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### **Submission by the Institute of Internal Auditors (IIA) to the review of Tasmania's Local Government Legislation Framework**

The Institute of Internal Auditors–Australia (IIA–Australia) is making this submission in relation to the review of the Local Government Act 1993.

This submission is focused mainly on *Part D – Responsible and Effective Councils* and particularly the notion of legislating eight good governance principles.

Firstly, the IIA-Australia will argue the basis of creating a strong governance structure and framework relies not on just legislating principles, but adopting a more prescriptive governance regime, which in part relies on having an effective third line of defence – internal audit.

The evidence to support this proposition is discussed in more detail in the submission.

Secondly, most States have legislated for an internal audit function as a major component of an Audit and Risk Committee's responsibility (Audit Panels).

Third, there is a major emphasis on internal auditors following the International Professional Practices Framework (IPPF), which defines the function of internal auditing, contains a code of conduct, and the International Standards for the Professional Practice of Internal Auditing (*the Standards*).

Finally, most States now acknowledge that internal auditors should be 'suitably qualified' to responsibly perform their function, and specifying the qualifications required is generally included in either Treasury's Directions at State level or outlined in supporting regulations and guidance documents at local government level.

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## 1. Introduction

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

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

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

The inclusion of an internal audit function, by suitably qualified internal audit practitioners, following the International Standards for the Professional Practice of Internal Auditing, makes for a better governance outcome for Councils and their stakeholders.

As confirmation of this point, a review of Internal Audit Capacity in the NSW Public Sector conducted by the New South Wales Department of Premier and Cabinet highlighted the costs to government of not recognising the internal audit function as a significant and effective part of agency governance.<sup>1</sup>

Some examples of costs incurred by not improving governance structures highlighted in the report included inefficient use of existing resources, lack of reliable information for decision making, and increased opportunities for fraud and maladministration. Attention to regular monitoring and revision of agency governance is encouraged. Having an effective and appropriately resourced internal audit function will achieve these outcomes.

In **Tasmania**, the local government legislation currently requires the *Local Government Act 1993 (TAS)* to establish Audit Panels, with at least two independent members, that must have respect to corporate governance and risk management.

But the Act does not mandate the internal audit function in legislation (Section 85, 85A and 85B of the Local Government Act 1993 and the Local Government Panels Order 2014), which makes it out of step with legislative reforms in other States.

Our recommendation is that the Tasmanian Government's review should conclude that the internal audit function should be mandated in legislation along with key activities expected of the Audit Panel.

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<sup>1</sup> Review of Internal Audit Capacity in the NSW Public Sector, Department of Premier and Cabinet, New South Wales, 2008

In the Reform Directions Paper Part D Section 36, it states:

‘The Director of Local Government already has the power to require information from councils and this would not change. What is currently not clear is the scope of the advice councils’ audit panels are providing to councils, including what risks and mitigation actions are being identified and recommended. Similarly, it is not clear how well councils are responding to their audit panels’ advice. Consequently, it is proposed that audit panels would be required to provide their reports to the Director of Local Government, upon the Director’s request’.

And under Part D Section 37, it states:

‘Under the current Act, instances of non-compliance with the Act can occur but with little consequence. For example, the Act may set out requirements to be followed, but there is no express penalty for not doing so. Many of these do not warrant an offence, but there is a gap with regard to powers to remedy non-compliance.

This direction would provide the power to the Director to require an undertaking to be given by a council, councillor or general manager to either correct an act of non-compliance, or to ensure there is no recurrence’.

Direct reporting lines are critical in delivering better governance outcomes.

It is recommended that the current act be changed to give power to the Director of Local Government to ensure that recommendations from Audit Panels and the internal audit function are acted upon.

It is also recommended that internal auditors, whether sourced in-house or outsourced, report directly to the Chair of the Audit Panel, and also to the Director of Local Government when requested to support undertakings or investigations.

Currently, the Department of Premier and Cabinet Guidance on *Audit Panels – A Practice Guide (2018)* outlines the functions of audit panels. In section 2.2 the outline of governance activities includes ‘effective internal audit policies’ and a ‘risk management framework’.

However, this is not mandatory – only voluntary. Councils can share Audit Panels and independent members and resources. Audit Panels must have 4-5 members of which two must be independent

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

The *Good Governance Guide for Local Government in Tasmania* is principally aimed at elected members, not Audit Panel members, council employees or financial or other assurance providers.

The Department of Premier and Cabinet is currently reviewing its Local Government Act and its governance framework is also under review. But, providing power to the Director of Local Government to oversee the work of Audit Panels is a sensible policy move and will be critical in delivering better governance outcomes.

## 2. Local Government Reforms in other States

To ensure the best outcome from this review of legislation, Tasmania should assess the reforms being undertaken in the local government sector across Australia.

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

Tasmania has legislated for Audit Panels but should move one step closer to prescribing and mandating all the functions required of the Audit Panels, including internal audit. It should also move to provide more oversight of Audit Panels by giving more power to the Director of Local Government to ensure there is timely follow up on recommendations made by the internal audit function.

As an example, **New South Wales** has been at the forefront of governance and risk management reform at State and now local government level. They were the first State to mandate the internal audit function in legislation.

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

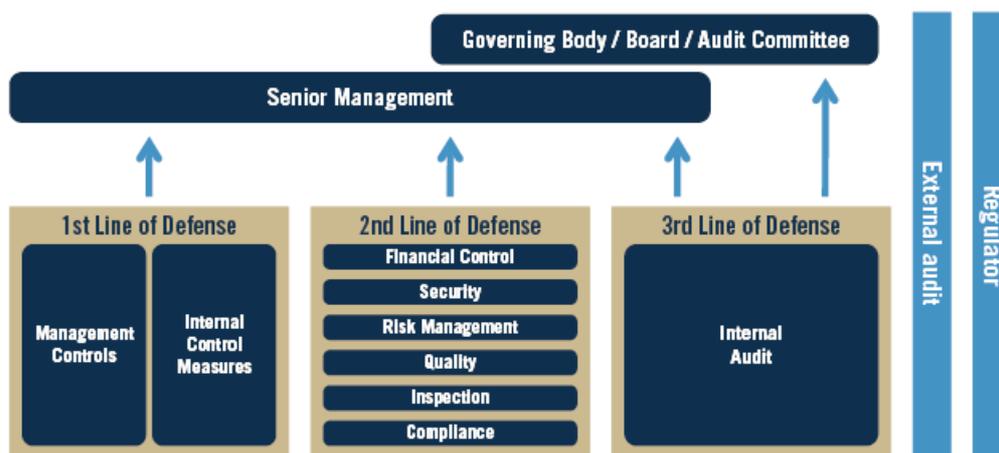
New South Wales set the pace for local government reform, and in 2016, the NSW Government made it a requirement under the *Local Government Act 1993* that each council have an Audit, Risk and Improvement Committee (ARIC) in place.

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

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

Part of the reasoning for these reforms is that the NSW Government follows the Three Lines of Defence risk management framework.

## The Three Lines of Defense Model



Adapted from ECIIA/FERMA *Guidance on the 8th EU Company Law Directive, article 41*

1st line of defence – operational functions implemented by council to own and manage risk. Council’s first line of defence against risk is for council staff to own and manage the risks that occur in their sphere of influence. This means they are given responsibility and held accountable for identifying risks and implementing internal controls (where appropriate).

2nd line of defence – management functions implemented by council to ensure operational functions are managing risks. Council’s second line of defence against risk is to ensure that the controls in the first line of defence are properly designed, implemented and operating as intended. Second line of defence activities are generally reported to senior and mid-level management.

3rd line of defence – independent external assurance. Council’s third line of defence against risk is to receive assurance from an independent body external to the council that its risks are being managed appropriately across the first and second lines of defence. External assurance is designed to provide council with a level of confidence that its goals and objectives will be achieved within an acceptable level of risk.

Independent external assurance is provided by an Audit, Risk and Improvement Committee, supported by an internal audit function that provides objective assurance.

External assurance activities are reported to the governing body of the council and the general manager by the internal audit function.

The requirement for each council to establish an Audit, Risk and Improvement Committee is seen as the third line of defence, to continuously review and provide independent advice and assurance on council's first and second lines of defence. The *Local Government Act* also envisages the establishment of an internal audit function in each council to support the work of the Committee.

The government has since been working to develop the regulatory framework that will support the operation of these committees, and the establishment of a risk management framework and internal audit function in each council.

They have released a discussion paper, *A New Risk Management and Internal Audit Framework for local councils in NSW (September 2019)* <sup>2</sup> which details the regulatory requirements and operational framework being proposed.

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

These requirements are based on the international standards (AS/NZS ISO 31000:2018 and International Standards for the Professional Practice of Internal Auditing) and the experience of Australian and NSW Government public sector agencies that have implemented risk management and internal audit. Most importantly, they reflect the unique needs, structure and resources of the NSW local government.

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

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

The operation of sections 428A and 428B will be supported by regulations. These will prescribe the requirements that councils are to comply with when appointing their Audit, Risk and Improvement Committee and establishing their risk management framework and internal audit function. They will also include internal audit as a function of the ARIC under section 428A (2) (i) of the *Local Government Act*.

The Local Government Regulation will also prescribe a Model Internal Audit Charter and Model Terms of Reference for Audit, Risk and Improvement Committees, which all councils

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<sup>2</sup> <https://www.olg.nsw.gov.au/content/new-risk-management-and-internal-audit-framework-local-councils-nsw>

must adopt and comply with when operating their internal audit function. The discussion paper describes the key requirements that will ultimately be prescribed by the Local Government Regulation.

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

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

All NSW Heads of Internal Audit must have "appropriate professional qualifications" or demonstrate high-level experience. The footnote in TPP 15-03 page 24 cites "Appropriate professional certification might include those, which would be recognised by the Institute of Internal Auditors, CPA Australia or Institute of Chartered Accountants".

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

Regulations and Guidance materials for Councils are yet to be published but is expected to include reference to the International Standard for the Professional Practice of Internal Auditing and guidance on 'suitable qualifications' for internal auditors.

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

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

The Victorian Auditor-General remit also includes the local government sector.

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

The *Local Government Act* requires local government to establish an audit committee, which prepares an internal audit plan, progress reports, assesses the compliance with the internal audit plan, and then carries out the 'effective internal audit function'.

Guidance material in the form of Local Government Bulletins 08/15 recommends internal auditors follow the 'International Standards for the Professional Practice of Internal Auditing'. These Bulletins also outline the appropriate qualifications required of an internal auditor.

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

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

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

The Queensland Audit Office also has a remit for local government audits.

Queensland Treasury also provides guidance not only for State Government departments but also to local government on Head of Internal Audit (refer *Queensland Treasury Information Sheet 2.6*).

Mandated minimum qualifications as prescribed by the Regulation which states "the person assuming the responsibilities of Head of Internal Audit must, as a minimum, hold a level of professional membership outlined below:

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

It should be noted however that membership of an accountancy body alone will not qualify the practitioner as an internal auditor.

In **Western Australia**, the *Local Government Act 1995* requires all councils to establish audit committees and the internal audit function is recommended. Local government reform (Part 2) is due in 2020.

The recently revised WA Treasury Instructions included Audit Committees and the internal audit function.

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

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

The Western Australia Auditor-General also has remit for the local government sector.

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

However, only public corporations are required to have an audit committee and an internal audit function (Section 31 *Public Corporations Act 1993*).

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

The South Australian Auditor-General has conducted a number of reviews of local government entities when requested, but currently does not have the remit to audit local councils on an annual basis.

### 3. Recommendations

**Reporting Lines** - Internal audit should be structurally independent and free from coercion by management to be effective in its role. Functional reporting to the appropriately constituted audit panel on key issues ensures that the head of internal audit is able to report objectively and without fear or favour.

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

- a. That the hiring and firing of the head of internal audit should be a decision on the recommendation of the Audit Panel.
- b. That the remuneration of the head of internal audit should be a decision reviewed and endorsed by the Audit Panel of the Council (and not senior management).
- c. That the scope for internal audit should be a decision reserved by the Audit Panel on the recommendation by the head of internal audit, and the budget reviewed and endorsed by the panel.
- d. That all internal audit work should be required to be reported to the Audit Panel, and the Audit Panel should periodically request confirmation that all reports have been tabled. In addition, internal audit should also report to the Director of Local Government when requested to ensure that Audit Panels ensure that management is acting upon the recommendations.
- e. That the key results of all internal audit work should be reported to the Audit Panel and the Audit Panel should periodically request confirmation from the head of internal audit that all material matters resulting from internal audit work have been reported to the Audit Panel, and if requested to the Director of Local Government.
- f. That throughout the year the chair of the Audit Panel, and annually the Audit Panel as a whole, should meet privately with the head of internal audit without management present, and if requested also to the Director of Local Government.
- g. That at least annually, the Audit Panel should have satisfied themselves that the internal auditor is appropriately positioned and adequately resourced; that the work of the internal auditor is being conducted in conformance with the International Standards for the Professional Practice of Internal Auditing; that they have satisfied themselves that the internal auditor has not been impeded in their work; and, that management has responded appropriately to internal and external auditor representations.

#### **4. To be included in regulations and guidance documents**

- a. The Council's head of internal audit must follow the International Professional Practices Framework (IPPF) containing "The International Standards for the Professional Practice of Internal Auditing".
- b. The head of the internal audit function should be 'suitably qualified' and have a direct reporting line to the Chair of the Audit Panel and, when requested, also report to the Director of Local Government in support of Council undertakings or investigations, as they bring the requisite degree of independence and objectivity to the role.

Qualifications and suitable experience for an internal auditor – either the Certified Internal Auditor (CIA®) designation or the Graduate Certificate of Internal Auditing (GradCertIA) qualification or be a Professional Member of the Institute Internal Auditors – Australia (PMIIA).

## 5. About the Institute

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

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

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

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

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

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

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# Appendix 1

## Inter-jurisdictional Comparison – Audit Committees and Internal Audit - Summary

April 2019

Jurisdiction	Audit Committee				Internal Audit	
	Audit Committee	Independent Chair	Independent Members	Knowledge and Experience	Internal Audit	IIA Standards <sup>^</sup>
<b>Corporate Sector</b>						
Listed	R*	R*	R*	R*	R*	G
Non-Listed	G	G	G	G	G	
Financial	R	R	R	R	R	
NFP						
<b>Australian Government</b>						
Federal	R	G	R	R	G	G
<b>State and Territory Governments</b>						
ACT	G	G	G	G	G	
NT	R		R	R	R	
NSW	R	R	R	R	R	R
QLD	R	G	R	G	R	G
SA	R#	R#			R#	
TAS	R		G	R	R	R

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Jurisdiction	Audit Committee				Internal Audit	
	Audit Committee	Independent Chair	Independent Members	Knowledge and Experience	Internal Audit	IIA Standards^
VIC	R	R	R	R	R	R
WA	R		R		R	R
<b>State and Territory Local Government</b>						
ACT	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
NT	R	R	R	R		R
NSW	G	G	G	G	G	G
QLD	R	R	R	R	R	G
SA	R		R	R		
TAS	R	R	R	R	G	G
VIC	R	R	G	G	R*	G
WA	R	R	R	G	R	R

“R” Required (Mandatory) “G” Guidance (Not Mandatory) Blank = No expectation # = Public corporations only \* = if not, why not

A= International Standards for the Professional Practice of Internal Auditing.

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