking this investigation that there is still a very large number of Councils which could improve their viability through amalgamation.
- 4.8 Of most concern to the Committee was the absence from legislation of any specific requirements for reporting on the seemingly fundamental financial

³ Submission, Local Government Auditors' Association of NSW, 11 April 1990

⁴ The Australian Accounting Research Foundation (AARF) International Auditing Practices Committee forwarded to the Committee the manuscript, *Understanding Financial Statement Audits*, whose objective was to explain "the assurance provided by the auditor's opinion on financial statements".

indicators, such as liquidity, and in providing Council and ratepayers with a reasoned evaluation of Council's viability.

Recommendation 1

It is recommended that the reporting requirements contained in the Local Government Act be amended to include a requirement that the auditor comment as to the Council's viability and liquidity position.

Expectation Gap

- 4.9 An audit evaluation such as that outlined by the AARF is closer to the general public perceptions of what is provided by an audit:

*"References to a public expectation gap generally reflect the profession's analysis of a difference between what the community expects to see from an audit report and what the profession would like to deliver. ...In many ways the profession's analysis is accurate; some people in the community have a view that an auditor is capable of identifying every instance in which money has been misappropriated and is able to predict whether a company will be profitable or fail. In other respects there I think is some basis of concern about the profession's response to this claim because generally the accounting profession has taken the view that it's main role in an audit is simply to express an opinion on financial statements, whereas, the courts for one have taken a wider view, that an auditor has a responsibility to identify internal control weaknesses and the potential for fraud in the conduct of an audit of a company."*⁵

- 4.10. Closing the expectation gap involves more than changes to the Local Government Act. Auditors require some legal protection from unjustified

⁵ Minutes of Evidence, Professor R. Walker, School of Accountancy, University of New South Wales, Inquiry into the Auditor-General's Office, 3 November 1989, p. 2

actions by their clients for breach of their duty of confidentiality or for defamation where they report in good faith to appropriate regulatory authorities matters of concern uncovered during an audit. Such protection would allow the profession's stance to accord more closely with that of the public.

4.11 The Committee is aware of the long history of concerns about the professional liability of auditors and that to change from the current compliance focus to a broader reporting style re-opens the issue of what protection the law affords to auditors who publicly report on the financial performance of their clients.

4.12 The Defamation Act 1974 has undergone numerous amendments to provide absolute privilege to reports from medical practitioners, workers compensation and legal professionals. Without statutory protection, auditors at present must rely on defences of qualified privilege and fair comment.⁶

4.13 The NSW Attorney General, John Dowd, wrote to the Committee, 18 May 1990:

*"As you may know I am currently in the process of examining the liability of professionals and in due course would appreciate the advice of the Committee in relation to the liability of auditors."*⁷

4.14 A policy document of his Department further stated:

*"It is in the interest of the public that members of professions should conduct their practices in a forthright manner. Undue exposure to financial risk may well lead the professional to conduct the practice in an over-cautious way, to the client's detriment."*⁸

4.15 The Committee is aware that modification of the Local Government Act or Public Finance and Audit Act in isolation will not address the problem,

6 Absolute privilege is provided under Section 18, Defamation Act 1974, for publication in the course of an inquiry, while Section 30, Companies Code 1982, provides only qualified privilege to corporate auditors.

7 Submission, 18 May 1990

8 Attorney-General's Department Discussion Paper on Tort Liability in New South Wales, April 1990

common to all professional reporting in Australia: There is at present no specific "whistleblower" protection legislation.

- 4.16 In practice, the Committee considers it unlikely that a successful action in defamation could be brought against an auditor who has made a critical report. The current situation, however, contains elements of uncertainty as to the re-appointment prospects of the auditor, liability in negligence, and whether a Council might use the resources of ratepayers to at least bluster about litigation. The Committee seeks to reduce such conjecture.
-

Recommendation 2

It is recommended that auditors engaged in auditing Councils' financial and other records be given statutory protection for information provided in accordance with the performance of their duties under the Local Government Act.

- 4.17 In evidence before the Inquiry, it became apparent that there was a range of reliance in Councils on audit information, from indirect through management letters, to direct personal cooperation between Councillors, management and auditors. This may be due, in some cases, to the higher accreditation standard of many auditors compared to accounting staff in local government. Some of the reliance of Council managers on auditors was described in written evidence given to the Committee:

*"Included in the audit service is access to advice on a range of areas from accounting to taxation. ...a superficial relationship would ensue with the Auditor in the workplace and would also mean an end to the availability of general professional accounting advice without additional cost."*⁹

"Speaking from Woollahra's point of view it has been important in the past, and will be in the future, that the auditor be a source of advice and information beyond the general expectations of

⁹ Submission, Mr D. W. Mead, Town Clerk, Liverpool City, 16 May 1990

*auditing. Just as solicitors provide legal advice auditors ought to provide accounting advice. ...Staff are unsure as to the 'proper' way to treat a certain transaction.. they will seek the auditor's advice. Also, from time to time, the auditors have provided information on changes in legislation and/or procedures (e.g. disposal of records). ...In addition to these roles, is that of computer audit..."*¹⁰

*"The introduction to the Department's discussion paper refers to the 'primary duty' of the auditor being to report on the Council to the public. ...However, there seems to have been a significant trend recently towards the provision by the auditor of information to the Council on internal management and control. Both functions appear to be necessary and valuable."*¹¹

*"Recently Council received advice and assistance in the development of Business Plans for its various undertakings, and has relied on advice from its Auditors in relation to Land Development matters over a long period. This knowledge and experience is important when Council is seeking advice in relation to sensitive or political matters."*¹²

*"Independent advice on management structure, financial management practices, forward planning and assessment and review structure within a Council's operation are areas that the auditor could offer an improved service to local government."*¹³

"Other services which Councils would consider as being 'part' of the audit such as personal service, attending Council meetings from time to time, casual advice during the year on Fringe Benefits Tax, Accounting Policies, Group Tax, or as a sounding board on particular matters for the Clerk or Alderman from time to time, would not be possible if the auditor was acting as an Agent for the Auditor General since these things and anything

10 Submission, Mr M. Regnis, Town Clerk/General Manager, Municipality of Woollahra, 4 April 1990

11 Submission, Mr S. W. McPherson, General Manager/Town Clerk, City of Greater Lithgow, 25 January 1990

12 Submission, Mr T. A. Slattery, Mayor of Dubbo, 17 April 1990

13 Submission from Shire Clerk, Coonabarabran

*except the Annual Audit would be outside the terms of the contract between the Auditor General and the sub-contracted Agent."*¹⁴

- 4.18 The duty of care of auditors has been the subject of a recent review by courts in Australia and overseas. The Committee took particular heed of the description of professional risk by Lord Oliver Aylmerton of the House of Lords, who stated:

*"To apply as a test of liability only the foreseeability of possible damage without some further control would be to create liability wholly indefinite in area, duration and amount and would open up a limitless vista of uninsurable risk for the professional man."*¹⁵

- 4.19 The duty of care owed clients in respect of professional work has common themes across a wide range of disciplines. In Australia the *"foreseeability"* test has overshadowed the other requirements that have to be shown to establish a case in negligence. The High Court of Australia considered in *Voli v. Inglewood Shire*, that:

*"He is bound to exercise due care, skill and diligence. He is not required to have an extraordinary degree of skill or the highest professional attainments. ...It is now beyond doubt that, for the reasonably foreseeable consequences of careless or unskillful conduct, an architect is liable to anyone whom it could reasonably have been expected might be injured as a result of his negligence. To such a person he owes a duty of care independently of his contract of employment."*¹⁶

*Auditors of a public company's accounts owe no duty to care to members of the public at large who rely upon the accounts in deciding to buy shares in the company. The duty of care which is owed by auditors is owed to the shareholders as a body and not to individual shareholders."*¹⁷

14 Submission, Mr B. McCleary, Coopers & Lybrand, Deniliquin, NSW, 24 April 1990

15 *Caparo Industries PLC v. Dickman* [90] 2 WLR 358

16 *Voli v. Inglewood Shire Council*, 1963 110 CLR 74, discussed in White, *Law Society Journal*, July 1990, p. 51

17 *Caparo Industries op cit*

4.20 Within the public sector, the role of auditor has retained some of the original features of the profession, of broader scope and long-form reporting. The local government auditor has been given statutory powers of investigation. Aldermen and Councillors are limited in power, and may be held personally liable to be surcharged under Section 213 of the Act¹⁸, for expenditure outside statutory provisions. The uniformity of local government audits, in comparison with the breadth of commercial varieties, allows greater concentration upon the adequacy of internal controls and possibility of uncovering fraud.

4.21 A submission from the Shire Clerk of Balranald noted the need for a broader investigation of auditing requirements:

*"Perhaps the question that really needs addressing is the role of the Auditor rather than the method of appointment. Under the current system a Council can be falling further into the financial mire with no real requirement on the auditor to ring the alarm bells. In other words, it is alright for Councils to get into financial difficulties as long as they do so legally."*¹⁹

4.22 The main area where auditors investigate misconduct has traditionally been the misappropriation of assets. Given the extensive checking on transactions that is possible with today's computers, audit emphasis could change to investigation of action by Council management which result in a misleading picture of performance being presented to the public.

4.23 The Committee sees as a desirable goal the smooth transition of the role of local government auditors from the current focus on the stewardship of specific funds to a broader involvement with the long-term problems facing today's Councils.

¹⁸ Local Government Act, 1919

¹⁹ Submission, Mr G. Jones, Balranald Shire Council, 28 February 1990

5. Councils' Needs for Audit Information

- 5.1 Elected representatives and managers of local government in NSW are often required to make decisions on a similar scale as a large business. Mr Tony Kelly, Town Clerk of Dubbo City Council, described his role as

*"...management of a wide range of enterprises in a multi-million dollar commercial activity over the largest saleyards, for example, in Australia, the greatest throughput in terms of capital value of stock through those yards in any year, an independent airport, owner-operated, and a very large land portfolio which has been part of the growth and the development of this City over many years."*¹

- 5.2 One complex issue facing the Committee in this Inquiry was determining the needs of local government participants for information. To do this, the Committee sought to find out the views of those involved as to whether they wanted more information, of what type, and in what sequence.

Views of Ratepayers

- 5.3 The Committee examined evidence from recent surveys of the attitudes and perceived needs of local government ratepayers. The responses reported in these surveys bear on the form of accountability that needs to be provided by audits.
- 5.4 Of most interest to the Committee were views on whether the level of interest in local government would justify improved audit reporting, and whether increased information would contribute to reducing confusion and uncertainty of ratepayers about Councils' activities.

1 Transcript of meeting at Dubbo City Council, 19 April 1990

- 5.5 The Committee has formed several impressions on the basis of these surveys in the context of other evidence:
- a. Ratepayers take an active interest in local government. They are familiar with and make direct contact with members of Council. When they perceive that their interests are not being looked after, they will attend meetings to make their point. When they are not satisfied numbers of them do not hesitate to make formal complaints to the Ombudsman and to the Independent Commission Against Corruption.
 - b. Ratepayers are appreciative of well-presented Annual Report information. They would examine digestible audit information.
 - c. Ratepayers have a realistic view of the problems of maintaining services in an inflationary environment. They do not approve of the presentation of information which conceals the erosion of the asset base. They would prefer to see rates rise with inflation, if necessary, to maintain Council viability.
 - d. Rises in rates are, nevertheless, politically unpopular and ratepayers seek value for money.
 - e. Ratepayers' suspicions about finance can be easily provoked. Even if happy with overall Council performance, they would like to maintain some check on both petty and material corruption.

Responses from Bodies Representing Councils

- 5.6 In addition to ratepayer surveys, the Committee considered the survey of Councils' views on current procedures for auditor appointment, conducted by the Department of Local Government. The Department's main concerns were about:
- a. the current system of accrediting auditors based on specialised educational qualifications alone;

- b. accountability questions - is the auditor accountable to the Council and/or the stakeholders e.g. the Government (for expenditure of grants), the ratepayers (for rates expended) and the community (for efficient and effective use of funds and compliance with regulations and standards)?;
- c. the lack of a competitive tendering process;
- d. what standard of audit is expected and how is quality assessed - the Act does not currently define this;
- e. the duties and rights of auditors and of Councils in their relationships.²

5.7 Responses from seventy Councils received to April 1990 indicated overwhelming support for tendering. In addition, most respondents favoured Councils being empowered to call tenders, with the Auditor General (or some other mechanism) to accredit and undertake quality control.

5.8 The Department Secretary's submission to the Inquiry also considered whether the scope of the audit should be comprehensive, that is, prescribing a broad mandate comprising a combination of financial, regularity and performance audits. Performance audits can be those commonly known as value for money, management, operational, or efficiency and effectiveness programs.

*"It is my view that the main objective in this exercise relates to financial and regularity audits. However, there may be some merit in following the position of the United Kingdom Audit Commission which requires a value for money audit on one functional operation of a Council each year."*³

5.9 In this submission, mechanisms for oversight of auditors were outlined with regard to the proposed changes in the Local Government Act and proposed Local Government Commission. Mr Elliott proposed that the Commission would have an oversight of accounting standards, financial reporting and auditors:

² Submission, Mr F. A. Elliott, Secretary, Department of Local Government, 9 April 1990

³ Ibid

"The Local Government Act should lay down the duties and rights and the obligatory scope of the audit generally by reference to standards where appropriate and be complemented by an appropriate Code of Practice.

*The Minister and the Department have a joint commitment to present to the Government a modern, contemporary and dynamic piece of legislation that will provide local government with the opportunity to move into the next century without being hindered by over-regulatory restrictions and to allow it to operate effectively and responsibly, but with appropriate mechanisms for accountability. The role and responsibility of the Auditor should be central to this philosophy."*⁴

5.10 The Local Government and Shires Association of New South Wales (LG & SA) Submission reported a recent survey of Councils in conjunction with the Review of the Local Government Act. Questions and responses were:

1. If local government accounting standards are to be more like standards for other levels of government and private enterprise, is there any need to continue a restraint on who can be a local government auditor?

yes:	43	33.5%
no:	80	62.55%
n/a:	5	4.0%

2. Should there be more open competition for auditing?

yes:	109	89.0%
no:	6	5.0%
as is:	4	(3.0%)
n/a:	4	3.0%

3. On what basis should a Council be able to terminate the appointment of an auditor?

Performance:	77	49.0%
Contract Engagement and Termination of Contract:	24	15.0%
Cost:	17	11.0% ⁵

⁴ Ibid

⁵ Submission, LG & SA, April 1990

5.11 Further evidence to Committee from the LG & SA stated:

"The LG & SA see a diminishing requirement for separate qualifications. There is a need for a Code of Practice to be developed, or the transfer of any existing Code to Local Government. ...the LG & SA consider the proposed Local Government Commission or equivalent body could play a major role in any continuing monitoring of the local government auditing process.

*The LG & SA do not support the mandatory auditing of Councils' accounts by the Auditor-General. They see this as infringing on the autonomy of the third sphere of Government. However, they support the option being open to Councils."*⁶

5.12 The Local Government Auditors' Association recommended to the Inquiry:

- an accreditation system in place of the current certification system;
- appointment of auditors by Councils in a manner to protect the independence of auditors;
- the ability of a Council to remove an auditor subject to Ministerial approval;
- introduction of a peer review;
- establishment of an Arbitration Committee consisting of two representatives of the LG & SA, two from the Local Government Auditors' Association and a chairman from the Department of Local Government.⁷

5.13 The LG & SA presented their formal views to be:

1. While acknowledging some responsibility under legislation to the State Government, a Council's prime accountability is to its local community - its stakeholders;

⁶ Ibid

⁷ Submission, Local Government Auditors' Association, December 1989

2. In the ultimate, the auditor's responsibility is to that same community;
3. The current provisions of the Local Government Act are limited (notwithstanding the requirement to report to the Council and the Minister on "*any other matters which in his judgement call for special notice or which are prescribed*"). Improvement is needed to make the accounts more understandable to the community. The current provisions of the Act cover financial audit only, and should be extended into a management role;
4. These improvements may be achievable under the provisions of Exposure Draft 50 (ED50): *Financial Reporting by Local Government*, published by the Australian Accounting Research Foundation (AARF), currently under review by the Department of Local Government for introduction to local government;
5. The objective of ED50 is to improve the accountability of local government by more closely following commercially-based accounting principles. If these standards are introduced special qualifications in local government auditing may not be required;
6. Elected members and staff of Councils should regard auditors as a protection in their expenditure of public funds, and not as a costly duplication of Council's accounting process;
7. There should be no as-of-right reappointment of auditors. Commercial entities have the option of calling tenders for audit, and this option should be available to Councils.⁸

5.14 In evidence to the Committee, the Town Clerk of Newcastle City Council, stated:

⁸ Submission, response to the Departmental Discussion Paper, Department of Local Government, 19 February 1990

"With the proposed changes to financial statements in local government, it would be very difficult for the Auditor-General to rule that auditing firms not having prior local government experience should not be accredited. As a corollary to this argument, any registered company auditor would have to be accredited. If this is so, what purpose would accreditation serve?"

Any negligence in performance of duty would be covered by the remedies utilised generally against auditors i.e. dismissal of the auditor from the audit engagement and if appropriate, legal action for damages.

If there is no need for accreditation of auditors, and audits are to be conducted by registered company auditors, then I believe that the appointment of auditors should be the responsibility of the individual Councils.

The Discussion Paper takes the view that the auditor's primary duty is to the public rather than the Council, that under the existing system the auditor is appointed by the body he is required to report on... It is suggested that some body other than the Council make the appointment.

The second reason for arguing against the requirement for local government auditors to be appointed by a separate body lies in the professional responsibilities of auditors."⁹

5.15 The Shire Clerk of Cowra, submitted to the Inquiry:

"Council is opposed to any involvement of the Auditor General in the audit function in local government on the grounds of his role as a State Officer and the need to retain the independence of local government from State being involved in its management practices. Furthermore, the Auditor-General's involvement would be seen as cumbersome as he would either have to contract out to private accountants the Councils audit work or have a substantial increase in his personnel."¹⁰

⁹ Submission, Mr W. B. Lewis, 19 February 1990

¹⁰ Submission, Mr N. Armstrong, Cowra, 6 April 1990

5.16 The Town Clerk of Woollahra stated:

"It need hardly be said that the costs of auditing are miniscule in the general budgeting scene. In my view the auditing requirements do need to be clearly stipulated; it being made clear that the auditor role is and shall be seen to be independent of the Council.

Section 211 of the Act needs re-writing ...If sub-section (8)...has words inserted, as appropriate, in or to the effect of:- "... and in so doing the auditor shall draw attention to any matter, policy or procedure, which in his opinion, will or may adversely affect the financial operation of the Council.

I must also say that the replacement of independent auditors by a State government instrumentality is inconsistent, to say the least, with the State government's avowed intentions of increasing the autonomy of local government. Quite frankly, Woollahra Municipal Council would not want an audit only to the standard of the Auditor-General's Department. Also, the cost figures stated earlier in this letter are such that the Auditor General's Office claims that tendering has lowered the cost of audits... is not an inducement."¹¹

Summary of Findings on Councils' Need for Audit Information

- 5.17 In the light of current problems in the commercial area, there needs to be a raised awareness of the role of the auditor in local government.
- 5.18 The Committee found considerable consensus in the views expressed, either directly to this Inquiry, to peak representative bodies, or in opinion polls. There was little support for the involvement of the Auditor-General in local government auditing or for the tabling of audit information in NSW Parliament.

11 Submission, Mr M. Regnis, who also represented the Institute of Municipal Managers, 4 April 1990

- 5.19 The Committee noted that local government ratepayers take a realistic and active interest in this level of government; the Committee feels that the primary need for audit information rests with local Councils and ratepayers.
- 5.20 The Committee is of the view that although there is a need for an expanded form of audit to ensure that questions of overall financial viability are addressed, ratepayers still warrant a comprehensive compliance check which can allay suspicions about fraudulent or corrupt practices.
- 5.21 For most Councils, the auditor plays an important role. As members of the wider accounting profession, they are valued for their independent perspective on the reports of management as well as their knowledge of information systems. Councils rely on the professionalism, honesty and impartiality of audits.
- 5.22 The Committee was made aware that many Councils, large and small, valued the advisory services of their auditors. Mr Stan Neilly, Accountant for the Cessnock City Council, praised Coopers & Lybrand's contribution at the Maitland Hearings:

"They deal in the private enterprise world substantially and I think they do bring that breadth and that different perspective, because in their advice at times they'll relate not specifically, but generally to an outside circumstance and say, 'Maybe you can try this tack'". ¹²

- 5.23 In the light of continuing problems in commercial auditing the Committee is of the view that there needs to be a raised awareness of the role of the auditor in local government.

Recommendation 3

It is recommended that the Local Government and Shires Association of NSW assist Councils to provide training programmes for elected members emphasising the role of the auditor and interpretation of financial reports.

¹² Minutes of Evidence, Hearings at Maitland City Council, 20 April 1990, p. 223

6. Local Government : Auditing the \$ 3.3 Billion Industry¹

6.1 Recent corporate failures have served as timely reminders to the Committee that auditing cannot be relied on to provide the entire check on management financial accountability.

6.2 The report by the Special Investigator into the collapse of Rothwells Ltd. was described as *"required reading for all auditors and those who provide their professional indemnity insurance"*. The compliance of the Rothwells auditor, was *"essential for these bogus adjustments to be treated as genuine."*

*"The relationship between auditors and management became more intimate. ...Too often, the auditors became part of the decision-making instead of being the adjudicator."*²

6.3 Such a history could only give the Committee concern during a time when the Local Government Act Review has a stated intention to *"reflect the status of local government as modern corporate organisations..."* and *"to allow Councils to be free to get on with the business of running their operations..."* However much it might be desired to equate private and public sector management through such analogies, the concerns of their managers are different. Public sector managers can affect the *"bottom line"*, through cost-cutting, but have difficulty expanding top-line revenue through entrepreneurial activity.³

6.4 Private sector managers find the loss component of the profit and loss system far more important than the profit component. Their deepest fears in this respect are to avoid the retribution of liquidators. Auditors have even less control over events. They are limited to warnings, while management has the

1 Department of Local Government, Annual Statements of Account, Total Expenditure, 1990

2 *The Sydney Morning Herald*, 31 August 1990

3 Department of Local Government, White Paper, July 1990

discretion to adjust the entire scale of the enterprise to best balance revenues and costs.

- 6.5 There would be no benefit to be gained from imposing statutory limitations on Councils' powers to incur operating risks, as these are the very purpose of the Council. Financial risks, however, can be more narrowly defined. Councils' powers of investment of money are specified in the new section 201 of the Act⁴ and Ordinance No. 24A. Section 201(1) states that a Council holding money that is not for the time being required for any of the purposes for which the money may be applied, may invest the money as authorised by section 201(2) of the Act in:

"any security authorised by the Trustee Act, 1925:

or

in any prescribed investment and not otherwise."

- 6.6 Ordinance No. 24A prescribes the following additional investments that a Council is authorised to invest in, namely:

"a. a deposit with the Local Government Investment Service Pty Limited;

b. a bill of exchange that is drawn or accepted by a bank;
and

c. a deposit with the Treasurer."

- 6.7 The Auditor-General's Report 1989, Volume II, pp. 85-86. outlined the scale of activity within NSW local government and the perception of need for improved methods to ensure accountability:

"The 175 Cities, Shires and Municipalities which make up the local government portion of the public sector in this State carry out over 80 public service functions, comprises 1,852 democratically elected members of Councils, employ a workforce in excess of 41,000 people and are responsible for an estimated \$10 billion of infrastructure assets.

⁴ Local Government (Powers of Investment) Act, 1983

In comment in Section Three of this Report I have included reference to the expenditure by the Department of Local Government of \$273.8m which included \$266.5m in the form of grants and subsidies to local Councils. While acknowledging that the bulk of this expenditure was in the form of on-funding of Commonwealth revenue sharing, I am concerned as to the lack of financial accountability to Parliament for this expenditure.

Since 1986 there has been a legislative requirement for Councils to report annually on their operations and their financial management to the electorate. This has been a positive step towards increasing the accountability of the elected local government representatives and of Council officials to the citizens and ratepayers.

The common thread in the requirements of users would appear to be that the statements show, insofar as financial statements can, whether the Councils are achieving their objectives efficiently and effectively and are adequately maintaining the assets and resources available to them.”⁵

- 6.8 Because public monies are at risk and because these risks arise, not from voluntary speculation but through the powers of a tier of government to gain revenue from all within its bounds, the focus has traditionally been on detection of fraud and the movements of special purpose funds. Elaborate mechanisms have evolved to track fund transfers so as to prevent transactions based upon “reserves” which are, in reality, earmarked for other specific purposes.
- 6.9 Specific public concerns regarding local government business bear similarities to those from commercial businesses. Management encompasses both operating risk, that associated with the fortunes of services or products in the consumer market, and financial risk, that associated with the acquisition of resources. Returns to stakeholders are observed as surpluses or profits, in the case of operating risks, and dividends or service bonuses, in the case of financial risks. The information base underlying each forms a separate component of financial reporting.

⁵ Volume II, pp. 85-86

- 6.10 The operating or profit and loss statement and the balance sheet are the primary reporting instruments. When it occurs, overall economic distress will appear in both types of statement. The operating account will reflect a high component of debt repayment while the balance sheet will show a poor "liquidity" position - the ratio of short term obligations to the accessible funds to meet these. A "red flag" system can be developed to report on either trend. The problem is to allow this system to develop and to ensure that it captures the most salient information in terms of its current economic environment.
- 6.11 The Committee noted that the current Local Government Act and Ordinances do not require comment on liquidity, perhaps the most vital question facing a particular Council's finances. The Secretary of the Department of Local Government told the Committee of recent developments:

"We are endeavouring ... to try and develop a model that will not only test the short-term cash liquidity but also find ways to identify the longer term concerns ... we have been trying to get Councils to adopt longer term financial planning and to be able to assess ahead of time what their likely problems might be in the future ... we have developed, in conjunction with the Queensland Department of Local Government, a financial model will allow them to use, on a PC computer, the possibilities of financial modelling.."

*...we have developed the model for short-term liquidity. We are now working on a project to try and develop performance indicators for Councils to use ... to try and get on-line relationships with Councils, to be able to send data backwards and forwards so we can assist them ... we can also look ahead in terms of what their longer term liability might be. Every State at the moment is engaged on a similar project ... it is difficult to come up with standard performance indicators."*⁶

- 6.12 The Committee is aware that over many years Councils have provided an abundance of data to the Department of Local Government and the Australian Bureau of Statistics. It is of the view that the Department should make public the information received from quarterly Council returns and

⁶ Minutes of Evidence, Mr F. A. Elliott, 10 April 1990, pp. 129-130

should publish inter-Council comparisons to assist Councils to evaluate their own performance. Data could be published in categories such as: country city councils, country shire councils, metropolitan general-purpose councils and metropolitan large city councils. Councils in these categories would then be able to compare themselves across common industry profiles and trends.

Recommendation 4

It is recommended that the Department of Local Government publish the quarterly information it receives from Council in a format which will enable Councils to evaluate their performance and compare it with industry profiles and trends.

- 6.13 The Committee is conscious that members of Council do not always have a full understanding of local government accounting and that all local government auditors do not report personally to full Council. Council usually has a detailed involvement in the development of budget estimates for the year. When the accounts are presented at the end of the year there is no requirement that they be presented in the same format as the estimates and no requirement that actual performance be reported against estimates. Council members therefore do not have the opportunity to measure Councils performance against the objectives set in the estimates. This comparison could help them to perform their functions better by allowing them to evaluate expenditure decisions they made during the year and to thus refine and improve their performance.
-

Recommendation 5

It is recommended that Councils' annual budget estimates be presented in the same format as their annual accounts to allow elected members and ratepayers to readily assess Councils' performance in the year in achieving their budgeted objectives.

6.14 Over the course of the Hearings, the Committee became aware of a range of areas in which Council decisions were capable of creating major financial risks. As these involve policy, the Auditor is limited to comment on the potential financial impact of the decisions. Among those most commonly described were:

- not providing sufficient funds for payments on capital and revenue;
- transfers from capital funds across to operating funds with limited disclosure;
- running down reserves;
- transferring monies from capital funds to working funds through the sale of floating floor space to private development;
- expenditure being undertaken against potential loans not actually taken out by the Council at the date of expenditure;
- showing expenditure against potential loans in future years as unfunded loan works;
- costs presented to Council initially undercosted or not including expenses such as the need to hire specialist staff.

6.15 The Committee noted a number of instances where these issues had not been addressed by auditors because of a narrow, literal interpretation of the Local government Act. In the Committee's view such a narrow interpretation does Council's and their ratepayers a disservice. The financial consequences of Council policy and emerging financial trends are an obvious requirement for audit and financial reporting.

6.16 The standards for local government auditing in this regard should be no different than those of the rest of the auditing profession.

Recommendation 6

It is recommended that the audit standards prescribed under Section 211 and Ordinance 26 of the Local Government Act be re-written in line with current auditing standards and further amended to incorporate changes in accounting standards as they occur.

Recommendation 7

It is recommended that the auditing standards prescribed under the Local Government Act be revised and redrafted by a working party comprising representatives from the accounting profession, the Auditor-General's Office, and the Department of Local Government.

Recommendation 8

It is recommended that the cost of the project be met by the Department of Local Government, by way of a special allocation from the Budget.

- 6.17 The issue of standards of Council financial management was highlighted by events in August 1990. The Minister for Local government, David Hay, announced that at least 10% of Councils were in financial trouble, with implications of higher charges or reduced services. local government in NSW would have to 'lift its game'.⁷

⁷ ABC Radio, 2BL, 28 August 1990

- 6.18 43 of the 176 Councils in NSW were to be the subject of a performance review on the basis of the previous year's figures. Those Councils which had asked for increases in rates above the allowable limit were automatically subject to a *"management and efficiency assessment"*.
- 6.19 The Minister has publicly expressed concerns about the lack of accountability for such relatively large Council transactions. He mentioned that, like many sectors of the community, local government has *"lived off the fat of the land"*, with *"archaic"* controls inhibiting change by tying Councils to incomprehensible accounting practices. He quoted the Premier as having pointed out that local government could *"no longer be a sheltered workshop"*.
- 6.20 A Cabinet decision resulted, asking the Department of Local Government to develop performance review criteria, engaging Coopers & Lybrand as consultants. A separate exercise evolved on the initiative of Blue Mountains and Hornsby Councils, with 12 other Councils now cooperating in the establishment of performance indicators. The result should be a *"vigorous reassessment"* of goals, efficiency, work practices, management, planning and controls.
- 6.21 Perhaps the most publicised such investigation during 1990 was that associated with the Baulkham Hills Shire Council. The Ombudsman reported to Parliament that
- "An exhaustive investigation found misconduct which I believe to be serious and to have wider implications for local government in NSW."*⁸
- 6.22 There were problems with costing of the Baulkham Hills Entertainment Centre and difficulties in obtaining a *"fair and true"* view of the funds available to the Council. The role of the Council's auditors was to report internally to management about any problems encountered during the audit and recommend any adjustment to the stated accounts prior to the actual audit report. Their Management Letter found its way to The Sydney Morning Herald⁹, which commented

8 New South Wales Ombudsman, 7 June 1990, also the subject of a Special Investigation Report by the NSW Department of Local Government, September 1990

9 11 July 1990

"...the accountancy firm said that \$2.25 million had been set aside as reserves... 'This is not so [because] the only portion that has been funded at 31st December, 1989, amounts to \$747,264, leaving a shortfall of \$1,503,322. ...In view of Council's financial position...we are of the opinion that the unfunded amount cannot be transferred for a number of years. Accordingly, that amount should not be included in the statements'."

- 6.23 The report of a Special Investigation by the Department of Local Government showed that

"...only \$747,264 was represented by cash. The majority of the Reserves was shown as being due from Working Funds, however there was insufficient cash available in the Working Funds bank account to fund that amount.

...The Auditor had properly drawn the attention of the Council to the anomaly that it was purportedly holding Reserve funds which it could not fund in cash. That is, the Reserve balance could not be expended without further resorting to the use of overdraft.

The large deficit of \$2,871,110 means that at 31/12/89, the Council did not have sufficient liquid funds to meet the commitments it had entered into up to the end of that year. Consequently, the Council was forced to rely heavily upon overdraft accommodation to fund its day-to-day operations.

The Inspectors noted that 'the overdraft is virtually a long-term borrowing ... [and] should be utilised only to fund operations on a temporary basis...'

...reliance by a Council upon overdraft ...could ...be an indication of ...financial ill-health:-

- (i) *the provision of a level of works and services which cannot be supported by the financial resources available;*

- (ii) *use of overdraft to finance works and services not provided for in the budget; and*
- (iii) *use of overdraft to finance major infrastructure or fixed assets which should have been financed from fixed loans.*

...The decision not to increase rates in 1988 (...part of the electoral platform of several Councillors...) has proved a costly exercise, involving an indexed annual loss now in order of \$1.3 million. ...the cumulative loss will be \$6.6 million by the end of the six year period to 31/12/93...

...The cost is equivalent to \$456 for each rate assessment, with a further \$112 per assessment of estimated debt servicing costs.

...In our opinion, unless the Council can identify ongoing additional revenues or large expenditure cuts, there remains only substantial rate increases (to increase the rating base) to provide a long-term solution to the Council's financial difficulties." ¹⁰

- 6.24 Another set of incidents received publicity as a result of the Public Accounts Committee's Inquiry. The auditor of North Sydney Council appeared before the Committee on 23 April 1990, followed by the Town Clerk of North Sydney. The Committee noted the different perspectives which auditors and management brought to bear on the same series of events which took place in 1986.
- 6.25 The Committee questioned the auditor on particular problems which arose in North Sydney Council in 1986 when the Council's income for the year showed a 22.2% decline on the previous year. Specific matters raised included the omission of leave payments from actual expenditure, over-expenditure on capital projects, generally not providing sufficient funds for payments for capital and general fund expenditure and inaccurate reporting of expenditure resulting in unrealistic estimates for 1986 whereby Council set the rating level for 1986 based on inaccurate information.

¹⁰ Mr C. C. Wheeler and Mr K. Boyle, Baulkham Hills Shire Council, Special Investigation, Department of Local Government, September 1990

6.26 The auditor had replied:

*"...I had been fairly critical of the control that was being exercised over the financial situation generally. ...It was a pretty serious sort of matter because the accrued leave entitlements, as I recall it, had not been put into the budget. This was picked up by the new accountant. ...He certainly put us on notice that the results for the year, when they were finally determined, were going to be worse than was thought."*¹¹

6.27 The Committee was told that the final figures resulted in an undercosting of a "little less" than \$2.4 million.¹²

6.28 The Town Clerk, when the Committee raised these issues of undercosting, described them as "total rubbish", stating that, although the auditor had suggested that leave reserves should be at a higher level, the level of funding was a decision taken by Council.¹³

6.29 The Town Clerk stated that this appraisal did not include interfund transfers including money due from trust funds back to the general fund, money due from loan funds to revenue, or that due from reserves or capital funds:

*"I hold the view that is a matter for policy, provided that at the end of the day it is satisfactory to the auditor."*¹⁴

6.30 The North Sydney auditor, who also audits Snowy River Shire Council, Randwick Municipal Council, and South Sydney City Council described this period as

"...the lowest ebb of fortune, I believe, of North Sydney Council during my period as auditor.

The velocity of expenditure at that stage of the game was such that it was outstripping the actual funds that were available.

11 Minutes of Evidence, Mr J. Thackray, 23 April 1990, p. 368

12 Ibid, p. 369

13 Mr R. Kempshall, 23 April 1990, p. 397

14 Ibid, p. 395

...The Council was in a position where it was running ahead, the commitments were outstripping the money available.”¹⁵

6.31 The NSW Government had introduced rate pegging in the 1977 rating year, in response to extremely high Council rate increases over the period 1974 to 1976, which averaged 2.4 times the corresponding C.P.I. increase. The system, introduced in 1977, specified a maximum rate increase that could be taken up by Councils.

6.32 The Committee was concerned at the example of North Sydney Council setting the level as early as possible in the New Year in order to get rates in early and to take advantage of high interest rates, and doing so without adequate knowledge of Council's true financial position. In North Sydney the auditor did not meet with the Council, he referred to

“...the Mayor who dominated the Council at the time. ...Put it this way, I do not think he wanted me to speak to the Council.

If you look at the history of the events of North Sydney, in the first instance we had a mayor who was quite happy to distance himself from the auditor because the auditor was raising questions which did not quite sit comfortably with the elected representatives' policies.”¹⁶

6.33 The inquiry brought into view the financial problems that can arise if Councils choose not to increase rates for political or other reasons. In an inflationary environment, with other costs increasing, rate shortfalls must be met with credit, other charges, or with reduced services.

6.34 The Town Clerk of Botany described such problems to the Committee. During a period of expansion there were problems in the Council's capacity to fund the infrastructure for a number of subdivisions being developed in the municipality. The considerable lapse of time before Council was able to recoup money from the landholders requiring services created particular difficulties:

¹⁵ Minutes of Evidence, Mr J. Thackray, 23 April 1990, p. 373

¹⁶ Ibid, p. 378

"It was not unusual to have situations where subdivisions which were to Council specification - tar-sealed roads, footpaths, curbing and guttering and so on - had a two, three or four kilometre goat track to get to the particular location because the Council did not have the available financial resources to fund that work.

*Admittedly that is only one of the pressures, but another of the pressures was the inability of Council to recoup costs from those particular owners of those particular parcels of land because there was not a valuation which allowed them to levy a rate."*¹⁷

6.35 The Auditors had addressed a management letter to the Mayor of the day questioning whether Council was managing its affairs responsibly in relation to the reduction of its rate levy reserves management practices dealing with the turnover and replacement of items of plant.

6.36 In a submission to the Committee the Deputy Town Clerk during the period stated that he believed:

*"...a number of the problems that occurred during that period and identified during the course of the Inquiry can be related to the Council seeking to meet its short-term objectives as opposed to the long-term needs of the municipality and to the lack of protection for Council servants faced with the direct involvement of elected representatives in the day-to-day operation of the Council, particularly where advice tendered was perceived to be contrary to the objectives of the Council."*¹⁸

6.37 The Committee also heard how North Sydney Council's rate reductions had involved financial risk. North Sydney Council, during the early 1980's, had followed a policy of reducing rates in real terms, not taking the full pegged increase permitted by the State Government. The different views of auditors and management were as follows.

17 Minutes of Evidence, Mr John Patterson, 24 April 1990, pp. 454-455

18 Submission, Mr D. Flanagan, 27 May 1990

6.38 The Auditor told the Committee in evidence that he had expressed:

"...some concern about the dropping of the rate policy and the impact on future finances. They were the two questions, but the rate policy of North Sydney is a sacred cow.

*They were selling one-off assets which happened to be floating floor space. There was a bank of floor space that was being sold. It was capital expenditure that was not necessarily going to produce income in the longer term."*¹⁹

6.39 He stated that he was concerned that in the longer term, with the lesser availability of government grants and reductions in the residential base for rating purposes, limitations were being placed on the growth of the central business district and the maximum rate potential for the commercial area.

6.40 The floor space to which the auditor referred was part of the proposed Sabemo development of the civic centre site, which at the time of sale was vacant land. The proposed development was to build new Council chambers, a new library, a convention centre, a 47-storey office block, and underground parking, described by the Town Clerk as "\$40 million worth of development".

6.41 The Minister of the day had set out a series of floor space allowances for the different components of the project. This determined the number of occupancies which could be realised for a given amount of space. Over the period in question this had varied by a factor of 3.5 to 1. The Committee was concerned that companies who bought when it was low were disadvantaged by comparison with their competitors who might have bought when the ratio was increased.

"We changed it in discussion with the mayor of the day and we put a report to Council suggesting that we should use the higher ratio. ... No, I do not think the ratio had anything to do with advantage or disadvantage. The price went up, of course, as the demand changed and we had the value of the floor space revalued by valuers from time to time, but the change to sell X

¹⁹ Minutes of Evidence, Mr J. Thackray, 23 April 1990, p. 353

amount of whatever it was, at 1.5, had nothing to do with financial advantage to any particular company.”²⁰

- 6.42 The Town Clerk rejected the suggestion by the Committee that there had been a fiction associated with selling floor space for a building.

“Council purchased that site. It was a commercial site and Council had a proposal to build a major development on that site. It was a major asset and the political situation changed. The project did not proceed and in that situation any Council would be within its rights to attempt to realise the value of that asset and to provide other community facilities instead. The legality of it in terms of the planning situation, I think is another issue.

...So there was never, at any stage, any rezoning, whilst I was Clerk and I made it very clear, you would never get into that. To rezone a park simply to sell it off would be ludicrous.”²¹

- 6.43 The Town Clerk described a potential liquidity problem arising from the inability to catch up on rating levels forgone due to Council decisions to hold rate increases:

“... it is all right on one hand to reduce one source of income and substitute another where one source is guaranteed and the other is not guaranteed, but at the same time have your expenditure increasing annually by CPI.”²²

Certainly the auditor and I agreed that a continuation of that sort of deficit was unacceptable, and I think it was put in reports I made to the Council in previous estimates that we could not have such a deficit again. ... Irrespective of what the Council might do, recurrent expenditure was going up at the rate of \$1.2 million per annum, and we could not afford that sort of deficit in future.”²³

20 Minutes of Evidence, Mr Kempshall, 23 April 1990, p. 399

21 Ibid

22 Ibid, p. 392

23 Ibid, p. 398

- 6.44 In the Committee's view auditors should disclose precisely in their financial report whether or not funds have been transferred from reserves to working funds or vice versa. In addition, transfers between categories of reserves should be detailed, e.g. long service leave, plant replacement, parks, etc.
- 6.45 The Committee asked about North Sydney Council's policy on the sale of assets and raising of loans in lieu of rate revenue. The Committee raised the issue of monies earmarked for a particular capital fund which, during a given year were not included in that year's estimates, and whether, without formal Council approval, these might be transferred out of capital funds into operating revenue:

"There are no prohibitions within a general fund of the Council for capital income, if I can use that word, to be applied in terms of meeting ordinary operating revenue. There are no restrictions that apply under the Act. The only restrictions that appear to apply are those which involve cross-subsidisation of water and sewerage funds and general funds.

That is a very good way of manipulating results - transfers to and from reserves. The idea is, of course, that transfers to reserves would be part of the original budget. But what used to happen many years ago, and it still does happen, is that if a Council has a good result it will swap it back. What I would do in my report is that I would say that the Council's result for the year was so-and-so, but included in that is a transfer to reserves which has still to be approved or resolved or confirmed by Council.

For those two years I think we took up whatever the allowable loan borrowing rate was - \$1.2 million or \$800,000, I am not sure - but we took up those loan allocations. ... I think you will find most of them were public works. ... basically in areas of stormwater drainage augmentation and some public works. But we took them up, I think probably like every other Council did.

*...we were not into the situation where we had to think about reducing services or curtailing services in any way. We had not reached that level."*²⁴

Recommendation 9

It is recommended that Councils should create a reserve fund only for a specific long-term purpose. These reserve funds should be subject to the following constraints:

- a. Transfers to and from reserves should only be made upon a resolution of the Council;**
 - b. Proposed capital movements and transfers to and from reserves should be disclosed as part of the Council's budget;**
 - c. Any proposed funding of activities to be financed from capital movements or reserves should be disclosed as part of the budget;**
 - d. The value of reserves stated only to the extent that they are backed by cash.**
-

6.46 In the case of North Sydney reserves were held of money raised from sales of floating floor space and these were transferred from time to time to supplement working funds. As a consequence Alderman and ratepayers would see working funds growing during the year, but this apparent growth was misleading because of nondisclosure of transfers from reserves.

6.47 The Committee is also of the view that auditors should comment upon funds expended or committed by a Council in anticipation of loan raising. This action could impact on the viability of Council in future years if there was little likelihood of loan funds being realised.

²⁴ Minutes of Evidence, Mr Kempshall, 23 April 1990, p. 392

Recommendation 10

It is recommended that the Local Government Act be amended to prohibit Council reporting practices which have the effect of stating future transactions as current reserves or assets.

- 6.48 During the Hearings, there was discussion on a wide range of such discretionary decisions by Councils, the efficacy of which would depend on the scale and timing of the activity.
- 6.49 The Committee strongly believes that Councils should be thoroughly briefed, early in the decision-making process of the financial and policy impacts of these activities.
- 6.50 At the same time the Committee is mindful of the potential conflict of interest if auditors become too closely involved in the decision-making process. The Audit Committee, discussed more fully in Chapter 14, fulfils many of the criteria for an independent non-executive directorship capable of informed discussion of the long-term financial consequences of Council policies.
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Recommendation 11

It is recommended that Council Audit Committees have a responsibility for appraising and reporting on the impact of proposed future activities on the financial standing of the Council.

- 6.51 The Committee is concerned that with greater complexity of Council roles, there will be greater difficulty for auditors to keep track of activities. Auditor Mr John Thackray described such problems with respect to North Sydney Council:

*"I was very concerned that the sheer velocity of programs that were put were such that it might take a lot of money to stop it by the time they ran their course."*²⁵

- 6.52 The Local Government Act has been described as "archaic" because it currently diverts resources to checking the minutiae of 655 Sections, 103 Ordinances, and over 1000 separate provisions. In an era in which a single public liability case, let alone large scale management decisions, can cost millions of dollars, the Committee feels that this is not a productive use of auditors' time.
- 6.53 Computer systems, which have revolutionised accounting in this decade, allow much of the checking of statutory compliance to be automated. The auditor must be responsible for verifying the reliability of such automated systems. This is less time consuming than the work which would have been required to process the same volume of information manually. The net result of this freedom is greater flexibility to use the system to generate information to answer more fundamental questions about performance.
- 6.54 In Councils with substantial investment activity financial risks have largely dwarfed operating risks. The then Town Clerk of Marrickville described the pressures on Councils before legislation was put in place to regulate the many forms of investment that were on the market.

"Councils were having to compete because they had a lot of money sitting there idly that was not working for the ratepayers.

We were caught up in the Nugan Hand excitement of the day. We made \$100,000 from our investment...The auditors originally were asked to comment on the safety of investments in Nugan Hand and endorsed them with certain conditions, which we followed. That evidence came out in the Royal Commission.

An ordinance came out under the Local Government Act, which set out exactly what you are supposed to do with your investments... The Nugan Hand exercise made sure that there was a local government ordinance which clearly said what your

25 Minutes of Evidence, 23 April 1990, p. 373

*investments could do. All the auditor had to do was to make sure that we had a policy which addressed that, which I put to the Council once the audit was in place, and we went down that path with a firm audit on the Council's accounts on that basis....the ordinance came out after the incident - within about 12 months."*²⁶

- 6.55 While the Committee is aware that existing safeguards may have prevented any manifest financial failures in local government, it noted the observations of Mr Tony Baldwin, Special Projects Officer of the Department of Local Government:

*"...in the past many Councils have got themselves, or were starting to get themselves into financial difficulties. I think the department has actually performed a role in pulling some of them back from the brink. Secondly, if Councils do get themselves into a difficult financial position, there is no doubt that that reflects on the Minister and the government of the day very adversely because people out there do not see Councils as being responsible; they see the Minister or the Government as being responsible. It is highly sensitive and highly political. There is definitely a role for somebody to monitor the financial performance of Councils."*²⁷

- 6.56 The limitations of the current legislation on obtaining a global audit focus were highlighted at the Committee's Dubbo Meeting:

"The inspectors used to come in and want to check the petty cash and they were missing the whole scene. What they were missing was the management of the whole operation ... if you free up Section 211 that's when you might have some reform in the auditing system."

If you go to the other extreme, you can have a laissez faire system where you, as a Council fully deregulated, determine the scope of your audit. ...there would be no way that I would be a party to a system like that because it leaves itself open to obvious

26 Minutes of Evidence, Mr Bruce Gardner, 24 April 1990, pp. 468-469

27 Minutes of Evidence, Mr A. Baldwin, 10 April 1990, p. 216

*exclusions from your audit. If you have a problem area that you're aware of and you're having difficulty in solving it then you'd go soft on that section of your specification. That's what you're suggesting."*²⁸

- 6.57 The Committee noted that Councils' financial problems are most immediately felt by those reliant on Council services. The North Sydney Town Clerk described the problem:

*"...you are creating an ever-expanding gap. Should a situation arise where other sources of income fall off and you have got no control over them, you could end up having problems. The solution has to be to cut services. My advice to Council was that it should not see itself in a situation where it was going to have to reduce services. That is never an easy decision to make."*²⁹

28 Transcript of meeting at Dubbo City Council, 19 April 1990

29 Minutes of Evidence, 23 April 1990, p. 392

7. Special Features of Local Government Accounting

7.1 The overall issue confronting the Committee in this Inquiry was to determine the extent to which local government warrants special and particular rules for accounting and auditing and separate requirements for the appointment, qualifications, standards, duties, rights and reporting processes of its auditors.

7.2 The Auditor-General of NSW, Mr K. Robson, in a submission to the Committee's Inquiry into his office, 31 October, 1989, expressed the view that *"The purpose of preparing and publishing financial reports should be addressed according to the needs of the users of the reports"*. He viewed legislation as having been the chief determinant of the system of fund accounting and its requisite specialized training:

"This basis and the proclaimed method of preparing the statements appears to be produced predominantly for the statistical and research purpose of the local government and other departments rather than the other external users of the statements".¹

7.3 The Chairman of the Local Government Auditors' Association of NSW sought to answer critics of local government accounting:

"The criticisms I have heard of double accounting are:

- (a) Transfers to and from reserve to conceal a particular 'result' (movement in Working Funds).*
- (b) There are too many schedules in the presentation of the annual accounts.*
- (c) There are inconsistencies in the treatment of some capital expenditure (e.g. Roads construction not capitalised but written off in the year of construction).*

¹ Submission, The Auditor-General of NSW, Mr K. Robson, Report on the Auditor-General's Office, 31 October 1989

I believe there is a valid answer to all these criticisms, as follows:

- (a) Notes to the accounts describing the movements in reserves and ensuring that they are in accordance with Council resolutions will make such transfers understandable.*
- (b) The schedules should be regarded as nothing more than "working papers" used in the production of the annual accounts. The essentials are contained in the balance sheet and revenue account and notes to the accounts.*
- (c) The inconsistencies in treatment of certain capital expenditure when compared with commercial accounting should be explained in notes to the accounts as there is very good reason for this inconsistency, i.e., commercial standards are not applicable."²*

7.4 During the course of the current Inquiry many variants on the positions, of the Auditor-General and of the Local Government Auditors Association were heard. A professional body differentiated solely by arcane and antiquated reporting requirements would foster criticism as a "club" with restrictive entry practices. A differentiation based upon necessary public reporting procedures requiring advanced skills, on the other hand, would foster the envy accruing to any professional specialty.

Proposed Changes to Accounting Standards - ED50

7.5 Some of the most important changes in local government auditing currently in train have been proposed by the accounting profession itself. The Australian Accounting Research Foundation produced an Exposure Draft 50 (ED50), which would bring a uniform standard to accounting practices across local government in Australia.

7.6 The Committee is aware that changes in line with ED50 will bring local government accounting closer to current commercial accounting and reporting under the Companies Law. The chief changes to practice ED50 will bring are

² Submission, Mr G. F. Thomas, 26 April 1990

in the aggregation of funds and reserves, the reporting of operating surplus, and in the valuation and depreciation of assets. In place of the current breakdown of statements for specific funds, it will consolidate the statements for the council as a whole. In addition, it will bring full depreciation charges to the operating figures.

- 7.7 The Auditor-General³ expressed the view that the adoption of a uniform accounting standard such as ED50 would require local councils to prepare their financial statements on a similar basis and format to a commercial organisation, using full accrual accounting, preparation of a Statement of Operations, a Balance Sheet and Source and Application of Funds Statement:

"It could be that the present structure of local Council accounts, with its restrictive, inhibitive and outdated formats, has become patently unsuitable for meeting modern day accounting and reporting requirements.

In this respect, it is very pleasing to see that the previously referred to exposure draft, ED50 'Financial Reporting by Local Governments', this will completely take away the so called 'mystique' presently thought to be associated with the local Government double or fund accounting."

- 7.8 The Secretary, Department of Local Government, has set out the Department's views on the implementation of ED50:

"The Department does not oppose the requirement to prepare consolidated financial reports. ...However, if the system of separate funds is continued, the financial statements for these funds will be available for inspection at the council's office (as will the detailed accounts), the notes to the consolidated reports will contain a summary of the results of each fund, and a summary of the fund results will probably also be made in the Annual Report.

3 Submission, 26 April 1990

This Department agrees that infrastructure assets should be recognised. ...Concerns are held as to the amount of work which will be involved in bringing councils' base records up-to-date and the time required to develop a suitable methodology for valuation.

The Department does have problems with regard to the valuation of heritage and recreational assets. ...Some of these assets such as, for example, historic buildings and parks etc., will already be recognised in Councils' books at cost less, where appropriate, depreciation. Other assets such as monuments and so on are unlikely to be recorded at all.

Classification of Assets - Consideration will be given by the Department as to how investments held for long term purposes will be classified. Such funds are not really available and it can be argued that to show them as current assets would distort the figure for net current assets. Accordingly, consideration will be given to classifying such investments according to the purpose for which they are held.

...the question is whether the operating account should show the revenues and expenses on a 'type' classification or on a 'programme' classification. The problem is that under the existing system of reporting, while the operating account is prepared on a programme basis, the balance sheet is prepared on a 'type' basis. The two reports are not consistent. The Department is therefore prepared to go along with the requirement for the operating account and the statement of financial position to be prepared on a 'type' basis."⁴

- 7.9 The Institute of Municipal Management has outlined some of the problems which might be encountered if the present system were changed:

"No objection is raised to the proposal to prepare a single set of financial statements encompassing all of the operations which the Council controls. ...No objection is raised to the

⁴ Submission, Mr F. A. Elliott, 29 March 1990

*implementation of the full accrual basis of accounting for local government. ...It would appear to be more enlightening if the consolidated statements were prepared in a manner which disclosed individual results wherever practicable. ...Considerable concern must, however, be expressed that utilising the operating statement in the manner proposed will ensure that there are serious fluctuations for most Councils when comparing each year's end result ... whether explanations for such serious fluctuations by way of a note to the Accounts will be acceptable is questionable in view of the political climate in which local government operates."*⁵

- 7.10 The Committee is conscious that there will be an adjustment phase to a system such as ED50. In written evidence to the Committee, Mr F. A. Elliott, Secretary, Department of Local Government⁶, expressed concerns about the cost of implementing the requirements of ED50 and the impact implementation will have on the resources of the Department. He was of the view that it will not be possible to implement the requirements of ED50 prior to January 1992. It is possible that public attention could be attracted by the size of the newly-valued asset base and that the focus on operating surpluses could attract the public focus away from the non-profit goal of the Council to that of maximising service within the constraint of maintaining the asset base.
- 7.11 Similarly, depreciation charges in some Council statements could dwarf operating figures, suggesting big losses. More intangible figures could thus dominate the financial statement, obscuring figures for current operations.
- 7.12 However, these initial changes in emphasis should be offset by the fact that Councillors and their advisors are more likely to be able to work through ED50's more familiar reporting environment. The experience of Baulkham Hills and North Sydney Councils alerted the Committee to the prospect of aggregated reserves tempting councillors to function on the scale suggested by the total reserve figures. This temptation ignores the fact that the reserves can only be drawn upon for specific, not overall, purposes.

5 The Institute of Municipal Management, NSW Division. Submission on ED50 - Financial Reporting by Local Governments, March 1990

6 Submission, 29 March 1990

- 7.13 Of concern to the Committee were the financial difficulties which Councils can create for themselves on the basis of short-sighted decisions to minimize rate revenues. One of the benefits of a standard such as ED50 would be to bring such processes to awareness, by highlighting any rundown of reserves or infrastructure assets.
- 7.14 The Committee supports closer parallels between local government auditing and commercial accounting standards. To the extent that ED50 will represent an improved level of standardization in local government accounting, the Committee supports its introduction. It recognizes that there will be a financial cost in its implementation but acknowledges the long-term benefits to local government accounting and reporting.

8. Appointment Procedures

- 8.1 An Inquiry is, by its nature, likely to highlight deficiencies perceived in the current practice. There are few arguments in favour of an immobile system. The benefits of freeing up the system were noted by participants of all persuasions. There were no respondents who openly espoused a curtailing of local government autonomy. Many, however, cautioned that with increased autonomy would come greater accountability.
- 8.2 The Committee considered, for perspective, the information available about audit practice in other government sectors and in the private sector. It noted that many of the same concerns about accountability, fees and additional services have been debated with respect to tendering for audit services in the private sector.
- 8.3 The extremes of view presented to the Committee in this Inquiry could be summarised in terms of the traditional *"intervention"* versus *"laissez faire"* approaches. By and large, supporters for the Auditor-general's direct involvement were from government and semi-government instrumentalities. Councils stressed their need for autonomy.
- 8.4 The Committee was informed by Mr Baldwin, Department of Local Government, that most Councils would prefer to put their audits out to tender:

*"...I would say without exception Councils are opposed to the Auditor-General being involved directly in the audit of local government ... to top it all was the fact that he reports to Parliament, because local government would see itself as not being directly responsible to Parliament."*¹

- 8.5 The Committee is mindful that the search for an ideal compromise is ultimately futile - each extreme has its merits and pitfalls. Some auditors were perceived as being too *"cosy"* with management, as noted by the Local Government Auditors' Association of NSW.

1 Minutes of Evidence, Mr A. Baldwin, 10 April 1990, pp. 205-207

*"It has been suggested in some quarters that local government auditors are too close to the Council Clerk and it has been inferred that such a relationship has resulted in a less than effective audit. ...The relationship between the auditor and the Clerk is no different to that which exists between the auditor and chief servant of any other client."*²

- 8.6 Other Councils felt the auditor was too rarely seen and not familiar with local problems. This they saw as only being exacerbated by the involvement of the State Government.
- 8.7 The current term of appointment of the auditor under the Local Government Act is one year. This is inevitably renewed unless there is intervention by the Minister. The appointment is to an individual, rather than a firm, who holds a prescribed certificate issued under Ordinance 4 by the Local Government Clerks and Auditors Qualifications Committee. Under Section 211 Council, as an institution, has the autonomy to initially appoint the auditor. However, once done, subsequent Councils merely inherit, and annually ratify, this decision.
- 8.8 In the Committee's view this arrangement has potential to reinforce a personal relationship between the long-term Auditor and Clerk. There are far more incentives for cooperation than for an adversarial role for the auditor.
- 8.9 A submission by the Auditor-General to the Committee described the present manner, method, terms and conditions of appointment of local government auditors in New South Wales, under Section 211 of the Local Government Act and Ordinance 4 thereto, as being far too narrow and restrictive:

"In essence, it has created a 'closed shop' environment. Only auditors holding a Local Government Auditing Certificate are eligible for appointment and once appointed it is very difficult to remove them, even where a Council is dissatisfied with the service provided.

² Submission to the Inquiry into the Auditor-General's Office, 20 November 1990

Councils can only appoint individuals as auditors and not firms. Along with the scaling system for audit fees (referred to later), the restrictions provide little inducement for local government auditors to improve their standards and efficiency or to reduce audit costs. It is also felt that there should be no difference between the terms and conditions for appointment of local government auditors and those that exist for registered company auditors.”³

- 8.10 The Local Government Auditors’ Association of NSW saw the position differently:

“There are relatively more accounting firms involved in local government auditing in New South Wales than there are accounting firms involved in top company audits. Only 6 firms audit 755 (79%) of the top 1000 companies.

The fact is that there are 33 firms currently holding 171 local government appointments. This spread of appointments compares more than favourably to the commercial sector where 25 firms (including 6 Auditors-General) hold audit appointments to 914 of the top 1000 companies and control audit fees totalling \$274.6 million.”⁴

- 8.11 There are provisions within the Local Government Act which give Councils the power to change auditors and the Department power to discipline auditors if performance were unsatisfactory. For example, Ordinance 4, Clause 47 allows for the suspension of an auditor’s certificate, subject to an appeal on the weight of evidence or error of law. These powers have never been utilised. What would be needed in order to invoke these powers today would be a change in the overall context and policy.
- 8.12 This context has so far tended naturally toward inertia and a locking-in of existing appointments. This makes it hard for new entrants to break in or for Councils to change auditors because vacancies would only arise through attrition.

³ Submission, the Auditor-General, 26 April 1990

⁴ Submission, 11 April 1990

8.13 The Department of Local Government, in its review of the Act, is in the process of examining the evidentiary requirements for a removal request. At present, to exercise removal powers invariably raises questions about the professional competence of an individual. The Committee believes it possible that this process can be modified to enhance accountability, but without potentially unfairly damaging reputations.

8.14 Support for the assumption of responsibility for local government auditing by the Auditor-General came mainly from other State Government instrumentalities. For example, the Director-General of the Public Works Department said:

"By providing for the same Auditor General the standards of auditing in each will be consistent across the second and third levels of government. ...I believe the Auditor General should report to Parliament on results of his audit.

I believe the management of Councils should be responsible to Parliament. ...This would provide increased accountability similar to those available in second tier of government (i.e. individual departments can have internal management reviews. Local government will also have same number of internal reviews).

*To appoint the Auditor General to review quality performance when he does not have other responsibility is to make him a toothless tiger."*⁵

8.15 A similar view was expressed by the Ombudsman:

"In my view public confidence would be best served by bringing local government under a modified Public Finance and Audit Act. ...The important notion of the independence of local government authorities, however, would appear to dictate that

⁵ Submission, Mr R. D. Christie, 4 April 1990, with a copy of a submission by Mr A. Pang, Audit Manager, Internal Audit Branch, 6 March 1990

*acceptance of such a system would more likely occur if the Auditor General reported annually to the Minister for Local Government rather than the Treasurer."*⁶

- 8.16 Most Councils strongly emphasised that they were already accountable to an electorate and that interposing an additional level of bureaucracy would contribute little to stakeholders.

*"Any further involvement of the State Government will simply add to the perception that local government is only an agency of the State."*⁷

- 8.17 In addition to the submissions received from individual Councils, there was a collective expression through the LG & SA which forwarded the Submission paper recommended by its Audit Committee and advised the Committee that they did not favour the mandatory auditing of Council's accounts by the Auditor-General:

"The Association believes this suggestion by the Auditor-General is patently inappropriate for the following reasons -

*Councils should only be answerable to their own electorate and not to the New South Wales Parliament. ...Appropriate discharges for grants provided by other tiers of government can, and are, being provided by private sector auditors acting for local government. ...The Auditor-General does not have the resources to carry out the audits. ...Private sector firms are as professionally capable of carrying out the audits."*⁸

- 8.18 Alan Morse & Co., the auditor of more than 15 local government authorities, mentioned another implication of the Auditor-General's proposal:

6 Submission, Mr J. Pinnock, Acting Ombusman, 9 April 1990

7 Submission, Mr A. Ratcliffe, Shire Clerk of Eurobodalla, 2 May 1990

8 Submission, Mr W. A. Henningham, Secretary, LG & SA, 29 November 1989, p. 14

*"The Auditor-General can undertake this work himself at any time, to the exclusion of private firms. If this was ever to be the case there would be a substantial loss of employment from the country to the city."*⁹

8.19 In evidence to the Committee Mr John Mant, Partner, Phillips Fox Solicitors, stated:

*"A judgment has to be made between supporting the local economy and getting the best possible auditor. I have a lot of sympathy for the local Council wanting to employ local expertise, wherever possible."*¹⁰

8.20 The scale of local government is such that it is becoming increasingly harder for the elected representatives of this tier of government to devote adequate time to the financial management of operating expenditures as high as \$106 million.¹¹

8.21 The Committee views it as essential that the auditors of local government provide maximum accountability to the electors and ratepayers of NSW for the multi-million dollar business of local government.

8.22 The Committee holds that local government ought to be deemed as capable of assessing and appointing its auditors.

Alternative Accounting Approaches

8.23 Analogies are often drawn between local government and the commercial sector. One parallel is the visibility of Aldermen and Councillors in meetings at which the public is present. The ratepayers are equated with shareholders, the Council with the Board of Directors, and the Clerks/Managers with the professional management. The chief limitations of this analogy are the non-profit nature of business and the fact that ratepayers are not voluntary speculators.

9 Submission, Alan Morse & Co., 27 March 1990

10 Minutes of Evidence, 23 April 1990, p. 56

11 Annual Statement of Accounts, Department of Local Government, 1990

8.24 The Local Government Auditors Association of NSW put forward in evidence:

*"...the major difference between commercial organisations and local government organisations is that local government doesn't operate with a view to making a profit. ...It operates with a view to having sufficient money available within a given year to carry out its budgeted works and services."*¹²

8.25 The other prime limitation cited in evidence as the barrier to reform in audit practice is the Local Government Act which now includes 655 sections, 103 ordinances, and over 1000 separate provisions.

8.26 It is the Act which has been most often cited:

*"...the system of auditing is unique and it is very appropriate to local government. ...local government auditing again has been pretty well dictated by the act itself, and it is a more comprehensive audit, it requires more involvement in compliance".*¹³

8.27 If local government is to add a reporting function with improved scope for accountability in such areas as operating margins and asset depreciation, some trade-off is inevitable with the current emphasis on stewardship of funds. The tasks will be to preserve the essential features in the highly detailed system of accounts and to gain from the ability of alternative methods to highlight issues such as the depreciation of infrastructure assets.

8.28 The complexity of modern accounting systems is such that Councils would have had to extract different sets of "books" to fulfil statutory requirements for the Department of Local Government and Australian Bureau of Statistics, as well as to answer management questions about efficiency:

"I have a number of Councils who have actually prepared two form 2As, one for the Department of Local Government and

12 Minutes of Evidence, Mr Spencer, Vice-Chairman, Inquiry into the Auditor-General's Office, 3 November 1989, p. 93

13 Minutes of Evidence, Mr Thomas, Chairman, 3 November 1989, pp. 92-93

*one for the Council. The one for the Council of course is far more explicit in where the money is being spent and where it is being funded from..."*¹⁴

- 8.29 This complexity tends to exclude most electors and their elected representatives from the full information base available to the non-elected managers and auditors. The same would apply to the ability of shareholders and boards of directors to analyse detailed financial information in contrast to managers in the commercial world. Reinforcing this is the more permanent appointment of the non-elected management when compared with the transient tenure of elected office bearers and the irregular, voluntary participation of ratepayers.

The Competitive Market

- 8.30 There were many sentiments expressed in the Inquiry as to whether market forces could provide the necessary flexibility and autonomy to suit Councils' auditing needs while retaining auditors' independence through competition:

*"It is really not set by market forces in any way at all. ...there are arguments against market forces whereby auditing services may not be as good if firms are cutting prices, but, to me ... it becomes a cartel if you are using the auditors association, and the Local Government Association to determine the fee."*¹⁵

*"If we are talking about a competitive tender, provided there are performance agreements and pro forma specifications laid down and standards applied, the market place perhaps looks after itself."*¹⁶

- 8.31 The essential features of a competitive market are: sufficient entrants, homogenous product, freedom to profit or fail, and freedom of entry and exit to the market. Given the fact that audit contracts are already more widely

14 Minutes of Evidence, Mr Ferrier, 23 April 1990, p. 381

15 Minutes of Evidence, Mr C. Ellis, Consultant, Department of Local Government, 9 April 1990, pp. 100-102

16 Mr F. A. Elliott, Secretary, Department of Local Government, 9 April 1990, p. 39

distributed in local government than in other tiers of government or the private sector, there might not be a great deal of room for improvement from free market forces.

- 8.32 The Secretary of the Department of Local Government described the current accounting requirements of Councils as having been designed to keep the worst performers in line:

*"A code such as the present Local Government Act is a highly detailed code which ties all Councils hand and foot - then you always tend to do it to the lowest common denominator. You tend to say, 'what would the worst Council get up to and we will make sure that they do not get up to it'. The best Councils and the big ones who really want to get on with a quite different sort of job are constrained by the standards of the least best Councils. ...by opening up the auditing to a much wider range of people, auditors, you provide the opportunity for Councils to select the auditor that suits them best."*¹⁷

- 8.33 An open tender process, such as is currently required under Ordinance 23 for Council acquisitions, and contracts of \$50,000 or more, has been suggested as a means of opening up the appointment and rotation of auditors. Indeed, the Committee understands that the original fixed fee set by Council had served as a tender specification until the rise of professional fee-setting in the 1940s. The Committee is of the view that fees should become but one small consideration in the determination of an audit contract which would clearly delineate the scope of audit and responsibilities of the parties involved. In practice, such a process would also have to ensure that the needs for monitoring and supervision could be met within a deregulated system whose only controls were term of appointment, contract, review procedures and fees.
- 8.34 An audit contract with a large firm does not, of course, guarantee that the bulk of the work will be done by the more senior partners. The same would apply to the Auditor-General who, in turn, sub-contracts to private firms.

¹⁷ Minutes of Evidence, Mr F. A. Elliott, Secretary, Department of Local Government, 9 April 1990, p. 53

- 8.35 Mr John Parkinson, Assistant Auditor-General, gave evidence to the Committee as to how the Auditor-General's Office employed a mix of staff. The tenderer nominates, in the tender, how much time each staff member would spend on the audit: *"We take whatever steps are necessary to ensure that the senior officers' time spent on the audit is similar to what they undertook to spend."*¹⁸
- 8.36 The Committee heard evidence that this was perceived as a problem by some Councils.
- 8.37 There has been some experience with a tender process for audit services. The Auditor-General illustrated one advantage of using tenders when he made the point that since July 1987, when all *"electricity only"* County Councils were included in Schedule 2 of the Public Finance and Audit Act 1983, there had been a reduction of 17% in audit fees paid by the Councils.¹⁹
- 8.38 The Committee canvassed a range of opinions regarding the pros and cons of a tendering process.
- 8.39 In their Submission to the Committee, 11 April 1990, which included a Discussion Paper, the Local Government Auditors' Association made the following points:

"Where a council wishes to put its audit appointment out to tender, it should be permitted to do so.

We further submit that it is not necessarily in the best interest of either the council or the auditor to call tenders ... There is considerable disruption and expense to the council and the audit is more effective and efficient if the auditor can draw on detailed information gained over a lengthy period...

18 Minutes of Evidence, 10 April 1990, p. 157

19 The Auditor-General, Submission, Inquiry into the Auditor-General's Office, 31 October 1989, pp. 20-22

To a limited degree, the tendering process provides initial security of tenure (and therefore independence) but no such security is guaranteed for the latter part of the contract period as the council may not appoint the audit for a subsequent period because of adverse reporting.

Further, the tendering process does not ensure the provision of cost-effective audit services and often precludes smaller firms from being competitive because they are unable to absorb initial costs of a bid designed to obtain work.”²⁰

- 8.40 Some Councils were concerned about the influence of a tendering process on the “extra” services they now rely on from their auditors:

“If the appointment of auditors went to competitive tendering these additional roles could well be the first to disappear.”²¹

- 8.41 Mr Bruce Edwards, President of the Institute of Chartered Accountants, presented some of the issues involved in audit tendering:

“The Institute has not seen fit to publicly oppose the practice of audit tendering for several important reasons:

- *The fact that ‘the proprietors of a business have an indisputable right to choose their professional advisors and to change to others should they so desire’ is a fundamental principle which is acknowledged and formally recognised (Ethical Ruling AER2).*

- *Opposition to tendering could be construed as the profession acting in its own interests as opposed to the perceived public interest.”²²*

20 Submission, Local Government Auditors’ Association, 11 April 1990

21 Mr M. Regnis, Town Clerk/General Manager, Municipality of Woollahra, 4 April 1990

22 Mr B. Edwards, *Audit Tendering - A Current View*, The Chartered Accountant in Australia, November 1985

- 8.42 The Committee agrees in general with other concerns about aspects of the audit tendering process raised by Mr Edwards.

*"There have been instances where companies have called for audit tenders when in fact the appointment has already largely been determined and other tenderers have little or no chance of success. ...This abuse of the system has caused firms to unwittingly waste thousands of dollars and countless hours of time in preparing abortive submissions. ...The invitation to tender and the subsequent replacement of auditors is seen as being particularly undesirable when it follows the issue of a qualified opinion by the previous auditors. This practice, if it develops, could give rise to the repugnant practice of 'opinion shopping' as is occurring in some overseas countries."*²³

- 8.43 Accountant Mr Paul Hennessy noted that bigger firms might spend up to \$50,000 on a tender bid.²⁴

- 8.44 The Committee heard other views opposing tenders for audit:

*"Fee sensitive tenders have been submitted and I believe that the quality of service has suffered significantly in those audits ...if you eliminate the fee from the process you can look at everything on its merits."*²⁵

- 8.45 There was also the view that

*"...in many instances, you get a small fee the first time you tender and it generally creeps back up. ...it is one of the appropriate ways of testing a charge or fee in the market place."*²⁶

23 Ibid

24 Reported in The Sydney Morning Herald, 22 May 1989

25 Minutes of Evidence, Mr G. Wilson, Coopers & Lybrand, 9 April 1990, p. 81

26 Minutes of Evidence, Mr R. Ball, Town Clerk, Waverley Municipal Council, Institute of Municipal Managers, 9 April 1990, p. 117

8.46 Concerns were expressed to the Committee that the big accounting firms might come to dominate local government auditing, particularly if a tendering process is promoted. Concerns about market concentration have also been expressed in the media, due to the difficulty for smaller firms to maintain continuing education in the face of changes in accounting standards, tax, and companies legislation:

8.47 Evidence from the Shire Clerk of Narrandera presented other concerns:

"Many large firms utilise a high content of junior staff on their local government audits and consequently the quality of the audit is doubtful in some instances. To add to the staff and a considerable period of time is wasted during each audit period with familiarising new auditing staff with records and a background to Council's operation." 27

8.48 In evidence before the Committee the General Manager of Waverley Council was asked about his confidence in the junior staff employed by the Council's auditors:

"...I think one would have to say that one does not develop confidence in the junior staff; one develops confidence in the auditor. It is his prime responsibility to undertake that audit. I do not make judgement on the junior staff. However, if I were approached by junior staff and found their attitude to be less than what I considered acceptable certainly I would raise that with the auditor, but I do not make a judgement on the junior staff... he should feel confident about his position and be prepared to challenge me and test me." 28

8.49 Mr F. A. Elliott, Secretary, Department of Local Government, was the former Town Clerk of Fairfield. He recounted his experience to the Committee:

27 Minutes of Evidence, Mr K. M. Murphy, Shire Clerk, 28 June 1990

28 Minutes of Evidence, Mr R. Ball, Waverley Municipal Council, 9 April 1990, p. 113

*"...probably qualified certifying auditors would be there 75 per cent of the time. ...A lot of the work involved in auditing again is brought back by antiquated requirements. ...Some of it is straight ticking and flicking, if you like, and it is pretty hard to put highly paid, certified auditors on the course checking. ...a lot of them have senior clerks who may not be totally qualified and who do a lot of the ticking and flicking."*²⁹

- 8.50 The General Manager of Oxley County Council gave evidence to the Committee about the practice of audit firms relying on people on scholarships during university holidays, resulting in the following distribution of total audit work:

"Two days for a half-yearly - two days for the annual and one day for the half-yearly, as well as a senior audit clerk, a man who would have to be aged 38 or 40, who attended the whole time. The there would be one between him and a couple of young people, 21, 22, 23, so that there was a good spread.

There is a subtle difference, I will grant you, but they are under scholarship to Peat Marwick and when they are not at university, they work for the firm, and if their audit work at our place happened to coincide - There were five people there altogether, and the senior audit partner from Peat Marwick. ...Certainly they had access to a senior person every day they were there. ...The last time he was there he was not in the office. He did not get to the stage where he saw any of the records. He did not go past the foyer. The time before, he spent a little time reading the minute book. ...We only pay the standard audit fee for the total audit we get.

There is a possibility he may have made a profit?

*No doubt."*³⁰

²⁹ Minutes of Evidence, Mr F. A. Elliott, Secretary, Department of Local Government, 9 April 1990, p. 43

³⁰ Minutes of Evidence, Mr R. Newling, 10 April 1990, pp. 191-192

- 8.51 In addition to services offered by the auditor beyond bare specifications, there may be requirements arising from the Council's side of the bargain. Councils vary in the quality of their internal record-keeping. Poor internal controls can mean more work than budgeted for the auditor and lower margins, under a fixed fee system.
- 8.52 The Committee observed that for many Councils the auditor provides a range of services beyond the bare prescriptions of the Act. It is aware from previous Inquiries that professionals do not always merely "*work to rule*" and is concerned that changes which might flow from this Inquiry continue to harness voluntary initiative.
- 8.53 While the traditional external audit is a core service, the additional services of management consultancy, internal auditing and EDP offered by the most large accounting firms blur the boundaries of the market.
- 8.54 A good working relationship between the internal and external auditors can, by contrast, reduce the latter's workload.
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Recommendation 12

It is recommended that Councils and the selected auditors sign an audit contract covering the terms of the audit engagement.

- 8.55 The introduction of the new standardised and commercially orientated accounting format should also lead to greater consistency and standardisation of audit processes. Together with an open tendering process, this should ensure competitive tendering for even the most complex local government audits.³¹

31 Refer to Appendix 6, Terms of Engagement for Audit Services to the Auditor-General

Checks and Balances

8.56 On balance, the Committee considered the arguments for deregulation as most persuasive. The Local Government Act provides a double check on financial management through the Department of Local Government's Finance Branch and the Special Investigations and Management Audit Branch. However, there is scope for continued improvement in the Departments monitoring capabilities to enable quick response should the auditor miss information of long term consequence.

8.57 The Committee heard in evidence auditors' concerns about the Department's capacity to respond. Mr Ferrier, of Felser, Russell said in evidence:

"I think most of these reports are not read. If I had a report that needed to be read, I would ring up the department and speak to someone at the department, saying that I was sending in my report on X council or Y council and asking that person to look at it. In one instance I said, "Could you please get an inspector down to the particular council", but it took about 18 months for them to get an inspection because of some other overriding priorities".³²

8.58 Mr Thackray, local government auditor, also gave evidence on this matter.

"I think the department has had more of a monitoring role than a responsive role. In past years it has not had a direct involvement and a direct commitment to what used to be the inspectorial role. Even the role of the inspectors has changed, as you would be aware.

The auditor has tended to stand alone in the past few years, as far as the department is concerned, unless it has involved something that has been extremely pressing. As I said, I think the only way you can get action is by talking to someone within the department and informing them that there is a problem. To

³² Minutes of Evidence, 23 April 1990, Auditor Mr J. Thackray, p. 357

that extent, an extra burden has been placed on the auditor. If in his view there is something that requires immediate attention, I guess the best thing to do is to contact the department.”³³

- 8.59 Within the business world such second checks would not be performed under the Companies Code other than by complaint regarding malpractise. The practices of commercial auditors are now reviewed by the Companies Auditors and Liquidators Disciplinary Board constituted for purposes of the Companies Code.

“1.(1) The Board shall consist of 3 members appointed by the Minister, of whom -

- (a) one shall be a barrister or solicitor of the Supreme Court of not less than 5 years standing (in either or both capacities) who is nominated by the Attorney General; and*
- (b) one shall be selected from a panel of 3 persons nominated by the Institute of Chartered Accountants in Australia; and*
- (c) one shall be selected from a panel of 3 persons nominated by the Australian Society of Accountants.”³⁴*

- 8.60 The Committee sees merit in trying to standardise the rules for action and letting the market choose the participants. There is little evidence that free and open choice would compromise auditor independence and no evidence that state intervention would either prevent the rare occurrence of misconduct or provide a better system.

- 8.61 The Committee is in agreement with the view regarding external audit:

“An audit is not a service to management, it is an audit of management. As such it is the sole prerogative of the shareholders to choose the auditors.”³⁵

33 Ibid, p. 357

34 Australian Securities Commission Act, 1989, Part 11, Companies Auditors and Liquidators Disciplinary Board

35 J. Coates, *Government Owned Companies and Subsidiaries: Issues in Accounting, Auditing and Accountability*, Australian Journal of Public Administration, Volume 49, No. 1, March 1990

8.62 The Committee heard little support for the direct involvement of the Auditor-General in local government audits, except from other government instrumentalities. By making the Auditor-General eligible to tender, the Committee hopes to achieve the best mix of possibilities. If the Auditor-General's fees are, as described to the Committee, potentially much lower than commercial auditors, this should attract some Councils to the tender. If, as other Councils pointed out, this is a minor concern, they would be free to pay for the services they seek. Rather than burdening the Auditor-General with an entire tier of government to audit afresh, there would be an opportunity for both parties to gain experience gradually.

Recommendation 13

It is recommended that both commercial providers and the Auditor-General should be eligible to tender as Council auditors.

9. Accreditation

- 9.1 Local government auditors are professionals with advanced qualifications. The Committee seeks to ensure continued high accreditation standards but within in a more flexible system.
- 9.2 The Auditor-General stated in evidence to the Committee that he *"would place much more regard to the person being a registered company auditor"* than to take into consideration whether that prospective auditor were a member of the Local Government Auditors Association.
- 9.3 The Auditor-General, in his letter of 26 April 1990 gave the Committee his views on the limitations of the current standards of accreditation:

"...the Auditor-General has been the auditor for the [current] Council of the City of Sydney (and Sydney County Council) since their inception. Neither the current Auditor-General nor his predecessors or the personnel which have performed these audits, have held the special 'certificate' required for the audits of other local Councils. The Committee can be assured that the absence of the 'certificate' has not prevented this Office from performing a high quality audit of these organisations.

The main factor in giving the 'closed shop' image referred to earlier concerns the special qualifications that currently exist for a person to be eligible for appointment as a local government auditor."¹

- 9.4 The Auditor-General's suggestion that his office be responsible for the audit of local government Councils met with prompt reply from the then Chairman of the Local Government Auditors' Association of NSW, Mr G. F. Thomas, who drew attention to the fact that:

¹ Submission, the Auditor-General, 26 April 1990

"In order to be able to accept appointment as a local government auditor, a person must be a Registered Company Auditor who has also qualified by examination for a Certificate awarded by the local government Clerks and Auditors Qualifications Committee. Membership of our Association requires the applicant to meet all the above criteria and to be in practice as a local government auditor or in the employ of a practising local government auditor. All of our members are also members of either or both of the Australian Society of Accountants or the Institute of Chartered Accountants in Australia.

*Therefore, practising members are required to meet the continuing education requirements of the accounting body to which they belong. As it happens, the majority of our members have to meet the stringent Institute requirements for annual professional training. This, of course, is designed to ensure members maintain and develop their professional skills. Reference was made to our Association's Annual Seminar. Attendance is not compulsory for members. It is worth noting that in excess of 70% of our membership attend these activities. Virtually every local government auditing firm is represented, except those two who are not members."*²

- 9.5 The core of difference between the views of the Auditor-General and Mr Thomas is whether the special features which set local government auditing apart are, as in the former's view, an artefact of *"statistical and research purposes"* or, as in the latter's view, that the system of fund accounting is essential because of the extra responsibility of the statements to show ratepayers that their capital base is not being eroded and that funds were not used for purposes other than those for which they were obtained.³
- 9.6 The Chairman of the Local Government Auditors' Association detailed the necessity for training in fund accounting:

2 Submission, Mr G. Thomas, Chairman, Local Government Auditors' Association, Inquiry into the Auditor-General's Office, 20 November 1989

3 Submission, the Auditor-General, 26 April 1990

*"I have come to the conclusion that criticism levelled at 'double [fund] accounting' has been due to ignorance of the system. Whereas its teaching was once part of our accountancy course, it apparently has not been in the curriculum for some years. Ignorance, of course, breeds distrust so why should we not spend some time educating people who are normally able to understand commercial accounts; it takes little time to explain the difference and to understand the system."*⁴

- 9.7 The current requirements for eligibility are based upon the Local Government Certificate, as specified by the Local Government Act:

*"A person shall not be eligible to be appointed as auditor unless he holds the certificate prescribed".*⁵

- 9.8 This is more precisely detailed in Local Government Ordinance No. 4, Part 20(a). Qualification for certificate as Auditor, as

"A person who:

- (i) attains the educational qualification referred to in clause 22 for a certificate as Auditor; or*
- (ii) a) at any time has passed an examination which at that time was the qualifying examination for Auditors; and*
 - b) who satisfies the other requirements of this Ordinance, shall be entitled to receive a certificate as Auditor.*

Examination for certificate as Auditor from 1 January 1988:

- 22. (1) On and after 1 January 1988, the educational qualification for a certificate as Auditor is the passing of all subjects, at either "A" grade or "B" grade level, of the Professional Upgrade Programme for Auditors conducted by the Mitchell College of Advanced Education, Bathurst.*

4 Submission, Mr G. F. Thomas, Fund Accounting, 1988

5 Local Government Act, Section 211 (6)

- (2) *Each applicant for admission to the Programme in 1988 or any subsequent year shall furnish evidence to the Committee that the applicant holds a certificate of registration as an auditor under the Companies (New South Wales) Code.*
- (3) *Any person holding and producing to the Committee the certificate of an examining body that the person has passed an examination which, in the opinion of the Committee, is equivalent to an examination in all or any of the subjects comprising the Programme shall be exempt from examination in such subjects as the Committee may decide.*
- (4) *Each applicant for a certificate based on the qualifications referred to in this clause shall furnish evidence to the satisfaction of the Committee that the applicant has had, over such period (being not less than 2 years) as the Committee shall determine, auditing experience of a type acceptable to the Committee.*

Part B.- Auditors. Certificate as Auditor.

3. *A person shall not be appointed nor act as Auditor to a Council unless he holds a valid certificate as Auditor, such certificate being in accordance with this Ordinance."*

Special Requirements for Auditors

- 9.9 In 1981-8 Kuringai College of Advanced Education offered a residential course in Local Government Administration which was terminated due to lack of enrolments. Since then Mitchell College, now the Mitchell Campus of the Charles Sturt University, has continued the course but even this small programme is only sustained through integration with other business subjects.

- 9.10 As there are only a very limited number of new audit appointments in any one year, prospective entrants to local government auditing tend to be those in firms who work for a series of Councils. This can make it difficult for them to attend a residential course of study. The scattered location of candidates, and the small numbers involved, has made distance education the only viable alternative.
- 9.11 There are other areas of auditing beside local government, which have specialist requirements, such as the banking industry or trusts. In the main these needs are encompassed by the continuing professional development activities of auditors, through professional associations. Competitive tendering would capitalize on the skills developed in this way, provided that fee or task requirements do not become the sole determinants of tendering success.
- 9.12 The private sector does not require specialist qualifications beyond registration as an auditor, to deal with its wide range of commercial activities. In practice, the advanced training required for certification as a local government auditor is the equivalent of four full-time semesters or between one fifteenth and one twentieth of a degree programme. It might be possible for such a volume of study to become part of continuing professional development. Certainly, the more similar the statutory requirements for local government and other specialist auditing, the greater the opportunity for integrated post-graduate training. This, in turn, could lead to more movement of auditors between this and other fields of practice, bringing potential benefits of cross-fertilization of skills.
- 9.13 At the same time the Committee shares with the representatives of the Local government Auditors' Association of NSW a concern that there will remain a need for advanced training in the discipline. The complexity of rating alone justifies the need for at least some continuing professional development.
- 9.14 The Local Government Auditors' Association of NSW Submission, 11 April 1990, made the following points:

"Assessment for accreditation should have regard for professional qualification (registered company auditor) and experience, including experience in local government audits. Councils should have the right to appoint the auditor of their

choice. However, any appointment should be in line with the Companies Code to protect the independence of the auditor.”⁶

- 9.15 Professor David Fraser was asked by the Committee to review the local government auditors’ course at Charles Sturt University, Mitchell. He noted that *“All the required subjects are of course relevant to the local government area and thus must have some value for potential local government auditors.”⁷*
- 9.16 He expressed reservations, however, about the heavy concentration of law subjects, without a specific mention of negligence liability, and a possibly *“mechanistic and perhaps restrictive”* coverage of key skills. He urged development of discussion subjects on *“Current Issues”* covering:
- present efforts to develop a conceptual accounting framework - alternative models for local government and general accounting;
 - harmonisation of local government accounting practices within the federal framework;
 - emphasis on accrual accounting.
- 9.17 At present, there are only a small number of new recruits to the local government auditing ranks each year. There was no suggestion, either in the referral for the Inquiry or in evidence, that there was any need to expand the number of auditors beyond the number currently applying. There was, however, throughout the hearings, an expression of the desirability of increased movement possible between existing and new auditors.
- 9.18 Ms Susan Browne, Internal Auditor, Lake MacQuarie City Council, gave the Committee at the Maitland City Council Hearings a perspective as someone qualified in accounting who would feel deterred from aspiring to become an external auditor:

⁶ Submission, 11 April 1990

⁷ Professor D. Fraser, School of Accounting, University of Technology, Sydney, 16 August 1990

*"The reason why there's such a small number of people with the local government auditor certificate is because it's been so hard to break in to, so why bother? ... It's so hard to remove their auditors once they've got the certificate. It's so hard to break into that field."*⁸

- 9.19 Mr Tony Baldwin, Department of Local Government, author of a discussion paper on the subject, discussed his findings with the Committee.

*"I would say most Councils want some sort of a change; they are not entirely happy with the present system. Quite a large proportion of Councils would be prepared to accept some form of accreditation system, even involving the Auditor-General..."*⁹

- 9.20 The Committee heard a suggestion from Mr A. W. Byleveld, Town Clerk of Lane Cove Municipal Council, that experience including duties as part of a large audit team could allow new entrants to develop skills leading to full certification.

*"...accreditation would be for various sizes of Council. For example, a small but professionally proficient country accounting firm would be authorised either to carry out the audit of its local Council or Councils up to a certain grading or expenditure level but not beyond that."*¹⁰

- 9.21 The Committee feels that the current system of entry and exit are inconsistent with any of the benefits of a market-based appointment process. The qualifications are largely tied to the intricacies of an accounting and rating system which is itself under review.
- 9.22 There is ample evidence that current local government auditors actively engage in continuing professional development. Deregulation would be unlikely to diminish this enthusiasm as competition would be likely to spark innovations in training and experience for auditors.

8 Minutes of Evidence, Hearing at Maitland City Council, 20 April 1990, p. 255

9 Minutes of Evidence, 10 April 1990, p. 205

10 Submission, 19 April 1990

Recommendation 14

It is recommended that the requirement of S. 211 (6) requiring possession of a Local Government Certificate for eligibility to practice as a local government auditor be abolished.

Recommendation 15

It is recommended that accreditation of local government auditors should become the responsibility of individual Councils. To be eligible for appointment as a local government auditor a person shall have the following minimum qualifications:

- i. tertiary qualifications for admission as an Associate of the Australian Society of Accountants or the Institute of Chartered Accountants in Australia;**
- ii. registration as a company auditor under the Corporations (New South Wales) Act 1990 and the Commonwealth Corporations Act 1989 Section 1280;**
- iii. maintenance of the continuing professional development requirements for accreditation by the Australian Society of Accountants and for the Institute of Chartered Accountants in Australia.**

The Auditor may also offer for consideration (or demonstrate eligibility on the following grounds):

- i. local government auditing experience with a comparable client base;**
- ii. demonstrated access to resources and capacity to adequately audit the Council's management, financial and computing procedures;**
- iii. local government content in formal qualifications.**

The Council may also consider:

- i. the auditor's standing within the profession;**
 - ii. the auditor's access to intermediate and senior advice;**
 - iii. the auditor's capacity to provide additional services in local government management, finance and computing as may be advantageous to the client Council.**
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10. Termination of Audit Contract

Present System of Dismissal

- 10.1 In this Inquiry, the Committee has paid equal regard to the processes of both entry into and exit from the market of local government auditors.
- 10.2 The Committee does not want to create the potential for Councils to arbitrarily dismiss auditors or for them to use the threat of dismissal to "shop" for favourable audit opinions. At the meeting with Councils in Dubbo, the Committee was told by a former local government auditor, Mr Colin Arnold who was involved for seventeen years in local government auditing, from 1948 to 1965 that:

"...we were sacked on four separate occasions. Luckily today that situation doesn't exist. It was because we said at the time what the facts were and what our duty was in relation to Council.

...we weren't at the Council meeting. ...we received this letter that said we wish to advise that applications are being invited for the position of auditor and we knew then, the writing was on the wall. ...Fortunately today that doesn't exist because of the protection given to the auditor.

Section 211 has certainly got to be changed because whilst ever you restrict the auditor to that and that alone you will never encourage the auditor to come out and make suggestions.

...he will do what the medical profession and the legal profession does, he will protect his back and he will tie himself strictly to that and he won't move."¹

- 10.3 The Committee heard evidence, in its Hearings of 23 April 1990, that such problems are not merely historical. Auditor Mr Robert Ferrier told the Committee:

¹ Mr C. Arnold, Transcript of meeting at Dubbo City Council, 19 April 1990

*"This particular Council are wanting to get me replaced, I am sure. ...Ku-ring-gai. ...I think it goes back just over the years of critical reporting we have made ... and things that have been going on in the Council."*²

- 10.4 The LG & SA of NSW, in its submission, expressed particular concern to the Committee about how an audit engagement may be terminated, referring to the process of Public Inquiry under Sec. 649 of the Act:

"It has always been conceded that a Council should not be able to terminate an appointment based on an unflattering audit report or malice. However a Council should be able to terminate an appointment for good and sufficient reason on giving reasonable notice of intent to do so.

*The LG & SA refer to the report of the Commission of Inquiry into the termination of the auditor's appointment to Kyogle Shire Council which outlines the problems. The Inquiry was an expensive means of satisfying the Minister that the Council had valid concerns."*³

- 10.5 The current process of exit requires the use of both Sections 211(3) and 649(1), Public Inquiries, of the Local Government Act:

"211(3) the appointment of an Auditor shall be renewed from year to year unless the Minister otherwise determines.

649.(1) The Governor or the Minister may appoint any one or more persons a Commissioner to hold a public inquiry and to report to the Governor or the Minister, as the case may be, with respect to -

- a. any matter relating to the carrying out of the provisions of this or any other Act conferring powers or imposing duties on the Council; and*

² Minutes of Evidence, 23 April 1990, p. 345

³ Submission, Secretary, LG & SA of NSW, April 1990

b. *any act or omission of any member of the Council or of any servant of the Council or of any person elected or appointed to any office or position under this or any other Act conferring powers or imposing duties on the Council...*

(2) *For the purposes of any inquiry under this section any person appointed to hold such inquiry shall have the powers, authorities, protections and immunities conferred on a commissioner, and -*

a. *where such person is the only person appointed to hold the inquiry - on a sole commissioner; or*

b. *where such person is one of two or more persons appointed to hold the inquiry and has been appointed as chairman of the inquiry - or a chairman of a commission ...by Division 1 of Part II of the Royal Commissions Act, 1923..."*

10.6 In 1980 the Department of Local Government issued a circular to Councils, setting out the circumstances under which the Minister will approve a change in appointment of auditors under Sec. 211 (3):

*"This provision was inserted in the Act on the basis that an Auditor should not be inhibited from reporting on the accounts of a Council because of fear of the consequences of any adverse comment he may make."*⁴

10.7 In practice, the procedures which must be followed to obtain the Minister's approval have served as a deterrent to exit from the market. The Committee examined the full list of applications for, and approvals for involuntary audit appointment changes between 1980 and 1990. Apart from the entry of new partners, retirements, mergers, dissolutions and amalgamations of Councils, approval to call tenders has only been given on the one occasion. There were only 20 actual changes, of which one resulted in a Public Inquiry under Section 649:

⁴ Department of Local Government, Circular No. 332, 28 July 1980

*"Only rarely have there been reasons substantiated, based on incompetence or quality of the auditor. ...very few Councils have used a bench mark to establish what they should expect from an audit."*⁵

- 10.8 The one case which resulted in a public inquiry was based on a request by Kyogle Shire Council to call tenders for the appointment of an auditor. The Secretary of the LG & SA, 1 May 1990, directed inquiries to Kyogle Shire Council to ascertain the real cost to the Council of the Inquiry, which was outlined as follows:

"Professional fees paid to Auditors, legal costs of representation at the Hearing, Cost to travel to Sydney to instruct, solicitors, Identification and indexing of Council minutes, typing of submission, photocopying and facsimile costs, cost of researching and preparation of submissions, instructing solicitors; attendance at Inquiry by Shire Clerk (3 weeks), Deputy Shire Clerk (3 weeks) and Shire Engineer (1 day)

\$21,706.00

Other costs incurred by individuals and paid or borne by them without reimbursement:

- *Overtime due but not paid*
- *Legal costs incurred by the Shire Clerk for his own representation*
- *Councillors' allowances not claimed \$11,500.00*

*9.37 It is anticipated that the new auditor will not accept the work done by the previous auditor and will require payment of a full year's audit fee in carrying out the full audit for the year. This will involve the Council in further expenditure in addition to the amount of \$21,706.00."*⁶

- 10.9 The same auditor who had been involved in this inquiry was referred to at the Committee's Public Hearing at Maitland by the Shire Clerk of Scone.

⁵ Submission Mr F. A. Elliott, Secretary, Department of Local Government, 29 March 1990

⁶ Submission, Mr W. A. Henningham, Secretary, LG & SA of NSW, 1 May 1990

"...Council were not happy with his services, ... they had actually offered him a fee well below the scale, hoping that he would not accept it and they would be able to remove him that way. He accepted the lesser fee.

*We first went to the Department of Local Government. ...one of those reasons was that a local auditor becomes more readily available. We tried it along those lines. The Department said, no, they weren't prepared to allow us to dispense with his services at that stage for that reason. We were told by the Department that if we wanted to change auditors, we would have to state a complaint."*⁷

- 10.10 The Committee was told that the Department of Local Government issued a report based upon an investigation which was critical of Council's financial management, but not critical of the auditor:

*"At this stage the Council did have a working fund deficit of some \$1.1 million. We were told that the only way that we could change all of this was to make a formal complaint ...his defence was to personally attack individuals in the Council ...He requested the president call a special meeting of Council ...he addressed that meeting and made quite - I think - undue criticism of the accounting staff."*⁸

- 10.11 The Scone Shire Clerk made clear to the Committee that the current removal procedures could exact a personal toll on all involved:

*"I believe in talking to my peers in other Councils that they have been reluctant to take the stand that I possibly took because of repercussions in their career paths. I was told informally that because of the doctrine of natural justice and because of the defamation laws as they were, to be careful and not to take that tack."*⁹

⁷ Minutes of Evidence, Mr I. Nunn, Shire Clerk, Scone, Hearings at Maitland City Council, 20 April 1990, p. 305

⁸ Ibid, p. 307

⁹ Ibid

*We've got a case where the community is virtually split in half by an auditor and it's virtually impossible to get rid of him. I think that's one of the most serious issues facing us."*¹⁰

- 10.12 Mr E. Glover, Coopers & Lybrand, mentioned the reasoning behind existing impediments to removal:

*"...it was there to protect auditors from being tossed out because they may have adversely reported or upset somebody on the Council, and because the attitude, I think, of the association of auditors, for example, has been that auditors have got to report to the minister as well as the Council, therefore they felt the minister should give them some protection..."*¹¹

- 10.13 Mr J.Mant, solicitor, who acted for the Kyogle Shire Council in the inquiry into their auditor, commented to the Committee:

*"Quite clearly, if the Minister has that gatekeeper role, every time he exercises it there is some sort of judgment on a person. Therefore, as a natural justice, there should be an inquiry...we professionally criticised a local government auditor in some detail in public. That seems to me potentially to be a damaging and unnecessary process. One might ask: What does it protect? It protects the system we have. The system we have is bad. A better system is required."*¹²

- 10.14 Mr W. Henningham and Mr D. McCullea, Representatives of the Local Government and Shires Association concurred:

*"We cannot have a situation where an unfavourable auditor's report leads to termination of an auditor's appointment ... We must have a means that is much cheaper than the Kyogle exercise."*¹³

10 Mr J. Walsh, General Manager, Port Stephens Shire, Public Hearings held at Maitland City Council, 20 April 1990

11 Minutes of Evidence, Mr E. Glover, Coopers & Lybrand, Public Hearings held at Maitland City Council, 20 April 1990

12 Minutes of Evidence, 9 April 1990, p. 522

13 Minutes of Evidence, 24 April 1990, p. 206

- 10.15 During the Inquiry the models most commonly raised as the appropriate system for terminating an auditor's appointment were not those pertaining to the State and Federal government but, rather, the private sector. The Corporate Affairs Commission was commonly cited as a model for the sort of committee that might be involved in removal and dispute actions in place of the Minister.
- 10.16 The Committee believes that the present process of Ministerial consent following public inquiry required to remove the auditor is an expensive and onerous process for all involved. The Committee sees a need to eliminate any unnecessary stigma involved in the removal procedure.
- 10.17 The Committee's goal is to ensure that the removal of an audit appointment continues to involve at least the same level of involvement by the elected representatives as is required in the commercial world.
- 10.18 Under the Corporations (NSW) Act, Section 329, an auditor of a company may be removed from office by resolution of the company at a general meeting, following special notice.
- 10.19 In reply, the auditor may request that a copy of the representations be sent to every shareholder prior to the meeting at which the dismissal is to be heard. Given the breadth of Company shareholding and the scrutiny of such correspondence from institutional investors, this process seems certain to attract attention to any such move. Because it is the shareholders who must propose, and pass the resolution, there is little chance for the executives of the company to influence proceedings without the concurrence of the company as a whole.
- 10.20 In adapting this procedure to local government, the Committee is mindful that elected members of councils are not directly analogous to shareholders in number or diversity.
- 10.21 For this reason, the Committee feels that simplification of the process of removal of a local government auditor must be accompanied by an adequate appeal mechanism for the dismissed auditor. In the local government environment, this requires an avenue of redress to an independent authority, which in the Committee view should be at the level of the Department of Government.

- 10.22 Restricting the appeal process to the employing Council, by analogy to the Corporations Law procedure, would not, in the Committee's view, be sufficient safeguard against arbitrary dismissal.
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Recommendation 16

It is recommended that the Department of Local Government establish an Appointment Review Committee to investigate and make recommendations on requests by Councils to terminate the appointment of the external auditors.

Recommendation 17

It is recommended that The Appointment Review Committee comprise representatives of the Department of Local Government, the accounting profession, the Local Government and Shires Association and the Institute of Municipal Management.

Recommendation 18

It is recommended that a Council's auditor should have the right to be heard by the Appointment Review Committee of the Department of Local Government prior to his/her removal by a Council.

Recommendation 19

It is recommended that recommendations of the Appointment Review Committee be submitted to the Department of Local Government for ratification prior to the dismissal of the external auditor.

10.23 In recommending this the Committee sees a valuable precedent in the role of the Companies Auditors and Liquidators Disciplinary Board under the Australian Securities Commission.

11. Professional Practices - Review Mechanisms

- 11.1 The Committee considered the mechanisms which exist within the public and public sectors for monitoring audit practice. The Auditor-General, in evidence referring to the United Kingdom practice, stated

*"The fact that local Councils had the right to appoint their own auditors was also considered to be a weakness. If this power was moved entirely to an outside authority there could be no question of auditors' independence of a local authority being impaired."*¹

- 11.2 He cautioned, however, that because of the two tier government system in the U.K., the Audit Commission there had a staff of 1500.

- 11.3 He was not supportive of a role for his office strictly limited to peer review:

*"That would put me, as Auditor-General, in a situation where I would be a peer reviewer for 167 Councils. It is like Big Brother looking over the shoulder. I would feel uneasy about looking over everyone's shoulder without having the responsibility for the audit."*²

- 11.4 The Committee is fully aware of the inadequacies of peer review mechanisms in many fields of professional life. It has no illusions that either private or public sector reviewers are immune to social and group pressures.
- 11.5 The Committee feels that adoption of uniform accounting standards will help the peer review process because it will allow a wider range of accounting professionals to understand local government reports.
- 11.6 The Committee also holds that the public interest requires a mixed system of peer review with both the private professionals and governments represented.

1 Minutes of Evidence, 10 April 1990, p. 169

2 Ibid, p. 166

- 11.7 The issue of peer review of auditor performance was discussed in detail at the Committee's Inquiry into the Auditor-General's Office.³
- 11.8 There was seen to be much to recommend private sector auditors reviewing the work of those in the public sector and vice-versa - a healthy rivalry.
- 11.9 The Committee understands that the concept of peer review is often poorly understood. In most professions it services more as a means of developing implicit and explicit criteria for evaluating performance and translating this into a professional development process than a disciplinary or competitive process.
- 11.10 For this reason, the Committee has no hesitation in recommending the involvement of the Auditor-General in peer review of Councils. Under the Corporations Act 1989, Section 1282, the NSW Auditor-General deemed to be registered as an auditor. This alone would make him eligible to tender for local government audits under the Committee's recommendations. To the extent that Councils employ the Auditor-General, this would, in turn, provide for a peer review from the private sector. Overall, the Committee foresees a much more flexible, yet accountable system emerging from the public/private sector mix.
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Recommendation 20

It is recommended that the Auditor-General be engaged to review the working papers of Council auditors as a peer reviewer for the purpose of maintaining audit standards and that Councils are to bear this expense.

³ Report on the NSW Auditor-General's Office, 3 November 1989, pp. 163-173

Recommendation 21

It is recommended that, in cases where the Auditor-General is the appointed auditor for a Council, the peer reviewer is to be appointed by the Department of Local Government or its replacement.

Recommendation 22

It is recommended that the Auditor-General be engaged to review Council audits on a cyclical basis reporting to both the Council and the Department of Local Government, as part of the peer review.

Recommendation 23

It is recommended that a peer review of a Council's external auditors working papers be conducted by the Auditor-General at least once every eight years (or two Council terms) and be at Council expense.

12. Term of Appointment

12.1 Under the current system of appointment for Local Government auditors the auditor is virtually guaranteed a re-appointment unless there is ministerial intervention.

12.2 The Act states:

"211.(1) Auditor shall be appointed by the Council." and

"(3) The appointment shall be for a term of one year. The appointment of an auditor shall be renewed from year to year unless the Minister otherwise determines." ¹

12.3 The Committee took special note of the views from rural NSW, as exemplified by Western Lands Commissioner, Mr D. A. Pearson:

"In most situations there would be such a firm within about 100 kms of the town where the Council was located.

...it is the Commission's view that in most cases the smaller Councils, especially the rural ones, will wish to remain with locally based firms or individuals, where possible.

A small general Council could call tenders for an auditor in relation to a first appointment and select from those responding for a period of no greater than two Council terms. This would give the Council a guide as to the cost savings which might be expected from a tendering process, and also give them a means of dispensing with an unsatisfactory auditor at the end of his term.

The introduction of a definite term for auditors would seem to be in the public interest in that a 'cosy relationship' between a Council and its auditor would be unlikely to develop and the Council would

¹ Local Government Act, 1919, Section 211

have a measure as to the performance provided by the auditor over time by being able to compare different auditors.

...it would be desirable for the auditor and Council to plan over the period of the term of an auditor to do an efficiency and effectiveness audit on one major Council project in any one year... These special audit activities should also be specified in the contract of appointment.

...the report should indicate, if required, whether Council should look at another means of having work done, e.g. employing contractors, or whether it should look at acquiring equipment and using day labour for the activity ... to consider sharing the purchase/employment cost of expensive equipment or staff...

...ratepayers would need such information in order to form a valid opinion on the activities of Council at election time."²

12.4 The Auditor General expressed his views:

"The ideal term of contract would have to be performance based. The auditor would need to comply with appropriate standards.

An audit period normally runs for the financial period, which is not consistent with the election period. If the auditor is appointed for a certain number of years there is no guarantee that at some time the Government might not change the election cycle, and it would get out of kilter.

The appointed auditor of County Councils is myself as Auditor-General. Those people are only my agents ... they are contracted. Some are two, three and four year contracts. Four years is the maximum I have at the present time."³

12.5 The Local Government Auditors' Association Submission, 11 April 1990, supported current practice. While the Committee agrees with their sentiment that

² Submission, Western Lands Commissioner, Mr D A Pearson, 2 May 1990

³ Minutes of Evidence, 10 April 1990, pp. 126, 147, 154

*"Inefficient Councils do not pay for their inefficiencies through increased fees to meet the additional cost caused by their inefficiency."*⁴

12.6 It also notes that view that the efficient Councils do not benefit either:

"It has been suggested that there should be a limited period of tenure of office and the auditors of Councils should change regularly to prevent them 'getting into intellectual grooves'.

*There has been no suggestion that the Auditor-General needs 'rotating' because he becomes stale after a term of several years and we believe private sector audit firms are no different. In practice, staff turnover and normal promotion ensures that there is a regular change in staff on each engagement."*⁵

12.7 The Committee was told by Professor Walker in evidence about the approach in Scotland :

*"I would see merit in appointing auditors for a fixed term. I have some preference for the Scottish Audit Commission's approach which involves fixed term appointments and the appointment of certain staff from the audit commission's office in rotation with private sector auditors at the conclusion of that fixed term, so you might appoint a private sector auditor for three or four years and then the audit commission staff might take over the job for one or two years and pass it on to a private sector firm again. That arrangement ensures that a fresh view is brought to bear on the problems and keeps both sides on their toes, because if they know they are going to be succeeded by someone who may find things that they missed, it seems to provide good value for money."*⁶

4 Submission, The Local Government Auditors' Association of NSW, 11 April 1990

5 Ibid

6 Minutes of Evidence, Professor Walker, 10 April 1990, p. 56

- 12.8 Mr F. A. Elliott, Secretary of the Department of Local Government, put the view:

*"If five years provides a better auditing fee over time than four and if there are still no other difficulties with an extra year, then I would say five years."*⁷

- 12.9 Mr Ellis, consultant to the Department of Local Government, added:

*"I would not see elected representatives coming in September being competent, if there is a majority of new ones, to be able to make that appointment in December."*⁸

- 12.10 The Town Clerk of Botany agreed with the Committee that it would be somewhat difficult to check the fourth year of a four year appointment and that there must be a review cycle beyond the term of appointment:

*"...any review would be undertaken in the fifth year. Therefore, the job would be undertaken in the first, second, third and fourth years so that if there were shortcomings in the audit in the first year, they would not be uncovered until the fifth year. If one is inclined to bend the rules or to turn a blind eye ... that individual would be more likely to bend the rules knowing that he has five years before he will have to justify his actions, as opposed to having to justify them tomorrow, next week or next month."*⁹

- 12.11 The Committee is aware, however, that Councillors, like auditors, must follow a learning period. A newly-elected Councillor cannot quickly develop an informed opinion on auditor performance.

- 12.12 The Committee saw no merit in perpetuating a system of virtual lifetime appointment. Even extending the period to four years, allowing tenders, and lessening the requirement for Ministerial approval for change, would not prevent many firms from establishing regular re-appointment. The Committee has no purpose in forcing involuntary removal.

7 Minutes of Evidence, 9 April 1990, p. 46

8 Minutes of Evidence, 9 April 1990, p. 101

9 Minutes of Evidence, Mr Patterson, 24 April 1990, p. 459

12.13 The Committee supports the general consensus from participants in the Inquiry that a four year term would be optimal. The Auditor-General adopts a similar policy, in that four years is his current limit of appointment for a given audit firm.

Recommendation 24

It is recommended that Council auditors should be appointed for a term of four years.

Recommendation 25

It is recommended that the tender and appointment of Council auditors be undertaken in the second or third year of the Council term.

*At least fourteen days before making an appointment of an Auditor the Council shall fix the fee, and shall (except where the Council proposes to reappoint the previous Auditor) then advertise in a newspaper circulating in the area and in a Sydney morning newspaper calling for applications and stating the fee offered."*²

- 13.7 It was difficult for the Committee to form a perspective on fees. The overall fees are known but the net profit to the auditors was not disclosed to the inquiry.
- 13.8 Total fees reported by local government auditors, according to the Survey by the Local Government Auditors' Association of NSW for the 1988 Financial Year were \$3,457,609.00. The survey reported costs of \$3,541,564.00, resulting in a net deficit. Fees for individual Councils ranged from \$6,838 for a Shire with a turnover of \$1,256,193 to \$96,501 for a metropolitan Municipality with a turnover of \$8,371,911.³
- 13.9 The Town Clerk, Greater Lithgow, was involved in the Local Government Association's Audit Committee. In written evidence presented to the Committee, 25 January 1990, he questioned some of the points raised by the Local Government Auditors' Association:

"...The Auditors' Association appears to fear a type of gravitation of local government auditing roles towards a few large auditing firms which would, it is claimed, be capable of taking losses on the local government auditing function to secure the business and shrink the field of potential auditors before increasing the fees. The Auditors' Association also claims that local government auditing in this state, and the fees payable, do not permit a profit to be earned. The Association appears to conclude that this gravitation toward big auditing firms will be effected, not withstanding this lack of profit on the existing scale...

² Local Government Act, 1919, Section 211(5)

³ Submission, Local Government Auditors' Association, 11 April 1990

One must wonder whether the global process of amalgamating accounting firms has had this deleterious effect on the auditing services provided by those corporations.”⁴

13.10 The audit fees as a proportion of turnover (termed Revenue Expenditure) reported in the 1988 Audit Survey were

- Metropolitan .0013
- Country Cities .0016
- Country Shires .0025⁵

13.11 The only available comparison figures are those reported by the Auditor General for the same period for the auditing of Council of the City of Sydney. General Purpose Councils ought to present a more complex auditing task than electricity producing County Councils due to the varied nature of business. The local government figures appeared to the Committee to compare unfavourably with the Council of the City of Sydney figure of .00083, ranging from 1.6 to 3 times the cost per dollar of turnover reported by the Auditor General. The Auditor-General's ratio, applied to a large council of \$80,000,000 turnover, would result in savings on the external audit fee of \$37,600, sufficient to fund an internal audit service.

13.12 The Committee notes, however, that it is not clear whether the lower costs represent a service stripped to the minimum and whether the Auditor-General faces the same sorts of costs with respect to professional indemnity.

13.13 When questioned by the Committee about charges made for other services provided as part of the audit, the Auditor-General replied:

“It should not be part of the tested compliance audit cost to perform part of the Value for Money type work. They have to have prior approval from me before they can undertake any consultancy work.

4 Submission, Mr S. W. McPherson, General Manager/Town Clerk, City of Greater Lithgow, 25 January 1990

5 Submission, Local Government Auditors' Association, 11 April 1990

...the tenderers tend to trim their quotations fairly tightly. The accounting firms really want to work for the Auditor-General. I think they feel there is some prestige in undertaking work for the Auditor-General and again it helps their workflow. There is a lot of interaction between the private sector and our organisation now that did not exist, say, five years ago because we are doing the contracting, it is really trimmed down, but if the client, so to speak, was doing the contracting, the figure would be different than has been quoted to me.”⁶

13.14 The Committee has noted with interest that the figures upon which the current scale of fees are based would suggest that most Local Government audit work is conducted at a loss to the firm. Net figures at a loss, such as submitted by the Local Government Auditors Association, could only keep practitioners in business if:

- a. they were charitably inclined;
- b. the audit was a service provided to gain other forms of business;
- c. costs submitted contained a personal benefit element, such as senior executive salaries, acquisitions and on occasion, cars and aeroplane.⁷

13.15 The Auditor-General informed the Committee about County Council audit fees:

“One of the benefits arising from the Auditor-General taking over the audit responsibility of these Councils has been a reduction of audit fees paid by the Councils.

⁶ Minutes of Evidence, 10 April 1990, p. 163

⁷ The Report on the Auditor-General’s Office, #49, discussed in some detail the level of professional fees embedded in the costs recorded by the auditors, pp. 35-39 and pp. 51-53

*In 1989 the additional Councils audits were all subject to tender by private auditors and the total audit fees decreased by \$118,700 (17%) to \$75,500."*⁸

13.16 In written evidence to the current Inquiry, 26 April 1990, he reiterated:

*"Nothing has occurred since then which would change my views. In fact, it is considered that since the Auditor-General was given the responsibility for the audit of the Electricity County Councils, there has been a noticeable improvement in the quality of both the auditing and accounting at these Councils. At the same time there has been an overall reduction in the level of audit fees. I feel it could be said that the same situation would occur in respect of Local Councils."*⁹

13.17 He discussed the basis of his remuneration for audit of Sydney City Council based on Section 211 of the Local Government Act, which stipulates that the remuneration of the auditor shall be fixed by the Council:

"This arrangement is out of step with contemporary industry practice...To illustrate this point, the audit fee in 1988 for the Council of the City of Sydney was \$130,000. Based on expenditure of \$157m in that year the fee was equivalent to 0.083%.

*Audit fees set at other councils based on the scale of fees is approximately 0.12% of expenditure which if translated to the Council of the City of Sydney would result in an audit fee in the vicinity of \$200,000, an increase of more than 50%."*¹⁰

13.18 There were views expressed to the current inquiry that fees were too high:

"The major area of complaint seems to be in relation to the fees charged by Auditors and their escalation above C.P.I." ¹¹

8 Submission to the Inquiry into the Auditor-General, 31 October 1989, pp. 20-22

9 Submission, 26 April 1990

10 Ibid

11 Submission, Mr A. F. Fifield, Commissioner, Grants Commission, 4 February 1990

*"Council considers that the Auditors' fees have risen to a point where they are a significant cost to the ratepayers of the Council area."*¹²

- 13.19 Despite some dissatisfaction with the current fee system, Councils did not feel that this would justify a view that they would fare better under the Auditor-General:

"We believe that if the Auditor General was involved this could result in delays in auditing, different Auditors auditing Council's books each time with the subsequent loss of continuity and need for time to be used for familiarisation and loss of personal contact with the Auditor of Council's choice.

With computers all ledgers are now self balancing and if an Auditor is satisfied that the internal controls are present, then his work should be considerably reduced. We believe that a reduction in Auditors' fees is definitely achievable.

*In order to fully justify their fees, we believe Auditors should report on any management techniques that a Council could adopt to improve their efficiency and effectiveness."*¹³

- 13.20 The option of opening audit appointment to tender has been the subject of controversy in both the private and public sectors. Within the private sector, this has mainly been due to the potential for the service buyer to use the tender as a means of obtaining a more sympathetic or less critical auditor. Within local government the concerns have been mostly to do with the potential for dilution of the quality of the audit, although the Committee was exposed to evidence that unfavourable audits have incited requests for removal.
- 13.21 There has never been a formal procedure for putting audit fees to tender, except in the event of change in auditor. Prior to the influence of the Local Government Auditors' Association in the 1940s, Councils had been able to advertise a fixed fee and receive sufficient applications to ensure competitive

¹² Submission, Mr T. Parker, Shire Clerk, Murray, 18 April 1990

¹³ Ibid

pricing. Since the amendment of Section 211 in 1958 to prevent arbitrary removal of auditors, the professional association has been able to impose a fee level as most Local Government auditors are its members. While cost factors can be taken into account in a request by a Council to the Minister to change auditor, this, in practice, has not been regarded as sufficient justification in itself to warrant ministerial approval.

13.22 The President of the Institute of Chartered Accountants made the point to the Committee that

"The profession recognises that the marketplace should properly allow competition to influence professional fees

It is important to recognise that economies of expenditure associated with unduly low tendering for auditing appointment should have the following detrimental effects:

- 1. The scope of the audit may be improperly curtailed to the available fee.*
- 2. The quality of audit staff being recruited may decline as it becomes increasingly difficult to offer adequate salaries.*
- 3. Less funds may be available for training thereby compounding the previous problem.*
- 4. Less funds may be available for internal and Institutional research and development of accounting and auditing standards."*

13.23 The Shire Clerk of Wollondilly supported *"standard remuneration fees to avoid 'cut throating' and encourage quality control."*¹⁴

13.24 Potential difficulties with a tendering process were discussed at the Committee's public hearing in Maitland:

¹⁴ Submission, Mr G. T. Clarke, 15 May 1990

*"...it takes quite a lot of set-up costs to get the programmes and files and everything in, and then you're sort of just getting into the swing of the thing - getting to know your Council and everything, and you come to the end of your four years."*¹⁵

*"...additional services...it's very hard to build in those and tender on because they vary so much - you could probably get the basic audit fairly right, but to tender on additional services, it would be very difficult to put it in a brief..."*¹⁶

*"...tenders do take a lot of time in interviewing the prospective tenderers and drawing up the specifications ...getting to know the system and the people... I think there's a lot to be said for some continuity of auditors rather than a consistent change."*¹⁷

*"I think if the brief said that, we'd have to put in a tender that said, 'This is the basic service and if you want anything extra you will have to pay for it.' ...we've always had the policy of just charging the scale part of a service. I prefer it that way because I think it inhibits the clerk or anybody from ringing you up and saying, 'Well, you know, what do you think about this?', if he thought perhaps he was going to get an account for it."*¹⁸

13.25 The Committee does not see tendering as a complete solution to perceived fee anomalies. It recognises that tendering could bring with it new problems for a Council dealing with participants known largely through their written submissions.

13.26 However, the Committee saw no benefits from the current fixed fee system. As with any regressive measure, it relatively disadvantages the poorer councils. In practice, this has been offset by many auditors who have provided their Councils with additional services. The Committee does not believe that removal of fixed fees will hinder this process.

15 Minutes of Evidence, Maitland City Council Hearings, Mr E. Glover, Coopers & Lybrand, 20 April 1990, p. 281

16 Minutes of Evidence, Maitland City Council Hearings, Mr C. Haxton, Coopers & Lybrand, 20 April 1990, pp. 282-284

17 Ibid, 282

18 Ibid, p. 284

- 13.27 Most professional associations publish fee guidelines for their members. Auditors and accountants are no strangers to market determination of their fees in other areas of practice.

14. Scope of Audit

14.1 The Committee heard a range of views recommending expansion of the current scope of audit of local government. As in other areas of audit development the Committee heard evidence favouring moves to performance evaluation. As discussed in the Committee's Report into the Auditor-General's Office¹, the technology and clear guidelines to support these demands are, however, far less developed.

14.2 One piece of Australian legislation which currently defines efficiency and value for money audits is Section 54 of the Commonwealth Audit Act, which defines an efficiency audit as:

"(a) An examination of the functions performed by, and the operations carried on by, the body or person for the purpose of forming an opinion concerning the extent to which those operations are being carried on in an economical and efficient manner; and

*(b) an examination of the procedures that are followed by the body or person for reviewing operations carried on by the body or person, and an evaluation of the adequacy of those procedures to enable the body or person to assess the extent to which those operations are being carried on in an economical and efficient manner."*²

14.3 The Auditor-General described the particular incentives for change:

"In years past, the auditing profession was involved primarily in establishing the accuracy of book-keeping and the absence of fraud. However, with the large growth in size of so many organisations, accompanied by the development of systems with improved internal controls, there was a change in the audit

¹ The Report on the Auditor-General's Office, Report No. 49, pp. 62-63 and 72-84

² Section 54 of the Commonwealth Audit Act, Section 24

'the accounts do not disclose any significant loss arising from waste, extravagance, inefficient financial administration, poor value for money, mistake or other cause'."⁵

14.6 In Great Britain the Local Government Finance Act 1982 made several significant changes to the auditor's responsibilities. In respect of value for money, two changes were of major importance:

- "- the replacement of the previous 'negative' responsibility in respect of poor value for money by a positive requirement for the auditor to satisfy himself that "proper arrangements" have been made by the authority "for securing economy, efficiency and effectiveness in its use of resources" (Section 15);*
- the inclusion within this statutory responsibility of the "effectiveness' with which resources are used.*
 - (a) economy - the terms under which the authority acquires human and material resources.*
 - (b) efficiency - the relationship between goods or services produced and resources used to produce them.*
 - (c) effectiveness - how well a programme or activity is achieving its established goals."*⁶

14.7 The Committee viewed sympathetically the re-emergence of interest in a broad-based audit function. It was also aware, particularly from the preceding Inquiry into the Auditor-General, that even within the relatively short experience to date with efficiency audits, limitations to the approach have been noted. Solicitor Mr John Mant observed that, rather than serving as management tools to address management questions, these can become an end in themselves:

⁵ Written Evidence, Discussion Paper on the Possible Introduction of Value for Money Audits in Local Government, 11 April 1990, p. 11

⁶ Ibid

*"There have been many performance reviews. If they are done quickly and more or less in secret and a report is produced which is dumped on the table, it is very often better for them not to have been done. They cause great disruption to the organisation. The organisation does not own the results and the organisation spends the next year making sure there are no changes which come out of that report, because they come out of that report".*⁷

- 14.8 There were reservations expressed to the Committee as to whether current practices would allow meaningful performance auditing. For example, the Town Clerk of Hurstville Council said:

"...at present I believe that local government auditors are not close enough to what is happening in particular Councils to undertake that role...

*A lot of auditors are not capable of carrying out performance audits. A lot of auditors at present in local government in particular are financial auditors and not performance auditors. That is one of the points we have been addressing for some years, that the information available to the community and to the council is not really sufficient to allow them to manage effectively."*⁸

- 14.9 A letter from the Town Clerk of the City of Grafton, stated:

*"Council also held the opinion that specialised fields such as a management review would require the service specialists in this field above what is expected of a firm of auditors."*⁹

- 14.10 The Chairman of the Local Government Auditors' Association praised the strengths of the existing legislation:

⁷ Minutes of Evidence, 9 April 1990, p. 59

⁸ Minutes of Evidence, Mr H. Wallace, 24 April 1990, p. 438 and p. 517

⁹ Submission, Mr K. B. Wormald, 21 May 1990

"...because of the original Ordinance 26 requirements, which were an attempt to bring formal internal controls into local government, there has been strong internal control within local government.

*the internal controls in Councils are generally far better than in the internal controls operating in the commercial sector. They probably serve to prevent large-scale fraud."*¹⁰

- 14.11 Local Government Auditors emphasised to the Committee the limitations of the Act, Ordinance 26, and Bulletin 8A, a Department of Local Government document, which commented on the need for internal controls and systems:

"...the ordinance itself is too prescriptive...the emphasis is certainly not on internal control, which is all about systems. ... We would take different sections and test the work without looking at their actual internal control system as the system works itself. We would just be taking so many of the vouchers and go through to see that they are going through the right motions from when the order is placed for the goods until they are received and accepted by the council. We go back to ensure that the vote was there originally and that they had the power to spend the money."

*Ordinance 26 is almost a checklist. ...pretty well out of date."*¹¹

- 14.12 Given the chequered history of accounting innovations brought in with the best of intentions, the Committee is wary of endorsing what could become a new means of obscuring poor financial performance with highly manipulable and difficult-to-audit efficiency indicators. These concerns were expressed by Mr Mant:

"That is why I have this worry about accountants doing performance reviews of government. They tend to run a ruler over them and run a set of measures and say, 'If you make these changes it will be all right'

¹⁰ Minutes of Evidence, Mr J. Spencer, Chairman, 9 April 1990, p. 87

¹¹ Minutes of Evidence, Mr J. Thackray, 23 April 1990, pp. 340-341

Changing and improving government organisations is much more complex than that. Unless the staff are with you and you have the time to change the attitude, no amount of formula prescriptions will improve that organisation. You have to be careful about that.

...there is no point in doing a performance review of a government organisation unless that organisation is prepared to co-operate and welcomes it. Therefore, whatever the system of choosing what area and how, you would need to make sure that the key players were at least satisfied with how the decision was made, and preferably supporting it.”¹²

- 14.13 An inquiry by the Premier’s Department’s Office of Public Management found that Government Business Enterprises and statutory authorities operating in commercial environments had major concerns about efficiency audits -

“...inadequate skills of audit teams; their high cost with inadequate benefits; redundancy of efficiency audits due to introduction of program budgeting; lack of confidentiality; and redundancy due to greater emphasis on managerial responsibility.”¹³

- 14.14 The Commonwealth Auditor-General noted that Australian auditing standards direct an auditor

“...to gain an understanding of the accounting system and related internal controls, and to study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

...All major accounting firms provide consultancies on taxation, management practices, and computer systems. Some auditees prefer private sector audit firms as external auditors....Where one part of an audit agency provided a consultancy to a client, for

¹² Minutes of Evidence, 9 April 1990, p. 59

¹³ The Commonwealth Auditor-General, Report No. 296, Joint Committee of Public Accounts, pp. 107-171

example, on the design of a financial management system, and later another part of the audit agency audited that same system, then the audit agency would be indirectly auditing itself.

...The importance to accounting firms of income from activities other than auditing has increased in recent years. For instance, for the auditors of the 100 largest listed companies on Australian stock exchanges, the proportion of total fees derived from auditing declined from an average of 79 per cent in 1982 to an average of 72 per cent in 1986. Over the same period, the greatest increase in income was in other fees which increased by 105 per cent compared with a 42 per cent increase in fees from auditing.

The Committee believes that maximum protection of the audit opinion is necessary where Government agencies are concerned. The Committee recommends that...a condition of the award of a contract by the Auditor-General to a private audit firm be that the latter offers no other services to the auditee during the life of the audit contract.”¹⁴

- 14.15 In its Inquiry into the Auditor-General’s Office, the Committee asked the representatives of the Local Government Auditors’ Association if they thought it would be appropriate to adopt the standard of the Auditor-General, that no consultancy type work be conducted for the auditee without approval:

“Do you see a conflict arising in relation to the changing role of the local government inspectors less involved in tick and check and more involvement with management concepts?---A. I think there is probably less conflict now than there was before, whereas they were getting involved in detailed tick and check now they are looking at management overview more particularly and I think the roles do fit fairly well together... There would be no fees to be earned by us on the implementation of that recommendation, the fees would be payable to software companies and hardware suppliers.”¹⁵

14 The Commonwealth Auditor-General, Report No. 296, Joint Committee of Public Accounts, pp. 97 and 116-117

15 Minutes of Evidence, 3 October 1989, p. 23

- 14.16 The Committee is of the view that a specification for a range of any services beyond the basic external audit should be included in the tender proposal. The hourly rate structure for any such services should be indicated in the tender.
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Recommendation 26

It is recommended that the extent of the audit, and any additional consultancy work required by Council, with the hourly rate structure for any such services, be specified in the audit contract and published in the Council's Annual Report.

Auditing Risk Management

- 14.17 Under an enlarged scope of reporting, an auditor must look at all major financial and operating risks facing the Council. The Committee is aware of two types of "crisis" facing local Councils worldwide. The first involves investment. As has been previously mentioned in this report, a number of steps¹⁶, have been taken by the Department of Local Government to minimize these risks in New South Wales. The second problem involves public risk.
- 14.18 An audit of operations risk exposure would emphasise different aspects, depending on the size, geography, and nature of services of councils. For some councils, public liability can loom very large. Councils provide a range of direct physical services such as recreational parks. Although it is possible to insure against such risks, the council still owes a duty of care to post signs, inspect facilities, and otherwise offer prevention. Insurance does not cover many of the legal costs involved. To provide a full picture of a council's operating risk exposure requires the auditor to examine public liability protection and preventive measures.
- 14.19 Insurance risk includes public liability, Workers' Compensation, motor vehicles and the amalgam of aspects known as Industrial special risk.

¹⁶ Local Government Amendment Act, 1983. See Section 201 and Ordinance 24a

- 14.20 Recent court cases have highlighted the extent of the council's duty of care. In Wyong Shire an inexperienced waterskier was injured while skiing in shallow water. The Council admitted in the High Court that it owed a duty of care to

*"persons waterskiing in that part of the lake in which the plaintiff sustained injury' i.e. that it owed a duty of care to the class of persons who were waterskiing there."*¹⁷

- 14.21 Sutherland Council was ordered to pay a claimant \$323,298 on the basis of not having provided signs with symbols for non-English speakers to warn of shallow water at Gunnamatta Bay. The Council had erected 12 signs in English. Insurance premiums do not reflect total costs, excesses and legal fees. For example, the Council now employs a person on weekends whose sole duty is to warn divers of shallow water. Sutherland Council's total insurance and related costs in 1989 were between \$2.5 - 3 million.

- 14.22 The award of \$3,869,000 against Waverley Council in a case of a swimmer struck within a patrolled area by a surfboard gave a number of Councils further cause for alarm: *"Led by Kyogle Council, Councils in NSW want to withdraw beach inspection services ... the very local authorities who are providing services to the public are being penalised if these services are not perfect."*¹⁸

- 14.23 Although it is not the role of an auditor to address public risk directly, it would be part of an expanded audit scope to alert Councils to risk exposure which could threaten overall financial viability. The scope of audit should be clearly spelled out in the terms of the appointment contract.

- 14.24 In evidence, Mr Tony Baldwin, Department of Local Government, told the Committee that he had prepared papers which looked at the components of a basic audit: regularity and financial audit. He mentioned the merits of a statutory requirement for a report from the auditor on the trend of the Council's financial position:

¹⁷ The Council of the Shire of Wyong v. Shirt & Others, 1980, 54 ALRJ 283

¹⁸ Glasheen v. Waverley Municipal Council, 1990, Australian Tort Reports 67, 711, NSW Supreme Court

*"...the auditor needed that sort of statutory backup. Sometimes when auditors start commenting without that sort of backup they get a reaction from the Council. So to be able to give the auditor statutory backup you must have a report on the trend of the Council's financial position."*¹⁹

- 14.25 Mr Baldwin agreed with the attractiveness of a statutory requirement for Audit Committees of Council consisting of some elected Alderpersons, The Chief Executive Officer, and The Finance or Treasury Officer:

*"Very quickly, I would say yes because I think probably a lot of Councils regard the audit as a chore, something that has to be done. Possibly to get more involvement in that regard would give a better appreciation of what an audit is all about."*²⁰

- 14.26 Section 530a of the Local Government Act confers on Councils the power to delegate to officers and committees powers and functions other than the making of rates, voting of expenditure, dealing with land and tendering.
- 14.27 The Barnett Committee noted that Councils varied greatly in the extent to which management was empowered to deal with detailed administration, freeing the elected members to confine their attention to key policy decisions.²¹
- 14.28 The evidence before the current Inquiry suggests that there would be advantages to Councils in making greater use of Audit Committees. Such Committees serve as a direct line of communication in which to discuss problems before they require broader exposure. They also allow the Council to better balance professional resources between internal and external audit and formulate plans for audits of broader scope, such as value for money or performance.
- 14.29 The Australian Society of Certified Practising Accountants has endorsed Audit Committees as a tool to improve reporting, maintaining the independence of external auditors, and strengthening the role of the non-

¹⁹ Minutes of Evidence, 10 April 1990, p. 211

²⁰ Ibid, p. 215

²¹ The Barnett Committee, Report of the Committee of Inquiry into Local Government Areas and Administration in NSW, December 1973

executive directors. It has recommended that such committees be formally appointed, with written terms of reference, and full Board support. The committee should consist of non-executive directors, with an executive included only for the purpose of direct communication with the firm's management.²²

- 14.30 The Committee sees merit in giving statutory support for the role of an audit committee. Current legislation provides the power to delegate authority to such a committee but no incentive to do so. For smaller Councils, the Audit Committee would not be able to provide such an independent function as there would be proportionately fewer non-executive officers available for the committee. For larger Councils, however, the Audit Committee would serve in a similar capacity to those in the corporate world.
- 14.31 The objectives of the Audit Committee are to discharge the elected Councils responsibilities related to financial reporting, ethics policy, accounting policy, and internal controls.
- 14.32 Audit Committees are mandatory for listed companies in the USA and Canada.
- 14.33 The Auditor-General in Volume II of his 1989 Report to Parliament pointed to the opportunity provided by audit committees to:

"...draw together the oversight of financial control and reporting systems, by providing communication between the board or senior management and both internal and external audit, to ensure that both internal and external expertise in these areas are fully utilised.

*Such committees are particularly beneficial where it is not practical for the Chief Executive directly to guide and then review the operations of internal audit."*²³

²² Audit Committees - A Working Guide, Price Waterhouse, 20 September 1990, p. 5

²³ Auditor-General's 1989 Report, Volume II, September, p. 114

14.34 The Australian Society of Certified Practising Accountants credits audit committees with making companies *"less prone to the financial reporting difficulties experienced by many during the recent period of turbulence in the corporate sector"*, due to improved communication between internal, external auditors and the Board and the strengthening of the role of non-executive directors.²⁴

Recommendation 27

It is recommended that there be a statutory requirement for each Council to establish an audit committee, consisting of elected members, the chief executive officer, and the finance or treasury officer.

²⁴ Letter, Mr K. Eastwood, 20 September 1990, to Mr T Griffiths, MP, of the Committee

15. Internal Audit

15.1 The Committee, in its inspection of Warringah Shire Council was surprised that Council had no internal auditor despite its expenditure of more than eighty million dollars a year. It appears, however, that this is not unusual among Councils.

15.2 The Local Government Auditors' Association of NSW informed the Committee that there was a policy of fee reduction for client Councils with internal audit mechanisms:

*"Where activities or changes have occurred which have materially assisted the auditor in conducting his audit at a cost less than that provided for in the scale, the auditor may reduce the scale up to a sum equal to 15% of the calculated fee, provided the fee charged is not less than his total audit costs."*¹

15.3 The Committee noted few Councils interviewed during the Inquiry seemed to be aware of the potential for a reduction of fees.

15.4 The Committee sees considerable benefit in encouraging the development of internal auditing in local Councils. Internal audit provides a service to management. It can focus on any aspect of compliance or performance.

15.5 The Department of Local Government provided the Committee with details of internal audit staff employed by Councils and expenditure incurred on finance and management advice since the last Local Government Elections held in 1987. Returns were received from all 176 general purpose Councils and from all county Councils, excepting electricity undertakings:

-	Number of Councils employing internal audit staff	23
-	Number of internal audit staff employed by Councils	43
-	Number of internal audit contract staff employed	1

¹ Submission, 11 April 1990

- Number of Councils Engaging Consultants for Financial/Management Advice, including External Auditors 62
- Expenditure incurred on Financial/Management Advice by Consultants, other than Councils' External Auditors \$2,449,130
- Expenditure incurred on Financial/Management from Councils' External Auditors \$614,523

15.6 The Committee became aware during its deliberations of the numerous approaches to internal auditing which could contribute to better financial management.

15.7 The viewpoint of the profession regarding the independence of internal audits was expressed in a Submission from the Institute of Internal Auditors NSW.

*"The internal audit co-operates with the external auditors through a number of working arrangements. Audit reports and the audit working papers are made available to external auditors and an effort is made to avoid duplication. External auditors are governed by Australian Auditing Standards AUP2 in determining the amount of reliance that will be placed on the work of an Internal Auditor."*²

15.8 The Institute of Chartered Accountants in Australia noted:

*"...There is no evidence available to this Institute to suggest that an audit is less effective because of local knowledge. On the contrary, an ongoing client relationship and local knowledge plus professional requirements of independence is more likely to lead to an effective audit."*³

15.9 The Council of the City of Sydney informed the Committee that their total auditing budget was estimated at \$500,000, with approximately three-quarters of that spent on the internal audit function. The Council of the City of Sydney

² Submission, Mr W. Middleton, Institute of Internal Auditors NSW, 23 July 1990

³ Submission, 20 November 1990

saw no inherent problem in cooperation between their external auditor, the Auditor-General, and the internal auditor:

*"Our internal audit and the Auditor-General co-operate, very much so. A lot of, shall we say, hack work is done by our internal audit under the supervision of the Auditor-General. ...There have been some identifiable money savings in that area because of certain savings we have made staff-wise."*⁴

- 15.10 The Committee endorses US Government auditing standards which contain specific guidance on the tests to be done before relying on the work of others:

"In all cases, the auditors should determine whether the audit organisations have an appropriate internal quality control system in place and whether the organisation participates in an external quality review program.

*Where the other auditors are internal auditors, tests should include determining whether they are qualified and organisationally independent, as well as determining the quality of their work and the exercise of professional judgement when attempting to determine the reliability of computer generated data."*⁵

- 15.11 The Committee is anxious to see internal audit and assessment procedures encouraged and expanded by Councils where feasible.
- 15.12 The Committee endorses the work done by both the Department of Local Government and Treasury Bureau of Internal Audit who are actively building training programmes to assist Councils in establishing improved self-assessment techniques.

⁴ Minutes of Evidence, 24 April 1990, p. 416

⁵ US Government Audit Office, *Government Auditing Standards: Standards for Audit of Governmental Organisations, Programs, Activities and Functions*, 1988, Volume 3.37 b and d, discussed in L. Pumphrey and K. Sparks, *Governmental Auditing*, CPA, Spring, 1990

Recommendation 28

It is recommended that the Local Government Act be amended to provide that Councils have a statutory responsibility to ensure that there is an effective system of internal control over the financial and related operations of the Council, similar to that prescribed in the Public Finance and Audit Act, 1983.

Recommendation 29

It is recommended that tender specifications for a Council auditor detail existing internal audit arrangements to enable prospective external auditors to review and tender on a fully informed basis.

16. Reporting to Council

- 16.1 The Committee was informed that current practices varied greatly between Councils as to the informal lines of reporting. While these, in the main, seemed adequate under normal circumstances, evidence was obtained as to how fragile these informal lines can be when matters of significance and controversy arise.
- 16.2 During the Inquiry there was unanimity of opinion on the need for improved reporting arrangements by Auditors to their client Councils.

"The reports in terms of section 211(9) of the Local Government Act are archaic. In other New South Wales legislation they were withdrawn in 1983 with the new Public Finance and Audit Act. They are a meaningless report.

In terms of the reporting, we are required to comply with the Local Government Act, but in terms of the audit we comply with the auditing standards and practice, which includes a review of liquidity. It would be wrong for an auditor to say he conducted an audit and not to look at liquidity. The auditor has not followed the accounting standards or has not adhered to the accounting standards when he has been undertaking the audit.

I am probably fortunate under the terms of the Public Finance and Audit Act that I am required to undertake an audit having regard to the professional standards.

*Local government should produce financial statements that are meaningful and timely, and the accompanying notes should be in such a manner that they adequately explain what they mean. Local government has slipped behind the reporting requirements of the State Government."*¹

¹ The Auditor-General, Minutes of Evidence, 10 April 1990, pp. 161-167

16.3 The Committee is of the view that the reporting process of local government auditors needs significant revision and that they should be involved in more regular reporting to full Council.

16.4 The Secretary, Department of Local Government, recommended to the Committee that the annual audit report should be submitted to the Mayor or to the President, and that the auditor should present in person at an open Council meeting to do so and be available for questions asked or to make unfettered comment, unless a matter were in some way sub judice, in which case that portion of the report would be to a closed Council:

*"We are looking in the future to a completely new reporting system. I hope the report that I have suggested should go to the open meeting of the Council and should incorporate that information and other more appropriate information than is provided now. As I said, we need to look at what the reporting arrangements should be. It should be to the full open Council."*²

16.5 During the course of the Hearings, the Committee formed the impression that many participants in local government did not understand the complexities of the current accounting systems. The Secretary of the LG & SA related this to obsolete Departmental requirements:

*"I can speak from personal experience because I have been an alderman and a mayor and although I am also a lawyer, I did have difficulty in interpreting the accounts. When I say interpreting, interpreting as to whether the Council was effectively and efficiently carrying out its functions."*³

16.6 The General Manager of Oxley County Council, told the Committee that the auditor's first responsibility should be to the Mayor and the Council, not to the Manager or the Clerk:

"To my mind that is integral to the role that the auditor should play; he is analysing my administration and therefore he should not report to me. ...It should be to the Council, as the

² Minutes of Evidence, Mr F. A. Elliott, 10 April 1990, p. 146

³ Minutes of Evidence, Mr W. Henningham, 24 April 1990, p. 509

*representatives of the local population. ...They elect the board. That is part and parcel of the function of the elected representatives, to analyse and report as necessary."*⁴

- 16.7 Mr G. Wilson, Coopers & Lybrand, expressed support for reporting direct to ratepayers as analogous to shareholders:

*"We are reporting to the board of directors but our submission suggests that the formal accounts should be put to the shareholders, being the ratepayers, similar to a company environment. At the moment it does not go that next step. In a company environment we can report to the shareholders by sending out an annual report to the directors, who then issue an annual report to the shareholders incorporating our report."*⁵

- 16.8 Marrickville's General Manager mentioned that the report to open Council may not be as practical as one would think. He cautioned against such meetings being dominated by interest groups with an axe to grind, perhaps not even part of the Council electorate:

*"...obviously they would have to be certified in some process that they were a shareholder, otherwise you would have a meeting that got out of hand for whatever reason - a political meeting with people coming along to stir the pot."*⁶

Lines of Communication

- 16.9 The Managers of Prospect, Sydney and Illawarra County Councils gave evidence before the Committee as to their practices with regard to treasurers and finance directors having direct contact with the external auditor over financial problems of significance:

4 Minutes of Evidence, Mr R. Newling, 10 April 1990, pp. 198-199

5 Minutes of Evidence, 9 April 1990, p. 84

6 Minutes of Evidence, Mr B. Gardner, 24 April 1990, p. 473

*"I believe that it should be reported both to the finance director and the general manager. If it is singularly a reference only to the director of finance, I would be concerned."*⁷

*"It is quite frequent for our senior officers, in particular the treasury, to discuss with the auditor the nature of accounts ... it is quite reasonable for the officer concerned, if he feels that way, to go directly to the auditor, but in my view he would have an obligation to report it to his superior officer."*⁸

*"I would have no difficulty at all with them going directly. I would just expect as a courtesy to be told."*⁹

- 16.10 Auditors Mr R. Ferrier and Mr J. Thackray also mentioned that such lines of communication currently exist informally:

*"Out of courtesy I would talk to the Clerk before I had finished, and then, as I was clearing the job, I would be taking up any matters I had with the President or the Mayor."*¹⁰

*"It is fair to say that the independence of the auditor is something that most town clerks are looking for in the reporting process, because ultimately it is their head that is on the block, and it is their people who are doing most of the work. ...The clerk is interested in finding out what the auditor is doing, not so much in a protective sense but to ensure he is getting full access to what he needs."*¹¹

- 16.11 In the case of one Sydney Metropolitan Council, the Committee was made aware of limitations on access of the auditor, of information withheld from the financial manager and auditor, and instances where a financial manager was silenced and punitive measures taken to restrict his effectiveness.

7 Minutes of Evidence, Mr P. Smiles, Assistant General Manager, Prospect County Council, 24 April 1990, p. 493

8 Minutes of Evidence, Mr D. Gray, General Manager, Sydney County Council, 24 April 1990, p. 494

9 Minutes of Evidence, Mr M. Greentree, General Manager, Illawarra County Council, 24 April 1990, p. 494

10 Minutes of Evidence, Mr R. Ferrier, 23 April 1990, p. 337

11 Minutes of Evidence, Mr J. Thackray, 23 April 1990, p. 338

- 16.12 The North Sydney auditor disclosed in evidence that he had been unaware that in 1986

"...the accrued leave entitlements ...had not been put into the budget. This was picked up by the new accountant".¹²

- 16.13 North Sydney Council's rates for 1987 had been set based on expenditure estimates for the coming year which were flawed. It was early in the New Year, the Clerk was on holidays, rate notices had been issued. The new accountant contacted the auditor to confirm his analysis. Following this the accountant was forbidden contact with the auditor.

- 6.14 The auditor, even at the time of the Committee's hearing, saw the undercosting as a mistake by the Council's previous accountant

"...the new accountant was questioning the figures that had put up by the previous fellow who had resigned ... the fellow had underestimated the cost of wages."¹³

- 16.15 The Town Clerk of North Sydney, however, in his evidence, told the Committee that

"The decision as to the level the Council would fund its leave reserves was a decision taken by Council".¹⁴

- 16.16 From the Auditor's evidence it was a Council decision that had never been communicated to the auditor neither at the time it was taken nor during the period in 1987 of his critical review of Council finances.

- 16.17 In a Sydney Metropolitan council, which has an open-Council policy, an important decision affecting financial viability appears to have been withheld from the both auditor and the senior financial officer. Auditors examinations must follow formal maps and signposts such as minutes and records of meetings and decisions. Without access to these they are not in a position to analyse the directions of the Council.

12 Minutes of Evidence, Mr J. Thackray, 23 April 1990, p. 368

13 Ibid, p. 369

14 Minutes of Evidence, Mr R. Kempshall, 23 April 1990, p. 397

- 16.18 The Committee was also aware of the need to maintain firm communication lines between the auditor and all arms of the Council. The auditor needs independent channels to the Town Clerk/Management and the elected Council. The Committee noted problems in this regard presented in evidence:

*"...the feeling is that if he reports to the treasurer there may be some conflict of interest in passing on any criticism he has to the higher echelon."*¹⁵

Management Letters

- 16.19 Auditor, Mr Ferrier, rejected in evidence to the Inquiry any notion that communication between auditors and Town Clerks led inevitably to a "cosy" relationship:

*"Not from my point of view. I have just gone through a case with one clerk who actually offered me his resignation rather than the president. It was not my position to accept..."*¹⁶

- 16.20 The incident he described involved an allegation that a clerk had been manipulating the tax system so that he could gain more take-home pay than the tax system allowed. Mr Ferrier cited this as typical of the subject of an auditor's management letter:

*"The management letter is something that really contains a litany of sins, if you wish - things that have not been attended to and things that you want attended to, which in themselves do not warrant being reported in the principal report, the public report."*¹⁷

- 16.21 Copies of management letters to Councils are currently not sent to the Department of Local Government or the Minister, they are regarded as internal documents.

¹⁵ Minutes of Evidence, Mr B. Nevin, City Treasurer, Sydney City Council, 24 April 1990, p. 416

¹⁶ Minutes of Evidence, 23 April 1990, p. 339

¹⁷ Ibid, p. 356

- 16.22 The Town Clerk of Ku-ring-gai Council, related to the Committee the procedures adopted by the recipient of the management letter:

*"In our case the auditor meets with the Treasurer and the Deputy Town Clerk and they review the matters that are likely to be in the management report. In fact the auditor gives that group a draft copy of the management report and they prepare a draft response to that. So the report that finally hits me is a report that contains both the auditor's comments and the comments from my staff. ...If there is something serious in it, I would go to the mayor first with it and sort out the approach that would be taken when it gets to the official Council level."*¹⁸

- 16.23 The issue of whether important financial information should be made public was never questioned by any participants in the Inquiry. The threshold at which information should be allowed to bypass the most immediate reporting levels was, however, open to question. As auditor Mr John Spencer observed:

*"...it depends on who the auditor is and whether he utilises the provision in section 211(9) which refers to 'any other matters' which in his opinion he wishes to include in his report to the Council."*¹⁹

- 16.24 Mr Spencer did not see any danger in the auditor forwarding the management letter to the Council Clerk. He gave examples of the sort of *"internal mechanical control"* material which would not warrant the attention of the Council:

"...For example, a number of payroll sheets might not have been signed by the engineer. I really do not believe Council is interested in that. I believe there is a great danger in an auditor referring those sorts of matters to the Council and not to the chief servant of the Council.

I still believe that the formalisation could be that all management letters, which we refer to, be presented to Council in addition to all section 211(9) reports. That would then cover

¹⁸ Minutes of Evidence, Mr W. Taylor, Town Clerk, Ku-ring-gai, 23 April 1990, p. 412

¹⁹ Minutes of Evidence, 9 April 1990, p. 83

*everything. I still think there is a need to distinguish under the Act those matters that go in the formal section 211.(9) report because they go to the Council and the Minister and I do not think the Minister should be bogged down with how much shortage there is in petty cash."*²⁰

- 16.25 The Committee agreed with the observations of Mr Ellis, Department of Local Government, that the optimum procedure, in balancing natural justice and accountability requirements would be for the management letter to be ultimately annexed to the final report. This would inhibit trivial or immaterial items but allow important issues to be presented:

*"It is quite open then, everyone is made aware of it and the auditor is not going to be putting anything in there that is irrelevant..."*²¹

Recommendation 30

It is recommended that management letters to Council management by the external auditor become part of the auditor's report to the Council at the end of each financial year.

²⁰ Ibid, p. 84

²¹ Minutes of Evidence, 9 April 1990, p. 104

17. Reporting to Ratepayers

17.1 Councils are required under section 654A of the Local Government Act to prepare an Annual Report ‘as soon as practicable after the end of the year’. There is limited guidance as to the form the report may take. Section 654a of the Local Government Act requires

- “(a) financial reports;*
- (b) a description of major problems encountered by the Council during that year and of the manner in which they were, or are proposed to be, resolved; and*
- (c) any other prescribed matter.*

The Minister has approved those reports which include the following basic information as complying with the requirements of Section 654A

- (1) A description of administrative divisions...*
- (2) A description of how the Council functions...*
- (3) Review of operations during the past year with comment on policies and policy changes, present or proposed together with a statement of the basis upon which policy decisions have been made with particular reference to major problems facing the Council’s area.*
- (4) Proposed activities for the current year...*
- (5) The dissection of estimated income and expenditure and working funds position for the immediate past year and for the current year showing major sources of funds and their application...*
- (6) Comment on the effect of external factors on Council finances and rating.*
- (7) Appropriate use of statistical information including numbers of permanent staff...”¹*

¹ The Local Government Act, 1919

17.2 The Auditor-General gave his view of local government reporting:

"It is my opinion that the statements in their format would be almost totally incomprehensible to other users.

I am advised that some Councils prepare and make a limited distribution of annual reports to residents and other ratepayers. Other Councils advertise the availability of detailed financial information. A summarised form of the Council's financial statements is distributed with a notation that the balance sheet and revenue accounts for the year including auditor's certificate, are available for inspection at Council's office.

*The financial statements should not only serve accountability purposes but must also be useful in economic decision making. The suitability of the current method of preparing the financial statements needs to be reviewed in the light of the users of the statements and their needs. I believe that the current method of presenting the statements does not satisfy the entire needs of users in the three categories. This, I believe, is because the statements have been designed primarily to meet the needs of the Department of Local Government and the Australian Bureau of Statistics."*²

17.3 Professor R. W. Walker commented:

"Most local Councils in NSW provide minimal financial information to ratepayers. A popular form of presentation involves the use of twin pie charts, showing income and expenditure. Those labels might be regarded as misleading, since the data is derived from a marginally modified form of cash accounting...

*This type of reporting focuses on inputs and outputs rather than the relationship between inputs and outputs."*³

² The Auditor-General's Report 1989, Volume II, pp. 85-86

³ Professor R. Walker, *Local Government Under Pressure to Go Commercial*, New Accountant, 22 March 1990

17.4 He gave the Committee some specific examples:

*"I notice that the Council spares no cost in printing photographs of aldermen and it includes an item under the heading 'Memorable Moments ... And a look ahead'. The mayor stated: 'One of the nicest things was swimming with a fairy penguin at Camp Cove Beach.' ...The annual report contains a lot of photographs and anecdotes like this which, no doubt, create great community spirit in the Municipality of Woollahra."*⁴

17.5 During the course of the Inquiry, the Committee often had cause to express surprise at the lack of quality of presentation of financial information to ratepayers. On at least two occasions it appeared that absolutely no financial reporting was undertaken to ratepayers, even in the form of an advertisement in the local newspaper.

17.6 The Committee is aware of attempts by Councils to improve reporting performance. The LG & SA described the introduction of the Dougherty Award for excellence in local government reporting:

*"...the message that is given to Councils too is that the measure of success with a report is not the standard of its glossiness. It is the way it conveys information to the stakeholders and that is the community ... there is a continuing concern by the judges of the Dougherty award that the standard of financial reporting still is not what it should be."*⁵

17.7 The Local Government Auditors' Association Submission noted that the present provisions do not require any audit report to be included in the report to ratepayers:

"The Association considers it essential that Councils be required to provide an annual report to ratepayers and electors which includes -

⁴ Minutes of Evidence, Professor R. W. Walker, 10 April 1990, p. 180

⁵ Minutes of Evidence, Mr W. Henningham, Secretary, LG & SA of NSW, 24 April 1990, p. 511

- *the financial statements for the previous year;*
- *an audit report thereon;*
- *indicators of the performance of the Council;*
- *a review of operations of the Council;*
- *details of the various activities undertaken by the Council.”⁶*

17.8 The Committee is aware of benefits in Councils considering options available from both public and private sector reporting formats.

17.9 The public sector provides a format in the form of the Annual Reports (Statutory Bodies) Act 1984 and Annual Reports (Departments) Act 1985. These have a much more highly detailed reporting format than is required of local government. The private sector alternative would be the Exposure Draft 50 standard being put forward by the Australian Accounting Research Foundation.

17.10 The Committee was advised that the Department of Local Government is adapting many of the facilities available in the commercial sector for use by Councils including:

- i. an accounting Code of Practice;
- ii. revised formats for reporting of financial data by Councils to government for statistical and monitoring purposes with the emphasis on reducing the current volume of data submitted; and
- iii. the development of a series of financial and nonfinancial indicators of performance, in conjunction with local government.

“The Department has in place a computerised system which allows tests to be made of the financial position and viability of each Council in the State, on a timely basis.”⁷

17.11 The process of this Inquiry seems to have made an impact, judging by comments made in the Hearings and exemplified by the correspondence from the General Manager of Prospect County Council.

⁶ Submission, 11 April 1990

⁷ Minutes of Evidence, Mr F. A. Elliott, Department of Local Government, 9 April 1990, p. 4

"I believe the tenor of the Committee's questioning raised the possibility of your Committee expecting a higher profile to be given to audit reports within the proceedings of this Council. With this in mind we will review the issue of Audit reports and the services the Auditor-General in order to ensure that this Council and its customers get the fullest possible value from audit services received." ⁸

- 17.12 The Committee recognises that a number of Councils already make available opportunities for the public to attend open meetings and to ask questions of the auditor.
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Recommendation 31

It is recommended that Councils be required to conduct an Annual General Meeting for presentation of the Annual Auditors' Report. The auditor would be obliged to attend and to be prepared to discuss the Report, so that ratepayers have an opportunity to ask questions of the auditor.

- 17.13 The Committee took special note of the process described in the New Zealand Local Government Act, which requires every local authority to prepare a report each financial year outlining *"the intended significant policies and objectives"*, *"the nature and scope of the significant activities to be undertaken"*, the *"performance targets and other measures by which performance may be judged in relation to objectives"*, and *"any significant changes"* between *"stated objectives and those previously specified"*.⁹
- 17.14 Section 223E of this Act requires this information to be presented in an annual report to the public concerning performance. The auditor's report is integral to this, as it is responsible for *"such other information as is necessary to enable an informed assessment of the operations of each entity"*, including a comparison between actual and projected performance expressed in the previous year's statement of corporate intent.

⁸ Submission, Mr G. R. Douglass, 27 April 1990

⁹ New Zealand Local Government Act 1989, Part XHIA, Section 223D

- 17.15 Such a process of reporting involves a greater degree of participation than may be required under the present system.
- 17.16 The Committee sees merit in the Department of Local Government further examining the New Zealand experience as part of its review of the Local Government Act.
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Recommendation 32

It is recommended that the Annual Report of each Council be provided to every elector, and include a copy of the following material from the audited annual accounts: the Balance Sheet, Income and Expenditure Account, and Notes Accompanying the Accounts. To assure that cost does not inhibit or delay this process, the minimum requirement should be that the Annual Report be inserted in a widely-distributed local newspaper.

Recommendation 33

It is recommended that the form and content of the Council's Annual Reports be in line with reporting requirements for public companies.

18. Issues Arising from the Inquiry

Professional Indemnity

- 18.1 The Committee, during review of the local government audit process, was exposed to a range of considerations which bear on the actions which follow audit. To some extent, the auditor is a professional informant who is often the bearer of unfavourable news: a "*whistleblower*". Given that capacity, the Committee wishes to ensure that protection is not overlooked when considering changes in audit role and process of removal.
- 18.2 One local government auditor mentioned an incident in which \$40,000 had been misappropriated. The Council concerned requested that he, as auditor, be peer reviewed by Touche Ross & Co. "*to give reasons why I should be sacked*":

"I do not know why they picked on me, because the bloke was getting cheques signed and cashed at the bank. ...The banking system should have been answering, not the auditor.

...I found all the reports I had given to Council complaining about the breakdowns of internal control were found in this guy's desk, and he had been using those to carry out the defalcation

*I just think I was the easiest target to have a go at."*¹

- 18.3 Concerns about the vulnerability of local government officials were raised with the Independent Commission Against Corruption (ICAC):

1 Minutes of Evidence, Mr R. Ferrier, 23 April 1990, p. 344

"Now assuming the Mayor thinks the Town Clerk has got his hand in the till and on suspicion reports it, subsequently, the Town Clerk or whoever is cleared, is lily white. What protection is there for defamation for the principal officer who, purely on suspicion, reports that person?"²

- 18.4 Mr Temby, QC replied that Section 11(1)c, ICAC Act 1988, under which the public sector is required to work, requires *"the principal officer of a public authority"* to report instances of suspicion of corrupt conduct:

"Section 11 has to be obeyed because it's a statute which is binding upon you... But the short answer to your question is, the protection must be absolute because a statutory duty is being performed."³

- 18.5 The Committee questions whether the ICAC was ever intended or would be capable of serving as a global safety net to protect community interests and the rights of persons who inform in good faith (a whistleblower protection system). ICAC is not obliged to pursue each request for inquiry, even if it fits the definitions of the Act. However, the implications of Section 11 (1) c have yet to be tested within local government. The Committee will follow further developments with interest.
- 18.6 The sensitivity of Councils to discussion of their financial affairs was further highlighted by North Sydney Council's demand, after its Town Clerk gave evidence to this Inquiry for an apology from the Chairman, and legal advice on whether the Chairman could be sued for defamation.
- 18.7 The Committee believes that this and other matters reported to the Inquiry lend support to the concerns expressed by local government auditors and officers about the inhibitions upon full reporting which exist in their political environment.
- 18.8 The issue of professional liability and indemnity in NSW is currently under consideration by the Attorney General's Department.

² Mr R. Harris, Councillor, Southern Riverina County Council, p. 2. Question to the 1990 Annual Conference of the Shires Association

³ Mr I. Temby, QC, Commissioner

- 18.9 The Committee considered the position of the Auditor-General from a number of perspectives. As a peer reviewer and potential tenderer for audit contracts there might arise a situation in which the Auditor-General was in a position to pass a judgement on a competitor then replace that firm as auditor. In practice, the Committee does not regard this as a likely problem. Indeed, this is the same situation which exists in the corporate world and in which the peer review process has been criticized for not taking sufficiently strong action following unfavourable review of an auditor.

A Level Playing Field ?

- 18.10 The Auditor General is seen by many as capable of providing a "floor" to the price of auditing. By being eligible to tender for local government work, the Auditor-General and Councils are able to adjust price and service according to their mutual interests.
- 18.11 The Auditor General has statutory protection which reduces the burden on that office for professional indemnity insurance. When subcontracting to private audit firms, however, these firms are required to show evidence of adequate insurance cover before being allowed to undertake the audit.
- 18.12 During the Inquiry the matter of auditors' fees was frequently contrasted with substantially larger fees paid to lawyers and consultants:

"...does anybody tell the aldermen that the quality of their legal advice is up to standard?"⁴

"In 1988 my fee of \$27,000 was 0.18 per cent of the total expenditure of the Council. Yet, by way of argument, in that same year the Council spent nearly \$270,000 on its solicitors who are never questioned on their appointment every year."⁵

"If auditing has a particular 'public interest' requirement, why not for legal services? or services' supply? or Department of Planning environmental plans work? The list is endless."⁶

4 Minutes of Evidence, Inquiry into the Auditor-General's Office, 3 November 1989, p. 27

5 Minutes of Evidence, Mr R. Ferrier, 23 April 1990, p. 381

6 Submission, Mr M. Regnis, Town Clerk/General Manager, Woollahra, 4 April 1990

- 18.13 Part of the problem stems from the fact that whereas such expenses as library services have a statutory reporting provision, professional expenses are listed for each separate fund to which they apply. In the discussions with North Sydney Council, the Committee pointed out the anomaly that \$1,000,000 in legal expenditure had not been mentioned in the Annual Report, despite reporting of far lesser amounts in other categories, to which the Town Clerk replied:

"That is correct. There is no reason for that other than that is the format that was set up. I can assure you that it has been well mentioned in the papers and in letters to the editors of newspapers on a number of occasions. At one stage - and I do not recall the specific matter - there was criticism made about the amount of legal fees, and the Council received a number of letters of support also. I guess it is because the people of North Sydney feel strongly about their environment and, in that particular area, environmental, overshadowing and privacy issues are important, and obviously the ratepayers believe the expenditure is warranted.

*It is difficult to say that in the case of North Sydney Council \$1 million is an unreasonable expenditure for the issues that have been involved."*⁷

- 18.14 The Committee is aware that when the Local Government Act was enacted, legal expenses were regarded as an overhead which should be apportioned to each particular fund activity for which it was incurred. Over the intervening years, the scale of legal activity has increased to the extent that it now may warrant separate reporting as an activity in its own right.

Corruption

- 18.15 The Committee's Inquiry also highlighted the limitations of auditing to deal with the myriad problems of potential corruption in local government. Mr Temby, QC, Commissioner of ICAC commented on the high number of complaints against Councils:

⁷ Minutes of Evidence, Mr R. Kempshall, 23 April 1990, pp. 389-390

*"This does not necessarily indicate a higher level of corruption in local than any other sphere of government. It rather reflects the fact that the business of local government is conducted at closer proximity to the individuals in our communities who may, rightly or wrongly, claim unfairness when they compare their treatment with that of their neighbours. It could also be said that land development generally has long been an area which attracts suspicion and allegations of corrupt practices. Therefore it is understandable that local government bodies are the focus of numerous complaints, whether reasonable or not, because they are the main agents in achieving changes to the development status of land."*⁸

- 18.16 The Department of Local Government noted that local government is distinguished from other levels of government and the corporate sector by virtue of being a non-sovereign government covering the location in which its members and employees live and in which it plays a quasi-judicial role in planning and development. The Department has noted a significant increase in demand for Ministerial exemptions, under Section 46d, from the pecuniary interest provisions of the Act for consideration of Local Environmental Plans. For example, one Council has recently required three ministerial exemptions due to the concentration of business activities and landholding interests of members in the main street of a town, being in conflict with their consideration of matters before Council.
- 18.17 Action has been taken to deal with such problems. In 1987, Section 46 of the Local Government Act was extensively amended to provide for compulsory disclosure of interests of Council members and committee members. Section 46C requires disclosure of interests at meetings and for the member to not take part in either discussion or voting. Section 46e requires disclosure of direct or indirect interests in development applications by any persons in a position to determine the application.
- 18.18 The Department of Local Government is currently considering several issues related to the evidence of the prevalence of conflict of interest: How representative of a community are local government members at present? Is

⁸ Address by Mr Ian Temby, Q.C., Commissioner, Independent Commission Against Corruption, to the 1990 Annual Conference of the Shires Association

the instance of a Council where the majority of members have an interest in a number of development control matters before Council an indication of a recurring sectional interest?

- 18.19 Such issues are beyond the scope of this Inquiry into Local Government Auditing and may well go beyond what might reasonably be expected to be revealed or even commented upon in an audit.

Conclusion

- 18.20 The Committee is aware that it is a time of turmoil in the auditing profession. Long resigned to the back rooms of power and regarded as a bit of a nuisance during boom times, more recently the auditor has gained prominence through the visible failure of the profession to draw attention to impending corporate failure.
- 18.21 The Committee has sought to address a number of these issues well before they might erupt in Council insolvencies. It is confident that in 1991 Council audits will change in emphasis from *"tick and flick"* exercises to a more comprehensive examination of Councils' financial prospects. The Committee believes that this changed role will be welcomed by both auditors and the Councils and communities to which they report.

APPENDIX 1

Call for Submissions



LEGISLATIVE ASSEMBLY OF
NEW SOUTH WALES

**Inquiry into the auditing of Local Government
in New South Wales**

The Public Accounts Committee has received a reference from the Minister for Local Government and Minister for Planning, The Hon. D. A. Hay, M.B.E., M.P., under Section 57(1) of the Public Finance and Audit Act, 1983, to inquire into the auditing requirements for local government in New South Wales.

The Terms of Reference of the Inquiry are to examine and report on the auditing requirements for local government in New South Wales with particular reference to:-

1. The manner, method, terms and conditions of appointment of local government auditors in New South Wales.
2. The necessary qualifications and experience required of persons or firms suitable as auditors of local government bodies.
3. The formulation of standards and codes of professional practices for local government auditors.
4. The basis of remuneration and contract of appointment.
5. The duties and rights of auditors and the scope and objectives of the audit assignment.
6. The reporting requirements of the auditor.
7. Any other matter relating to the auditing and accountability processes of local government.

Submissions relevant to this Inquiry are invited from interested parties and members of the public. Submissions will be treated as public documents unless otherwise requested and should be sent to:

The Director, Public Accounts Committee, Parliament House, Macquarie Street, Sydney, NSW 2000

Closing date for Submissions: 12 April, 1990.

Inquiries should be directed to Ms. V. Walker on (02) 230 2629 or Mr. J. Lynas on (02) 230 2632.

Phillip Smiles, LL.B, B.Ec., M.B.A., Dip.Ed., M.P.,
CHAIRMAN

APPENDIX 2

Submissions and Correspondence Received

Date	Name
20.11.89	Local Government Auditors' Association of New South Wales
undated	Coonabarabran Shire Council
undated	F A Elliott <i>Secretary, Department of Local Government</i>
undated	F A Elliott <i>Secretary, Department of Local Government</i>
7.3.90	Alan Morse and Co, Chartered Accountants
14.3.90	Muswellbrook Shire Council
23.3.90	Warringah Shire Council
26.3.90	Quirindi Shire Council
4.4.90	Woollahra Shire Council
5.4.90	Blayney Shire Council
6.4.90	Les McMahon <i>Institute of Municipal Management</i>
6.4.90	Cowra Shire Council
6.4.90	Newcastle City Council
6.4.90	Balranald Shire Council
7.4.90	Maclean Shire Council
8.4.90	Fairfield City Council
9.4.90	F A Elliot <i>Secretary, Department of Local Government</i>
9.4.90	J E Pinnock <i>Office of the Ombudsman</i>
9.4.90	Great Lakes Shire Council

Submissions and Correspondence Received (continued)

9.4.90	Mudgee Shire Council
9.4.90	Quirindi Shire Council
9.4.90	A S White
9.4.90	J R Hunt <i>Acting Chief Executive Officer, Law Society of New South Wales</i>
10.4.90	Wagga Wagga City Council
10.4.90	Tumut Shire Council
10.4.90	Ballina Shire Council
10.4.90	Wagga Wagga City Council
10.4.90	Lower Macquarie Group of Councils
10.4.90	B Castle
11.4.90	Local Government Auditors' Association
11.4.90	Oxley County Council
12.4.90	Ku-ring-gai Municipal Council
12.4.90	Tweed Shire Council
12.4.90	B Castle
16.4.90	Gilgandra Shire Council
17.4.90	Institute of Chartered Accountants in Australia
17.4.90	Dubbo City Council
17.4.90	Local Government and Shires Associations of New South Wales
17.4.90	Albury City Council
17.4.90	Mosman Municipal Council
18.4.90	Coonamble Shire Council
18.4.90	Dubbo City Council

Submissions and Correspondence Received (continued)

18.4.90	Greater Lithgow City Council
18.4.90	Ulmarra Shire Council
19.4.90	Culcairn Chire Council
19.4.90	Wyong Shire Council
19.4.90	Lane Cove Municipal Council
19.4.90	Hume Shire Council
20.4.90	Snowy River Shire Council
20.4.90	Wellington Shire Council
23.4.90	Greater Taree City Council
24.4.90	Brian McCleary <i>Local Government Auditor, Coopers and Lybrand</i>
24.4.90	Peter Luscombe
24.4.90	Hunter's Hill Municipal Council
24.4.90	Holroyd Municipal Council
26.4.90	K J Robson <i>Auditor-General</i>
27.4.90	Prospect County Council
27.4.90	Rockdale Municipal Council
27.4.90	Narrabri Shire Council
30.4.90	P Bartley
1.5.90	Parramatta City Council
1.5.90	W Henningham <i>Secretary, Local Government and Shires Association of New South Wales</i>
1.5.90	Ku-ring-gai Municipal Council
1.5.90	Gilgandra Shire Council

Submissions and Correspondence Received (continued)

1.5.90	Crookwell Shire Council
1.5.90	Tumbarumba Shire Council
2.5.90	Eurobodalla Shire Council
2.5.90	Western Lands Commission
3.5.90	Barraba Shire Council
3.5.90	Manly Municipal Council
3.5.90	Auburn Municipal Council
3.5.90	Strathfield Municipal Council
4.5.90	Cootamundra Shire Council
4.5.90	R D Christie <i>Director-General, Public Works Department</i>
7.5.90	Yallaroi Shire Council
8.5.90	Murrurundi Shire Council
8.5.90	South Sydney City Council
9.5.90	Armidale City Council
9.5.90	W A Henningham <i>Secretary, Local Government and Shires Associations of New South Wales</i>
10.5.90	Casino Municipal Council
10.5.90	P Ryan
11.5.90	Richmond River Shire Council
14.5.90	P Millington <i>Director, Department of Mineral Resources</i>
14.5.90	K Enderbury <i>Highways and Environment Association</i>
14.5.90	Prospect Electricity

Submissions and Correspondence Received (continued)

15.5.90	Wollondilly Shire Council
16.5.90	Liverpool City Council
17.5.90	Hurstville City Council
17.5.90	E T Brown
18.5.90	Murray Shire Council
18.5.90	W A Henningham <i>Secretary, Local Government and Shires Associations of New South Wales</i>
21.5.90	Grafton City Council
22.5.90	Hastings Municipal Council
27.5.90	D J Flanagan <i>Planad Services Pty Ltd</i>
6.6.90	W H Baker <i>Deputy Auditor-General</i>
6.6.90	B Forner <i>Manager, Policy and Research, Department of Local Government</i>
18.6.90	Guyra Shire Council
20.6.90	Wakool Shire Council
22.6.90	Campbelltown City Council
28.6.90	Narrandera Shire Council
4.7.90	S J Day <i>Secretary, Department of Lands</i>
11.7.90	W A Henningham <i>Secretary, Local Government and Shires Associations of New South Wales</i>
23.7.90	W Middleton <i>Jnr Vice President, Institute of Internal Auditors - Australia (NSW Branch)</i>

Submissions and Correspondence Received (continued)

- 16.8.90 D J Fraser
*Professor of Accounting and Acting Head, School of Accounting,
University of Technology, Sydney*
- 16.8.90 K J Robson
Auditor-General
- 10.9.90 Local Government and Shires Associations of New South Wales
- 12.9.90 G H Cowling
Local Government Auditors' Association

APPENDIX 3

Witnesses at Public Hearings

Date of Hearing Name of Witness

9 April 1990 Mr F A Elliott
Secretary
New South Wales Department of Local Government

Mr J H Mant
Partner, Phillips Fox

Mr J D Spencer
Chartered Accountant
KPMG Peat Marwick

Mr G J Wilson
Chartered Accountant
Coopers and Lybrand

Mr C V Ellis
Accountant and Retired Shire Clerk

Mr R J Ball
Town Clerk
Waverley Municipal Council

10 April 1990 Mr F A Elliott
Secretary
New South Wales Department of Local Government

Mr K J Robson
Auditor-General of New South Wales

Mr J A Parkinson
Assistant Auditor-General of New South Wales

Mr J R Mitchell
Assistant Auditor-General of New South Wales

Professor R G Walker
Professor of Accounting
University of New South Wales

Mr R F Newling
General Manager, Oxley County Council

Witnesses at Public Hearings (continued)

Date of Hearing Name of Witness

10 April 1990 Mr J W Walker
 Chairman, Oxley County Council

 Mr A M Baldwin
 Department of Local Government

20 April 1990 Mr P T Blackmore
 Mayor, City of Maitland

 Mr G A Brown
 Acting Town Clerk, City of Maitland

 Mr J W Walsh
 General Manager, Port Stephens Shire Council

 Mr C L Cowan
 Town Clerk, City of Cessnock

 Mr S T Neilly
 Accountant, City of Cessnock

 Mr P J Landy
 Shire Clerk, Dungog Shire Council

 Mr J R Rankin
 Town Clerk, Lake Macquarie City Council

 Ms S J Browne
 Internal Auditor, Lake Macquarie City Council

 Mr W B Lewis
 Town Clerk, City of Newcastle

 Mr C D Haxton
 Chartered Accountant, Coopers and Lybrand

 Mr E C Glover
 Partner, Coopers and Lybrand

 Mr I E Seymour
 Shire President, Muswellbrook Shire Council

 Mr L P Fisher
 Shire Clerk, Muswellbrook Shire Council

 Mr I R Nunn
 Shire Clerk, Scone Shire Council

Witnesses at Public Hearings (continued)

Date of Hearing Name of Witness

20 April 1990	Mr J A Flannery Shire Clerk/General Manager, Singleton Shire Council
23 April 1990	Mr J W C Thackray Chartered Accountant
	Mr R W Ferrier Chartered Accountant
	Mr R D Kempshall Town Clerk/Chief Executive, North Sydney Municipal Council
	Mr W I Taylor Town Clerk, Ku-ring-gai Municipal Council
24 April 1990	Mr B T Nevin City Treasurer, Council of City of Sydney
	Mr H E J Wallace Town Clerk/City Manager, Hurstville City Council
	Mr J F Patterson General Manager/Town Clerk, Botany Municipal Council
	Mr B S Gardner General Manager/Town Clerk, Marrickville Municipal Council
	Mr P H Smiles Assistant General Manager, Prospect County Council
	Mr D K Gray General Manager, Sydney County Council
	Mr M W Greentree General Manager, Illawarra County Council
	Mr W A Henningham Secretary, Local Government and Shires Association of New South Wales
	Mr D J McCullea Deputy Secretary, Local Government and Shires Association of New South Wales

APPENDIX 4

**Inspections and Meetings
of the
Public Accounts Committee**

DATE	SUBJECT	ORGANISATION	WITNESSES
9.4.90	Public Hearings: Inquiry into Local Government Auditing	Department of Local Government Phillips Fox KPMG, Peat Marwick Coopers and Lybrand Waverley Municipal Council Retired Town Clerk	Mr F A Elliott Mr J H Mant Mr J D Spencer Mr G J Wilson Mr R J Ball Mr C V Ellis
10.4.90	Public Hearings: Inquiry into Local Government Auditing	Department of Local Government Auditor-General's Office University of NSW Oxley County Council Department of Local Government	Mr F A Elliott Mr K J Robson Mr J A Parkinson Mr J R Mitchell Prof. R J Walker Mr R F Newling Mr A M Baldwin
17.4.90	Meetings and Inspections: Inquiry into Local Government Auditing	Grafton City Council Nymboida Shire Council Maclean Shire Council Ulmarra Shire Council Copmanhurst Shire Council Local Government Auditors Wagga Wagga City Council Albury City Council Gudagai Shire Council Junee Shire Council Lockhart Shire Council Southern Riverina County Council Wagga Wagga City Public Accounts	Mr J Shepard Mr S Llewellyn
18.4.90	Meetings and Inspections: Inquiry into Local Government Auditing	Coffs Harbour City Council Bellingen Shire Council Local Government Auditors Narrandera Shire Council	Mr B Herd Mr A Hogbin
19.4.90	Meeting: Inquiry into Local Government Auditing	Dubbo City Council Macquarie County Council Coonamble Shire Council Coonabarabran Shire Council Coolah Shire Council Narromine Shire Council Parkes Shire Council Wellington Shire Council	

Report on the Auditing of Local Government

Inspections and Meetings of the Public Accounts Committee (continued)

20.4.90	Public Hearings: Inquiry into Local Government Auditing Held in Maitland City Council Chambers	Maitland City Council Port Stephens Shire Council Cessnock City Council Dungog Shire Council Lake Macquarie City Council Newcastle City Council Muswellbrook Shire Council Scone Shire Council Singleton Shire Council Coopers and Lybrand	Ald. G A Brown Mr P T Blackmore Mr J W Walsh Mr C L Cowan Mr S T Neilly Mr P J Landy Mr J R Rankin Ms S J Browne Mr W B Lewis Mr I E Seymour Mr L P Fisher Mr I R Nunn Mr J A Flannery Mr E C Glover Mr C D Haxton
23.4.90	Public Hearings: Inquiry into Local Government Auditing	Local Government Auditors North Sydney Municipal Council Ku-ring-gai Municipal Council	Mr J W C Thackray Mr R W Ferrier Mr R D Kempshall Mr W I Taylor
24.4.90	Public Hearings: Inquiry into Local Government Auditing	Sydney City Council Hurstville City Council Botany Municipal Council Marrickville Municipal Council Prospect County Council Sydney County Council Illawarra County Council Local Government and Shires Association of NSW	Mr B T Nevin Mr H E J Wallace Mr J F Patterson Mr B S Gardner Mr P H Smiles Mr D K Gray Mr M W Greentree Mr W A Henningham Mr D J McSullea
7.6.90	Meetings: Inquiry into Local Government Auditing	Warringah Shire Council Manly Municipal Council Mosman Municipal Council Sutherland Shire Council Rockdale Municipal Council	

APPENDIX 5

List of Councils and Annual Turnover *

Council Code	Council Name	Revenue Expenditure	Capital Expenditure	Total Expenditure
005	Albury	20,157	4,808	24,965
010	Armidale	7,491	2,141	9,632
020	Auburn	17,754	2,771	20,525
025	Ballina	16,911	3,501	20,412
030	Balranald	3,275	624	3,899
035	Bankstown	62,359	40,188	102,547
040	Barraba	2,640	1,446	4,086
045	Bathurst	14,100	13,191	27,291
050	Baulkham Hills	34,806	8,725	43,531
055	Bega Valley	12,359	3,828	16,187
060	Bellingen	8,188	2,865	11,053
065	Berrigan	4,693	1,633	6,326
070	Bingara	2,253	1,016	3,269
075	Blacktown	68,638	25,595	94,233
080	Bland	6,251	1,131	7,382
085	Blayney	4,132	959	5,091
090	Blue Mountains	30,798	7,275	38,073
095	Bogan	3,639	678	4,317
100	Bombala	8,165	2,223	10,388
105	Boorowa	2,650	821	3,471
110	Botany	16,121	5,038	21,159
115	Bourke	4,685	848	5,533
120	Brewarrina	4,791	706	5,497
125	Broken Hill	7,229	1,412	8,641
130	Burwood	9,207	6,137	15,344
135	Byron	10,949	4,719	15,668
140	Cabonne	8,419	3,246	11,665
145	Camden	9,423	4,169	13,592
150	Campbelltown	45,836	18,770	64,606
155	Canterbury	41,157	6,911	48,068
160	Carrathool	4,538	1,662	6,200
165	Casino	5,318	1,020	6,338
172	Cessnock	20,610	4,254	24,864
175	Cobar	6,738	2,941	9,679
180	Coffs Harbour	20,446	7,093	27,539
185	Conargo	1,680	848	2,528
190	Concord	10,356	3,105	13,461
195	Coolah	4,582	746	5,328
200	Coolamon	2,753	847	3,600
205	Cooma-Monaro	5,906	3,112	9,018
210	Coonabarabran	5,401	995	6,396
215	Coonamble	6,265	1,822	8,087
220	Cootamundra	4,386	1,903	6,289
225	Copmanhurst	3,024	755	3,779
230	Corowa	4,016	1,653	5,669
235	Cowra	7,057	1,349	8,406
240	Crookwell	4,063	925	4,988
245	Culcairn	2,394	837	3,231
250	Deniliquin	3,989	1,197	5,186
255	Drummoyne	9,861	4,040	13,901
260	Dubbo	14,306	5,897	20,203
265	Dumaresq	3,614	732	4,346
270	Dungog	3,899	715	4,614
275	Eurobodalla	15,229	7,850	23,079
280	Evans	5,532	1,243	6,775

Report on the Auditing of Local Government

List of Councils and Annual Turnover (continued)

Council Code	Council Name	Revenue Expenditure	Capital Expenditure	Total Expenditure
285	Fairfield	63,312	17,514	80,826
290	Forbes	7,452	1,980	9,432
295	Gilgandra	4,347	1,968	6,315
300	Glenn Innes	3,094	1,466	4,560
305	Gloucester	4,077	1,586	5,663
310	Gosford	56,121	14,194	70,315
315	Goulburn	9,730	6,578	16,308
320	Grafton	6,857	1,632	8,489
330	Greater Lithgow	10,568	3,787	14,355
335	Greater Taree	15,290	6,378	21,668
340	Great Lakes	14,639	4,086	18,725
345	Griffith	10,693	2,589	13,282
350	Gundagai	3,212	765	3,977
355	Gunnedah	9,649	5,008	14,657
360	Gunning	2,019	1,103	3,122
365	Guyra	3,125	950	4,075
370	Harden	3,255	1,157	4,412
375	Hastings	18,118	11,068	29,186
380	Hawkesbury	21,999	18,814	40,813
385	Hay	3,100	780	3,880
390	Holbrook	2,793	923	3,716
395	Holroyd	22,922	6,027	28,949
400	Hornsby	43,083	13,543	56,626
405	Hume	3,446	1,505	4,951
410	Hunters Hill	4,215	654	4,869
415	Hurstville	22,142	6,278	28,420
420	Inverell	12,815	3,681	16,496
425	Jerilderie	3,085	1,353	4,438
430	Junee	2,635	1,221	3,856
435	Kempsey	12,099	4,640	16,739
440	Kiama	15,971	9,655	25,626
445	Kogarah	13,189	5,019	18,208
450	Ku-ring-gai	36,495	13,764	50,259
455	Kyogle	7,806	1,986	9,792
460	Lachlan	8,502	2,215	10,717
465	Lake Macquarie	59,187	16,941	76,128
470	Lane Cove	11,785	3,968	15,753
475	Leeton	5,255	1,986	7,241
480	Leichhardt	25,903	4,417	30,320
485	Lismore	18,630	4,463	23,093
490	Liverpool	35,779	11,021	46,800
495	Lockhart	3,243	651	3,894
500	Maclean	6,854	2,180	9,034
505	Maitland	16,650	3,619	20,269
510	Manilla	2,237	1,004	3,241
515	Manly	18,723	3,901	22,624
520	Marrickville	30,580	8,985	39,565
525	Merriwa	3,916	1,441	5,357
530	Moree Plains	19,354	3,658	23,012
535	Mosman	11,909	3,394	15,303
540	Mudgee	10,217	2,766	12,983
545	Mulwaree	5,044	1,114	6,158
550	Murray	3,965	1,729	5,694
555	Murrumbidgee	2,111	767	2,878
560	Murrurundi	2,312	868	3,180

List of Councils and Annual Turnover (continued)

Council Code	Council Name	Revenue Expenditure	Capital Expenditure	Total Expenditure
565	Muswellbrook	7,059	2,436	9,495
570	Nambucca	7,260	1,657	8,917
575	Narrabri	11,132	2,098	13,230
580	Narrandera	4,774	1,280	6,054
585	Narromine	4,263	2,011	6,274
590	Newcastle	63,096	29,215	92,311
600	Nundle	1,229	214	1,443
605	Nymboida	2,863	843	3,706
610	Oberon	3,726	3,114	6,840
615	Orange	16,828	5,483	22,311
620	Parkes	8,090	2,825	10,915
625	Parramatta	46,603	12,888	59,491
630	Parry	5,485	2,022	7,507
635	Penrith	52,584	21,248	73,832
640	Port Stephens	25,269	14,409	39,678
645	Queanbeyan	11,239	3,792	15,031
650	Quirindi	4,624	974	5,598
655	Randwick	35,043	13,947	48,990
660	Richmond River	8,119	3,109	11,228
665	Rockdale	24,110	4,575	28,685
670	Ryde	27,416	12,949	40,365
675	Rylstone	3,958	1,055	5,013
685	Severn	3,298	954	4,252
690	Shellharbour	14,192	4,270	18,462
695	Shoalhaven	33,664	16,265	49,929
700	Singleton	10,285	1,885	12,170
705	Snowy River	6,108	2,774	8,882
710	Strathfield	7,601	3,309	10,910
715	Sutherland	68,461	19,286	87,747
718	South Sydney	70,647	31,793	102,440
720	Sydney	169,317	54,042	223,359
725	Tallaganda	3,763	846	4,609
730	Tamworth	14,340	4,957	19,297
735	Temora	4,267	971	5,238
740	Tenterfield	4,340	1,404	5,744
745	Tumbarumba	4,270	1,817	6,087
750	Tumut	5,916	2,584	8,500
755	Tweed	23,365	6,076	29,441
760	Ullmarra	2,997	651	3,648
765	Uralla	4,067	1,076	5,143
770	Urana	2,278	684	2,962
775	Wagga Wagga	24,917	7,901	32,818
780	Wakool	4,998	1,096	6,094
785	Walcha	4,664	1,458	6,122
790	Walgett	7,895	1,732	9,627
800	Warringham	72,794	20,963	93,757
805	Waverley	26,066	11,058	37,124
810	Weddin	3,121	604	3,725
815	Wellington	7,275	2,216	9,491
820	Wentworth	3,920	763	4,683
825	Willoughby	24,865	19,268	44,133
830	Windouran	1,400	222	1,622
835	Wingecarribee	14,908	7,731	22,639
840	Wollondilly	11,458	5,468	16,926
845	Wollongong	76,640	29,606	106,246

Report on the Auditing of Local Government

List of Councils and Annual Turnover (continued)

Council Code	Council Name	Revenue Expenditure	Capital Expenditure	Total Expenditure
850	Woollahra	24,609	22,591	47,200
855	Wyong	47,392	17,540	64,932
860	Yallaroi	5,163	2,016	7,179
865	Yarrowlumla	4,140	1,072	5,212
870	Yass	4,827	1,854	6,681
875	Young	5,178	1,027	6,205
906	Castlereagh-Macquarie	784	492	1,276
908	Central Northern	330	46	376
911	Clarence River	2,215	319	2,534
913	Far North Coast	736	131	867
914	Far North Western Slopes	402	67	469
934	New England Tablelands	297	100	397
944	Richmond River County	208	26	234
***		2,649,696	944,811	3,594,507

* Statements 1989
 Total Expenditure (\$000)
 19 November 1990

APPENDIX 6

**Terms of Engagement
for
Provision of Audit Services**

TERMS OF ENGAGEMENT

FOR THE PROVISION OF AUDIT SERVICES

TO THE AUDITOR—GENERAL OF NEW SOUTH WALES

FOR THE AUDIT OF

Prepared and published by the
Auditor—General of New South Wales
after consultation with the
Institute of Chartered Accountants
in Australia, and the
Australian Society of Accountants
New South Wales Divisions

Terms of Engagement (continued)

1. **Appointment and Engagement of the Auditor**
 - 1.1 Appointment of an Auditor pursuant to Section 35 of the Public Finance and Audit Act 1983, is the sole prerogative of the Auditor – General, and such appointment may be revoked at any time by the Auditor – General.
 - 1.2 The Auditor hereby accepts the appointment and agrees to undertake the Auditing Services on the terms and conditions contained in this Agreement.
 - 1.3 It is irrevocably agreed that the Auditor is not an "employee" for any purpose including any statutes regarding employment benefits, superannuation benefits, or workers compensation. The appointed Auditor is not an "employee" under the Public Sector Management Act 1988 (NSW).
2. **Auditor's Duties**
 - 2.1 The Auditor shall provide the Auditing Services and carry out the Auditing Services with all reasonable skill and care.
 - 2.2 The Auditor has discretion as to the manner in which the Auditing Services are to be performed but shall have regard to:
 - (a) the practices and standards issued jointly from time to time by the Institute of Chartered Accountants in Australia and the Australian Society of Accountants;
 - (b) the Public Finance and Audit Act 1983 and any Regulations thereunder;
 - (c) any provisions which may be specified in any other legislation applicable to the Auditing Services.
 - 2.3 In addition to the matters set out in Clause 2.2 of this Agreement, the Auditor shall comply with any standards or directions which may be specified for the Auditing Services by the Auditor – General provided such standards and directions specified by the Auditor – General are not inconsistent with the practices and standards of the Institute of Chartered Accountants in Australia and the Australian Society of Accountants.
 - 2.4 The Auditor shall consult with the Audit Co – ordinator of the Auditor – General for the purposes of agreeing on a plan for the completion of the Auditing Services.
 - 2.5 The Auditor shall provide an Audit Plan and Audit Programme setting out the audit procedures to be followed in providing the Auditing Services.
 - 2.6 The Auditor shall agree with the Audit Co – ordinator upon a timetable setting out the relevant commencement and completion dates for the various stages of the Audit Programme, dates for submission of working papers for review by the Audit Co – ordinator and dates for submission of reports. The Auditor shall notify the Audit Co – ordinator in writing as soon as possible and within 7 days of becoming aware that he will be unable to meet an agreed completion or submission date.

Terms of Engagement (continued)

- 2.7 If the Auditor becomes aware of any matter which could change the scope or timing of the Auditing Services, then the Auditor will give written notice to the Auditor-General and where practicable in the circumstances, provide particulars of such change and their effects.
- 2.8 Any adjustments to the Audit Plan must be agreed to by the Audit Co-ordinator. Any consequent alteration to fees and/or expenses will be the subject of agreement between the parties. If the parties are unable to agree then the matter shall be determined in accordance with procedures referred to in Clause 6.1 of this Agreement.
- 2.9 In no circumstances shall the Auditor or members of staff of the Auditor's firm engage in the provision of other services of any nature to an Auditee either during the period of appointment or for a further period of twelve calendar months immediately following completion or termination of this engagement, without the prior written approval of the Auditor-General. The Auditor-General reserves the right to approve or deny approval upon such matters, taking into account issues of audit independence and conflict of interest.
- 2.10 The Auditor shall co-operate at all times with the Auditor-General.

3. Auditor-General's Duties

- 3.1 The Auditor-General shall assist the Auditor in having made available to the Auditor all accounts, information, documentation, computer programs and printouts and other material necessary for the Auditor to carry out the Auditing Services.
- 3.2 The Auditor-General shall appoint a person to act as the Audit Co-ordinator.
- 3.3 If the Auditor-General becomes aware of any matter which will change the scope or timing of the Auditing Services, then the Auditor-General will give written notice to the Auditor and where practicable in the circumstances, provide particulars of such change and their effects.
- 3.4 Any adjustments to the Auditing Plan must be agreed to by the Audit Co-ordinator. Any consequent alteration to fees and/or expenses will be the subject of agreement between the parties. If the parties are unable to agree then the matter shall be determined in accordance with procedures referred to in Clause 6.1 of this Agreement.

4. Fees and Expenses

- 4.1 The amount of the fee and the amount or the method of the calculation of the direct reimbursable expenses for the Auditing Services is set out in Schedule II to this Agreement.
- 4.2 The Auditor-General shall pay the fees and reimbursable expenses in the manner and within the times provided in Schedule II to this Agreement, subject to the Audit Co-ordinator being reasonably satisfied as to Audit Services having been provided to such value. If such times are not indicated the Auditor shall render monthly invoices to the value of the work done.

Terms of Engagement (continued)

4.3 Any invoice referred to in clause 4.2 and approved by the Audit Co-ordinator shall be paid in full within thirty (30) days of the invoice being received at the Office of the Auditor-General.

4.4 In the event of any dispute concerning the whole or any amount of any invoice submitted by the Auditor, the Auditor and the Audit Co-ordinator shall meet for the purposes of discussing and resolving the dispute. If the dispute is not resolved in this manner the Auditor may forward a notice to the Auditor-General informing him that the dispute or part thereof is not resolved. If the dispute remains unresolved within twenty-one days from the date of the notice then such dispute shall be resolved by the method referred to in Clause 6.1.

5. Audit Assignment – Audit Materials, Working Papers and Reports

5.1 Where during the period of engagement the Auditor is provided with materials of any kind, including but not limited to materials such as copies of statutes, audit manuals, training documents, standard forms, sample documents, evaluation questionnaires or audit guidelines, such materials shall remain the property of the Auditor-General and shall not be copied nor released to any person whatsoever without the prior written approval of the Audit Co-ordinator. Until returned to the Audit Co-ordinator, any and all such materials shall be kept in safe custody by the Auditor.

5.2 The Auditor shall ensure that working papers are neatly and legibly compiled containing adequate documentation to demonstrate the nature and extent of the Auditing Services, and containing sufficient audit evidence to support all audit conclusions, findings and opinions.

5.3 The Auditor shall, with the exception of Internal Control Memoranda or Management Letters, report only to the Auditor-General on all assignments undertaken under this engagement. All reports shall be submitted through the Audit Co-ordinator. The Auditor shall report in accordance with the requirements set out in Schedule 1. Notwithstanding the contents of this clause, the Auditor may issue Internal Control Memoranda or Management Letters to auditees subject to their contents being cleared with the Audit Co-ordinator.

5.4 Without limiting the provisions of Clause 2.6, the Auditor shall deliver all audit materials, working papers, reports, financial statements and other audit documents to the Audit Co-ordinator upon completion of an assignment, or within seven (7) days of termination of the Agreement, or at such times as reasonably requested by the Audit Co-ordinator.

5.5 The ownership of working papers provided to the Auditor-General by the Auditor in connection with the Auditing Services shall remain vested in the Auditor who shall have the right to make and retain copies of those documents for the purposes of the Auditor's own records.

5.6 The Auditor-General shall have a right to retain custody of the working papers referred to in Clause 5.5 of this Agreement and the right to make copies of those working papers provided that the Auditor-General shall not make copies of such working papers in connection with any matter other than for the Auditing Services unless prior approval in writing is obtained from the Auditor.

Terms of Engagement (continued)

6. Dispute Resolution

6.1 If the Auditor-General and the Auditor are in dispute regarding any matter arising out of the Agreement, then either party may, by notice in writing, served on the other require that such dispute be resolved by the determination of an independent third party acceptable to both parties. If the parties cannot agree upon an independent third party within seven (7) days of the date of service of the notice, then either party may request the person named in Schedule I to nominate a third party for this purpose. The third party appointed to resolve the dispute in this matter shall act as an expert and not as an arbitrator and his decision shall be final and binding upon the Auditor-General and the Auditor.

7. Termination of Auditing Services

7.1 This agreement may be terminated by either party during the period of engagement by the giving in writing to the other party 21 clear days notice of intention to terminate.

7.2 **The Auditor is to advise the Auditor-General immediately when the Auditor:**

1. is declared bankrupt or makes any arrangements or composition with his or her creditors.
2. is guilty of grave misconduct or is convicted by any Court of any offence which would materially affect the provision of the Auditing Services.
3. is incapacitated by accident or ill-health and is unable to properly perform the duties under this agreement for any period exceeding twenty-one (21) working days.
4. is suspended from or ceases membership of a professional accounting body of which proof of membership was required by the Auditor-General prior to commencement of this Agreement.
5. ceases to hold any of the practice certificates or registrations of which proof of existence was required by the Auditor-General prior to commencement of this Agreement.
6. acts in any way which would be deemed by a reasonable person to have rendered the Auditor unable to continue the engagement without conflict of interest and/or impairment of audit independence.

7.3 If this Agreement is terminated pursuant to clause 7.1 hereof, the Auditor shall be entitled to claim from the Auditor-General the reasonable fees and expenses incurred for work done prior to the date of termination.

Terms of Engagement (continued)

8. Scope of Liability – Professional and Other Risks

8.1 The Auditor hereby releases and indemnifies the Crown, the Treasurer of the State of New South Wales and his successors, the Government of New South Wales and the Auditor-General from and against all liability for or in respect of financial loss as a result of fraud or negligence howsoever arising in the execution and performance of this Agreement. In addition to and not so as to in any way limit the preceding indemnity as set out in this clause, the Auditor shall effect and maintain during the currency of this Agreement an indemnity insurance policy with an insurance company approved of by the Audit Co-ordinator to insure against any liability under the preceding indemnity with a covering amount of \$3.0m (or such other sum as the Audit Co-ordinator might from time to time reasonably require) for each event occasioning liability. Evidence from an insurer or insurance broker of such insurance cover shall be provided to the Audit Co-ordinator within 30 days of the date of this Agreement and the approval of the Audit Co-ordinator shall be obtained to any proposed reduction in such policy.

8.2 The Auditor hereby releases and indemnifies the Crown, the Treasurer of the State of New South Wales and his successors, the Government of New South Wales and the Auditor-General from and against all liability for or in respect of physical injury (including death) to persons or damage to property howsoever arising in the course of the execution and performance of this Agreement.

In addition to and not so as to in any way limit the preceding indemnity, the Auditor shall effect and maintain during the currency of this Agreement an indemnity insurance policy with an insurance company approved of by the Audit Co-ordinator to insure against the liability of the Auditor under the preceding indemnity with a covering amount of \$1.5m (or such other sum as the Audit Co-ordinator might from time to time reasonably require) for each event occasioning liability. Evidence from an insurer or insurance broker of such insurance cover shall be provided to the Audit Co-ordinator within 30 days of the date of the Agreement and the approval of the Audit Co-ordinator shall be obtained to any proposed reduction in such policy.

9. Auditor's Employees

9.1 The Auditor shall effect and keep on foot at his own cost and expense insurance against such liability as may arise by virtue of any relevant workers' compensation legislation, or common law action associated therewith, in respect of any activity carried out by the Auditor or the Auditor's Assistants employed or engaged by the Auditor in the performance of the Auditing Services. Evidence of such insurance cover shall be provided to the Audit Co-ordinator who also shall be advised of any cancellation of such cover.

Terms of Engagement (continued)

10. **Fraud, Misfeasance, Malfeasance, etc**
- 10.1 If during the course of an audit assignment the Auditor or the Auditor's Assistants detect possible fraud, misfeasance, malfeasance, breach of statutory requirements, or material discrepancy of any nature, then the Auditor shall immediately report the facts of the matter to the Audit Co-ordinator, and forthwith thereafter shall confirm the report in writing to the Auditor-General. The Auditor shall not give any advice or information regarding the matter to any person whatsoever in the absence of clear directions from the Audit Co-ordinator or Auditor-General so to do.
11. **General Conditions**
- 11.1 If requested by the Auditor-General or Audit Co-ordinator, the Auditor and/or an Auditor's Assistant shall join with the Auditor-General or a nominated representative in discussions with any Head or officer of an Auditee.
- 11.2 If there arises any event which results in the Auditor having a personal interest in the subject matter of the Auditing Services, then the Auditor shall immediately notify the Auditor-General.
- 11.3 The Auditor-General is the client for the Auditing Services provided under this Agreement and reserves the right to engage other Auditors as he sees fit.
- 11.4 The engagement of an Auditor by the Auditor-General to undertake audit assignments does not and shall not be deemed to create any auditor-client relationship between the Auditor and the Auditee.
- 11.5 The Auditor is bound by Section 38 of the Public Finance and Audit Act, 1983 and shall not at any time (except in the proper course of duty) disclose to any person any confidential information, nor use or attempt to use any such confidential information in any manner which is calculated to cause injury or loss to the Auditee, the Auditor-General or the Crown and the Auditor shall use reasonable precautions to prevent the disclosure of any such information by the Auditor's Assistants. The Auditor shall acknowledge in writing being bound by and being subject to the provisions of Sections 38 and 62 of the Public Finance and Audit Act 1983.
- 11.6 If circumstances arise which require the services of a specialist or expert outside the field of the Auditor's expertise, the Auditor may, with the approval of the Audit Co-ordinator, engage the appropriate consultant.
- 11.7 (a) Any notice required to be served by the Auditor-General on the Auditor shall be signed by the Auditor-General and shall be sufficiently served if forwarded to the Auditor at the address referred to herein by prepaid registered post, telegram, telex, facsimile or by hand delivery.
- (b) Any notice required to be served hereunder by the Auditor on the Auditor-General shall be signed by the Auditor and shall be sufficiently served if forwarded to the Auditor-General at the Auditor-General's Office, Goodsell Building, 8-12 Chifley Square, Sydney, New South Wales by prepaid registered post, telegram, telex, facsimile or by hand delivery.

Terms of Engagement (continued)

- 11.8 This Agreement shall be governed by and construed in accordance with the laws for the time being in force in the State of New South Wales.

Definitions

Unless the context otherwise indicates or requires; –

"Agreement" means the entire agreement between the parties, including the Schedules and Appendix.

"Auditor" means the company, person or firm named in the Agreement, provided that the Auditor may at any time alter the firm's membership by addition or deletion of partners, or change the structure of the auditing practice in accordance with the rules of the Institute of Chartered Accountants in Australia or the Australian Society of Accountants.

"Auditor's Assistants" shall include any partner, employee or other person employed or engaged by the Auditor in the performance of the Auditing Services.

"The Auditing Services" are those professional services of auditing and reporting in relation to the relevant entity or entities referred to in the Appendix and such other services specifically described in the Appendix or in the event that no such services are indicated in the Appendix such professional services as have been agreed between the Auditor and the Auditor – General to be performed.

"Total Remuneration" means the total amount payable to the Auditor under the Agreement other than reimbursable expenses on the basis that the Agreement was completed and as stipulated in Schedule I hereto.

Terms of Engagement (continued)

Travel Costs

The Auditor – General will reimburse actual costs of travel only when in the opinion of the Audit Co – ordinator such travel is essential for the conduct of an assignment, and costs relate exclusively and directly to the audit tasks assigned. Provision for travel costs does not extend to travel to and from normal place of work, or to and from location of audit assignment within a township boundary or, in respect of metropolitan areas, within a radius of 20 kilometres of the usual office or work. Travel cost reimbursement rates for use of own conveyance shall not, unless otherwise agreed, exceed rates usually payable to an employee under the Public Service Act in similar circumstances.

Accommodation and Out of Pocket Expenses

The Auditor – General will reimburse accommodation costs, such out – of – pocket expenses which the Audit Co – ordinator considers reasonable and which relate exclusively and directly to audit tasks assigned, incurred while the Auditor or the Auditor’s Assistants are on duty outside the area of their normal place of abode, such duty requiring overnight accommodation away from home. Reimbursement rates shall not, unless otherwise agreed, exceed subsistence allowance rates usually payable to an employee under the Public Service Act in similar circumstances.

For reimbursement of travel, accommodation and out – of pocket expenses, proof of actual costs incurred must be produced in the form of accounts, chits, receipts, dockets. No reimbursement of such costs and expenses will be made where such provision is not made in an assignment budget.

The Auditor – General shall reimburse the Auditor for such other direct costs of audit assignments, or for such other direct services, as may be agreed between the Auditor and Audit Co – ordinator.

Payment for Services by Instalment

Where necessary, the parties will agree on a schedule of payments and their timing in accordance with Clause 4.2.

Terms of Engagement (continued)

**SCHEDULES TO AND FORMING PART OF THE TERMS AND CONDITIONS
OF APPOINTMENT AND ENGAGEMENT AS AN AUDITOR TO PROVIDE AUDIT
SERVICES FOR AND ON BEHALF OF THE AUDITOR – GENERAL
OF THE STATE OF NEW SOUTH WALES**

SCHEDULE I:

- A. Person to be requested to nominate an independent third party to settle disputes pursuant to Clause 6.1.

The President of the Australian' Society of Accountants

- B. Minimum insurance cover to be held by the Auditor for the auditing service pursuant to Clauses 8.1 and 8.2.

As per Clause 8.1

As per Clause 8.2

- C. Total Remuneration payable to the Auditor in the initial year of the engagement excluding reimbursable expenses.

- D. Reports required to be prepared and submitted to the Auditor – General.
As per paragraphs 1.1 to 1.4 of tender specification number 89/11

Terms of Engagement (continued)

APPENDIX TO AND FORMING PART OF THE TERMS AND CONDITIONS
OF APPOINTMENT AND ENGAGEMENT AS AN AUDITOR TO PROVIDE AUDIT
SERVICES FOR AND ON BEHALF OF THE AUDITOR-GENERAL
OF THE STATE OF NEW SOUTH WALES

1. FULL NAME OF AUDITOR: _____
2. NAME OF FIRM (IF APPLICABLE): _____
3. BUSINESS ADDRESS _____
_____ Post Code: _____
4. POSTAL ADDRESS _____
(If different from 3.) _____ Post Code: _____
5. PROFESSIONAL MEMBERSHIPS AND MEMBERSHIP LEVELS:

6. PRACTICE CERTIFICATES AND/OR REGISTRATIONS:

7. PERIOD OF APPOINTMENT IS: FROM (Date): _____
TO (Date): _____ (inclusive).
AS PER PARAGRAPH 2.3 OF TENDER SPECIFICATION 89/11.
8. LOCATIONS TO WHICH AUDIT ASSIGNMENTS SHALL BE CONFINED ARE:
AUDITEE TITLE/NAME LOCATION
_____ All areas with the boundaries of _____

9. DETAILS OF AUDITING SERVICE
As per paragraphs 1.0 to 1.6 of tender specification number 89/11

Terms of Engagement (continued)

This AGREEMENT is made BETWEEN

THE AUDITOR - GENERAL OF NEW SOUTH WALES, Goodsell Building,
8 - 12 Chifley Square, Sydney, New South Wales ("the Auditor - General")

AND

Name ("the Auditor") _____

Address _____

WHEREBY the Auditor - General engages the professional services of the Auditor to provide the Auditing Services referred to in the Appendix and on the terms and conditions referred to in the attached.

SIGNED by THE)
AUDITOR - GENERAL in) _____
the presence of:) **AUDITOR - GENERAL**

(Witness) _____

(Date) _____

SIGNED by THE AUDITOR
in the presence of: _____
AUDITOR

(Witness) _____

(Date) _____

Terms of Engagement (continued)

CONFIRMATION OF APPOINTMENT AND EXECUTION OF
AGREEMENT BY AUDITOR – GENERAL

In consequence of an agreement dated _____ I hereby confirm the appointment of _____ as an Auditor in accordance with Section 35(1) of the Public Finance and Audit Act 1983. This appointment is only for the purposes of carrying out an audit of _____ and unless revoked earlier under my hand will cease to have effect on 31 October 1992.

K. J. ROBSON
AUDITOR – GENERAL

(Date)

Terms of Engagement (continued)

ACCEPTANCE OF SECTIONS 38 AND 62
OF THE PUBLIC FINANCE AND AUDIT ACT 1983
PURSUANT TO CLAUSE 11.5 OF THE AGREEMENT
BETWEEN THE AUDITOR – GENERAL OF NEW SOUTH WALES AND

(Auditor)

I acknowledge that I am aware of the contents of Sections 38 and 62 of the Public Finance and Audit Act 1983, and hereby agree to be bound by and subject to the provisions of those sections.

Auditor:

Date:

APPENDIX 7

Local Government Audit Firms

Firm	No. of Audit Appointments
Alan Morse & Co.	11
A. L. McNeil	1
Auditor-General of NSW	1
Bentleys	2
Chapman & Eastway.....	1
Coopers & Lybrand.....	24
C. R. Millington.....	5
Cummins & Wallace	4
F. Crutchet	1
Dawson Partners.....	3
Forsyths	6
Felser Russell & Co.....	17
G. F. Thomas	19
Hogbin, Quinn & Bentley.....	3
Hudson Shepherd	5
James F. Auswild & Co.....	6
James Murphy	4
John L. Bush & Campbell	1
James A. Gunn.....	1
J. W. Thackray.....	3
KPMG Peat Marwick.....	8
McDonald & Rogers.....	7
N. Mah Chut	3
R. G. Orr	2
Paul, Paroz, Brett & Associates.....	2
Price Waterhouse.....	1
R. Edwards.....	2
Roberts & Morrow	1
Tester Porter & Co.....	7
Thomas, Noble & Russell.....	2
Todd & Niven.....	2
Truman & Co.	7
Warton Thompson & Co.....	9