

CITY OF WEST TORRENS



## Notice of Committee Meeting

**NOTICE IS HEREBY GIVEN** in accordance with Sections 87 and 88 of the  
*Local Government Act 1999*, that a meeting of the

### **AUDIT AND RISK PRESCRIBED GENERAL COMMITTEE**

Members: Councillor S Rypp (Presiding Member),  
Councillors: G Vlahos, R Haslam, E Moran, S Spadavecchia

of the

**CITY OF WEST TORRENS**

will be held in the Mayor's Reception Room, Civic Centre  
165 Sir Donald Bradman Drive, Hilton

on

**TUESDAY, 30 MAY 2017  
at 6.00pm**

**Terry Buss  
Chief Executive Officer**

#### **City of West Torrens Disclaimer**

Please note that the contents of this Committee Agenda have yet to be considered by Council and recommendations may be altered or changed by the Council in the process of making the formal Council decision.

## INDEX

<b>1</b>	<b>Meeting Opened.....</b>	<b>1</b>
1.1	Evacuation Procedures	
<b>2</b>	<b>Present .....</b>	<b>1</b>
<b>3</b>	<b>Apologies .....</b>	<b>1</b>
<b>4</b>	<b>Disclosure Statements .....</b>	<b>1</b>
<b>5</b>	<b>Confirmation of Minutes.....</b>	<b>1</b>
<b>6</b>	<b>Communication by the Chairperson.....</b>	<b>1</b>
<b>7</b>	<b>Presentations .....</b>	<b>2</b>
7.1	Insurance and Indemnity Arrangements: Report to Councils .....	2
7.2	Internal Financial Controls Monitoring Risk Based Methodology .....	56
<b>8</b>	<b>Reports of the Chief Executive Officer.....</b>	<b>57</b>
<b>8.1</b>	<b>Financial Reporting and Sustainability.....</b>	<b>57</b>
8.1.1	Financial Reporting .....	57
<b>8.2</b>	<b>Internal Controls and Risk Management Systems.....</b>	<b>58</b>
	Nil	
<b>8.3</b>	<b>Internal Audit .....</b>	<b>58</b>
8.3.1	2016-17 Internal Audit Program Update.....	58
<b>8.4</b>	<b>External Audit .....</b>	<b>105</b>
	Nil	
<b>8.5</b>	<b>Committee Performance and Reporting .....</b>	<b>105</b>
	Nil	
<b>9</b>	<b>Outstanding Reports/Actions .....</b>	<b>106</b>
9.1	Open Actions Update .....	106
<b>10</b>	<b>Other Business .....</b>	<b>109</b>
<b>11</b>	<b>Confidential .....</b>	<b>109</b>
	Nil	
<b>12</b>	<b>Next Meeting .....</b>	<b>109</b>
<b>13</b>	<b>Meeting Close .....</b>	<b>109</b>

**1 MEETING OPENED****1.1 Evacuation Procedures****2 PRESENT****3 APOLOGIES****4 DISCLOSURE STATEMENTS**

Committee Members are required to:

1. Consider Section 73 and 75 of the *Local Government Act 1999* and determine whether they have a conflict of interest in any matter to be considered in this Agenda; and
2. Disclose these interests in accordance with the requirements of Sections 74 and 75A of the *Local Government Act 1999*.

**5 CONFIRMATION OF MINUTES****RECOMMENDATION**

That the Minutes of the meeting of the Audit and Risk Committee held on 14 February 2017 be confirmed as a true and correct record.

**6 COMMUNICATION BY THE CHAIRPERSON**

## **7 PRESENTATIONS**

### **7.1 Insurance and Indemnity Arrangements: Report to Councils**

#### **Brief**

This report presents the Local Government Association's review of its Local Government insurance and indemnity arrangements for information.

#### **RECOMMENDATION(S)**

It is recommended to the Audit and Risk Committee that the LGA's '*Insurance and Indemnity Arrangements: Report to Councils*' be received.

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#### **Introduction**

Following the Auditor General's report, '*Examination of the local government indemnity schemes: September 2015*', presented to the October 2015 meeting of the Audit and Risk Committee, the Local Government Association of South Australia (LGA) commissioned Finity Consulting and Rosey Batt and Associates to conduct a broad reaching review of its insurance and indemnity arrangements.

#### **Discussion**

The resulting report from that review contains commercial in confidence information so has not been released to councils or the public by the LGA. However, it has released a report that is suitable for distribution to councils. This report, '*Insurance and Indemnity Arrangements: Report to Councils*' is attached for information.

The LGA's Executive Director, Corporate & Member Services, Ms Kathy Jarrett, has been invited to present the report and its findings to this meeting of the Committee.

#### **Conclusion**

This report presents the LGA's '*Insurance and Indemnity Arrangements: Report to Councils*'.

#### **Attachments**

##### **1. Insurance and Indemnity Arrangements: Report to Councils**



# Insurance and Indemnity Arrangements: Report to Councils

LGA of SA

February 2017

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ROSEY BATT  
& ASSOCIATES





9 February 2017

Ms Kathy Jarrett  
Executive Director – Corporate and Member Services  
Local Government Association of South Australia  
GPO Box 2693  
ADELAIDE SA 5001

Dear Kathy

### Insurance and Indemnity Arrangements: Report to Councils

During 2016 the LGA commissioned Finity Consulting and Rosey Batt & Associates to assist the LGA with its broad-reaching review of the insurance and indemnity arrangements for Councils.

You have requested that we prepare a report suitable for distribution to Councils. The report is essentially the same as that provided to the LGA with omission of a number of items regarded as commercially confidential.

We wish to acknowledge the assistance we were given by LGA, its Audit Committee, JLT and Council representatives. We trust that the report will assist LGA and its members to respond to the issues that have been raised in recent years.

Yours sincerely

Geoff Atkins  
Fellows of the Institute of Actuaries of Australia

Gillian Harrex

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# Insurance and Indemnity Arrangements: Report to Councils

<b>Part I Executive Summary .....</b>	<b>4</b>
<b>Part II Background to the Findings .....</b>	<b>12</b>
<b>1 Introduction and scope .....</b>	<b>12</b>
1.1 Scope of assignment .....	12
1.2 Information provided .....	12
1.3 Finity Consulting and Rosey Batt & Associates .....	13
<b>2 What do Councils need and value .....</b>	<b>14</b>
<b>3 How insurance might be arranged .....</b>	<b>15</b>
3.1 Options for obtaining insurance .....	15
3.2 Options for management of the pools .....	18
<b>Part III Governance, Contracts and Licensing .....</b>	<b>20</b>
<b>4 Nature of the Joint Venture relationship between LGA and JLT .....</b>	<b>20</b>
<b>5 Current legal structures and licensing .....</b>	<b>21</b>
5.1 Overall legal structures .....	21
5.2 Removed on commercial grounds .....	21
5.3 Removed on commercial grounds .....	21
5.4 Removed on commercial grounds .....	21
5.5 Removed on commercial grounds .....	21
5.6 Removed on commercial grounds .....	21
5.7 Removed on commercial grounds .....	21
5.8 Removed on commercial grounds .....	22
5.9 The importance of contestability of services provided to Schemes .....	22
5.10 Government licences .....	22
<b>6 Proposals for change .....</b>	<b>24</b>
6.1 Project Management .....	24
<b>Part IV The Value for Money Equation .....</b>	<b>25</b>
<b>7 Value for Councils .....</b>	<b>25</b>
<b>8 Financial management of the Schemes .....</b>	<b>33</b>
8.1 Summary of observations .....	33
8.5 Investments and investment income .....	38
8.6 Accumulated surplus positions .....	39
8.7 Programs and development funds .....	39

## LGA Insurance and Indemnity Arrangements

<b>9</b>	<b>Individual Scheme issues .....</b>	<b>40</b>
9.1	Mutual Liability Scheme (MLS).....	40
9.2	Workers Compensation Scheme (WCS).....	41
9.3	Asset Mutual Fund (AMF).....	42
9.4	Income Protection Fund (IPF) .....	43
<b>10</b>	<b>Remuneration for JLT and LGA .....</b>	<b>44</b>
10.1	Removed due to commercial negotiations .....	44
10.2	LGA revenue from insurance and indemnity arrangements.....	44
<b>Part V</b>	<b>Other Aspects of the Review .....</b>	<b>46</b>
<b>11</b>	<b>Market testing and benchmarking .....</b>	<b>46</b>
11.1	A decision about market testing needs to be deferred .....	46
11.2	Benchmarking of products, services and costs .....	47
<b>12</b>	<b>Responses to external reports .....</b>	<b>48</b>
12.1	Auditor General Report.....	48
12.2	Response to KPMG report .....	49
<b>13</b>	<b>Reliances and Limitations.....</b>	<b>51</b>
13.1	Distribution and use .....	51
13.2	Data provided .....	51
13.3	Uncertainty.....	51
<b>Part VI</b>	<b>Appendices .....</b>	<b>52</b>



## Part I Executive Summary

The Local Government Association of South Australia (LGA) commissioned Finity Consulting and Rosey Batt to review the insurance and indemnity arrangements provided to Councils under the management of JLT. This review was part of LGA's response to the review prepared by the Auditor General of South Australia in 2015 concerning the operations of the insurance arrangements.

*Our full report was prepared in September 2016. LGA has advised that it wishes to provide the report to Councils and has asked us to prepare an amended report for this reason. Omissions relate only to certain information that is regarded as commercially confidential. Otherwise the content is essentially the same as the original report.*

### 1 The Current Insurance and Indemnity Structure

All Councils in South Australia participate in arrangements for insurance and indemnity that are managed by JLT (using the business name LGRS) under a range of agreements between JLT and LGA. The products and services provided cover:

- Liability
- Workers Compensation
- Assets
- Income Protection.

As well as the insurance protection, services to Councils include advice and placement of other insurance needs (e.g. travel and marine), risk management advice and claims management.

**The current structure of pooling risk in a mutual, buying reinsurance to protect the pool and using expert provider(s) for management is an effective model for local government, superior to alternative options.**

### 2 Strengths and Weaknesses of existing arrangements for Councils

Strengths	Weaknesses
One stop shop for insurance issues	Lack of confidence in governance
Confidence that the arrangements are run in their best interests	Lack of openness and transparency in the arrangements
Insurance cover that meets (and perhaps exceeds) their needs. Coverage is very broad	Lack of confidence that the contributions paid are commercially competitive
Services that broadly meet their needs and, with a few exceptions, are well regarded	Governance - the long standing arrangements with current providers is a barrier to contestability
Claims management that is sensitive to their needs and not litigious	
Stability and predictability of the arrangements and cost	

Overall we have found that the advantages listed above are real and are of value to Councils. However, while acknowledging the very significant advantages, there are a number of significant areas with the current legal and governance structures that require review and modernisation. This includes that the structures:

- Are complex, overlapping, inconsistent and lack transparency
- Reflect the nature of the historical Joint Venture approach and evolution over several decades
- Do not meet modern governance standards
- Provide LGA with limited flexibility to manage relationships
- Provide very limited opportunity to consider alternative providers.

Some of these issues have undermined confidence and raised important questions that our review is intended to help resolve.

**The governance structures for the various elements of the insurance and indemnity arrangements are, in our view, not fit for purpose and contribute to a lack of transparency.**

### 3 What needs to be changed?

Deciding and executing on changes is challenging because:

- On the one hand, the products and services provided to Councils are generally good and do not need radical change
- On the other hand, the current legal and governance arrangements are extremely complex, do not meet current good practice standards and should be rebuilt.

Change is necessary, but it would be a great shame if the continuity of product and service delivery was disrupted unnecessarily. As a matter of principle, LGA needs to have ultimate control (but not day-to-day management) of the arrangements and the various products and services need to be contestable.

Immediate moves to market testing would not only be legally risky and commercially disruptive, but would be unlikely to achieve a better service. We are not aware of any provider other than JLT that is capable of delivering (as a single provider) the complete package of products and services enjoyed by Councils in South Australia. There are providers capable of providing components of the insurance and indemnity arrangements.

**Before market testing is considered it will be necessary to put in place modern governance arrangements and to restructure the agreements to allow for the possibility of individual products and services being separated and made contestable. Engagement of all Councils during the process is critical to ensure that the arrangements retain 100% membership, which we regard as an enormous strength.**

## 4 Recommended structure and governance changes

The recommended structure and governance changes are currently the subject of ongoing negotiations and are therefore considered to be commercial in confidence at the time of preparation of this report.

## 5 Value for money

In 2014/15 Councils paid a total of \$52 million for insurance and indemnity (the total of contributions at the start of each financial year less the rebates that are paid a few months later).

While there has not been the opportunity to undertake market testing or benchmarking of this cost, there is no reason to think that it is excessive compared with buying insurance individually. Overall we found that the expense rates (after allowing for impact of risk management and compulsory charges) for all schemes are reasonable.

The arrangements are all 'mutual', in that any surplus funds belong to the Council members rather than to any service provider or insurer. At 30 June 2015 the funds had accumulated surplus totalling \$68 million. As surplus funds have increased in recent years some has been returned to Councils by way of 'special distributions' – the amounts vary from year to year but have been of the order of \$5 million per year.

The financial management of the Schemes has been prudent. With the exception of Income Protection, the other Schemes are run more conservatively than needed to still meet prudent practices. Workers Compensation, Liability and Assets all have contributions and surpluses that are higher than necessary.

**The insurance and indemnity arrangements provide good value for money. There is scope to improve the value for money for Councils (apart from Income Protection) by reducing the conservatism in contributions and further reviewing the accumulated surpluses.**

## 6 Finances for JLT and LGA

The revenue of JLT is considered commercially confidential information and therefore is not disclosed in this report.

LGA revenue of \$2.9 million in 2014/15 (which includes rent of JLT's tenancy in LGA House) makes a significant contribution to LGA's finances. Excluding the rent, the contribution made to LGA is roughly the same as the total of member subscriptions to LGA. If this revenue was removed there would be a significant impact on LGA's financial sustainability.

It is normal practice for a 'sponsoring organisation' such as LGA to receive revenue from any group insurance arrangements that it promotes or provides. The 2014/15 amount (excluding rent) is about 4% of the total amount paid by Councils, and this level of revenue is within the range typical in the marketplace. LGA should achieve transparency by openly showing to its members the financial contribution from the insurance and indemnity arrangements.



## 7 What Would Be The Next Steps?

Subsequent to the delivery of our full report, LGA management and Board have reviewed and noted the findings and recommendations of that report. LGA have commenced negotiations to modernise the current governance and financial structures. Given the current position of these discussions, it is inappropriate for this report to comment further.

**Implementing the reforms recommended in this report will be a substantial task requiring strong project management and careful analysis of the risks and complexities.**

## 8 Evidence and Explanations

The report we have prepared is long and aims to give the evidence and explanations that a reader would need in order to understand the reasons behind our findings and to form their own views.

An attachment summarising our findings and recommendations follows this Executive Summary. As highlighted above this Report has been prepared for distribution to Councils and it necessarily excludes some commercially sensitive information included in the original Report.

## 9 Reliances and Limitations

This report is subject to a number of important reliances and limitations set out in Section 13.

## 10 Findings/Recommendations Summary

Throughout our report there are a large number of Findings and Recommendations. For convenience, the tables below summarise these, with a cross reference to where they can be found in the body of the report.

### Findings

Section No.	Section Name	Findings
2	What do Councils need	Input we received indicated that Councils value the 100% membership in the arrangements. Our own experience supports the view that suitable arrangements with 100% membership are generally superior to situations where not all Councils participate.
3.1	Options for obtaining insurance	The current structure for arranging insurance through a discretionary mutual fund with pooling of insurance risk and purchase of excess cover provides substantial advantages and should be continued
		A significant advantage of discretionary mutual funds for Councils is that they provide considerable flexibility and potentially wider coverage and fewer disputes than traditional insurance contracts.
5.	Current Legal Structure and	

Page 7 of 52

February 2017  
R 2017\_02\_LGASA Insurance Review for Councils\_Final

**ROSEY BATT**  
& ASSOCIATES





## LGA Insurance and Indemnity Arrangements

Section No.	Section Name	Findings
<b>Licensing</b>		
5.7.2	Overall comments	<p>There are five distinct arrangements for insurance for Councils. These structures are:</p> <ul style="list-style-type: none"> <li>• Complex and overlapping</li> <li>• The outcome of decades of evolution.</li> </ul> <p>Overall, the current legal and governance structures do not reflect modern governance standards</p>
5.10	The importance of contestability	<p>The future arrangements should be structured in such a way that contestability of components of the arrangements can be market tested without disrupting the entire operation.</p> <p>Contestability should be scheduled for set periods, with the components to be contested determined by the governing body/ies.</p>
5.11	Requisite licenses	<p>LGA is the current holder of the workers compensation self-insurance licence and no change is necessary for this licence.</p> <p>Depending on future governance arrangements it may be necessary to apply for and maintain an AFSL (Australian Financial Services Licence) in the future (this licence is currently held by JLT).</p>
7	<b>Value for Councils</b>	
7.1	Insurance Cover	<p>Coverage provided by insurance and indemnity arrangements is broad and the discretionary nature of the cover means in some cases broader than provided by traditional insurance. Overall cover arrangements for Councils are 'fit for purpose' and provide a significant benefit to Councils.</p> <p>We note that the Minister for Local Government has recently advised that the minimum level of insurance for Councils will be increased from \$50 million to \$300 million. The current scheme will meet this minimum requirement</p>
7.2	Risk and claim services	<p>Overall the risk management and claim services are 'fit for purpose' and, with limited exceptions, are well regarded. There is always scope for improvement and components of risk management and claims management services could be contestable in the future.</p>
7.3	Gross contributions less rebates	<p>The current system of gross and net contributions provides incentives for risk management and allows for greater levels of year to year stability as increases/decreases can be 'smoothed'. However in</p>

## LGA Insurance and Indemnity Arrangements

Section No.	Section Name	Findings
		our view, the gross contributions for MLS and WCS could be reduced (with consequently lower rebates provided).
7.4	Accumulated surplus targets and special distributions	<p>Current accumulated surplus policies and level of surpluses are conservative for MLS, WCS and AMF. There is an opportunity to reduce overall surpluses without detriment to member Council security.</p> <p>Regularity of special distributions highlights that contributions may be too high for MLS, WCS and AMF.</p>
8.3	Reinsurance	<p>Reinsurance commission levels appear reasonable and broadly consistent with our understanding of reinsurance commission.</p> <p>The extent of reinsurance is professionally reviewed each year and seems appropriate. The reinsurance programs for both MLS and AMF appear very conservative given the strong capital position of the Schemes.</p> <p>The shared purchase of liability reinsurance (sharing with local government arrangements in other states) probably provides some savings relative to purchase by MLS alone.</p> <p>The Treasurer's Indemnity is of benefit to the MLS (but not to the other schemes), and the obligations are not particularly onerous provided placement of the minimum cover remains practical.</p>
8.4	Expenses and fees	The expense rates (after allowing for impact of risk management and compulsory charges) for all schemes are reasonable.
8.5	Investment and investment income	The current investment approach for all Schemes is appropriate even though returns are low. Funds are invested with LGFA, and so indirectly supports councils
8.7	Programs and development funds	There should be active oversight over approval, funding and performance of various programs and development funds that are supported by the Schemes.
9	Individual Scheme Issues	
9.1	Mutual Liability Scheme (MLS)	Given the current operating structure, with little risk retained by MLS, there is an opportunity to review the contribution arrangements, the accumulated surplus policy and the extent of reinsurance protection.

## LGA Insurance and Indemnity Arrangements

Section No.	Section Name	Findings
9.2	Workers Compensation Scheme (WCS)	<p>The current level of accumulated surplus in WCS is conservative and there may be an opportunity to review this.</p> <p>Council dissatisfaction with compliance requirements could be addressed.</p>
9.3	Asset Mutual Fund (AMF)	Given current operating structure in the AMF, there is a clear opportunity to review the contribution arrangements, accumulated surplus policy and extent of reinsurance protection purchased.
9.4	Income Protection Fund (IPF)	The current external market conditions suggest that future substantial increases in contributions may be required in the IPF to maintain solvency and meet costs of reinsurance.
10.2	Estimate of JLT revenue from LGA members	The revenue of JLT is considered commercially confidential and therefore is not disclosed in this report.
10.3	LGA revenue from insurance and indemnity arrangements	<p>Remuneration arrangements for LGA are complex and not transparent.</p> <p>It is normal, and commercially acceptable, practice for a sponsoring organisation to receive revenue from arrangements such as LGA has in place for the Councils.</p>
11.2	Benchmarking of products and service	It is worth considering some benchmarking with other state local government associations, although this process would have its own difficulties and needs to be approached carefully.



## LGA Insurance and Indemnity Arrangements

## Recommendations

In addition to the recommendations below, we further recommend that this report be provided to the Auditor General, as part of LGA's ongoing response to the Auditor General.

Section No.	Section Name	Recommendations
3.2	Discretionary Structure	Subject to the other recommendations made in this report covering legal and governance arrangements, the current business model of using a third party provider(s) for insurance services gives an appropriate balance of control and skills.
5.11	Governance Standards and External Legal Requirements	<p>Current structures require change to meet modern governance standards</p> <p>Distinct insurance schemes dealing with different insurance needs should remain, but with updated governance structures</p> <p>The LGA should pursue reconstructing the AM and IP Funds as Schemes as envisaged by the LG Act</p> <p>It may be necessary to apply for and maintain an AFSL in the future. Future contractual arrangements should allow for contestability of individual services and consistency across all Schemes.</p>
6.2	Suggested model for the future	As these matters are currently the subject of negotiations, they have been omitted from this report
6.3	Contractual arrangements with JLT	As these matters are currently the subject of negotiations, they have been omitted from this report
6.5	Project Management	Likewise, omitted from this report
10.3		We recommend greater transparency of the JLT and LGA remuneration arrangements
11.1	Market Testing and Benchmarking	LGASA should continue its broad relationship with JLT on insurance and indemnity arrangements. Any decision on potential market testing should be deferred until revised legal and governance arrangements are in place, with the Schemes being structured to make components of the products and services more readily contestable.

## Part II Background to the Findings

The detailed report is structured in four parts:

- Part II Background to the Findings – Sections 1 to 3
- Part III Governance, Contracts and Licencing – Sections 4 to 7
- Part IV The Value for Money Equation – Sections 8 to 10
- Part V Other Aspects – Sections 11 to 13

### 1 Introduction and scope

In May 2016 LGA engaged Finity Consulting and Rosey Batt & Associates to undertake a broad-ranging review of the insurance and indemnity arrangements provided to Councils through LGA. Those arrangements are provided by JLT through a series of agreements between LGA and JLT, and started at least 30 years ago. Over that time the arrangements have evolved and expanded in response to changing needs and circumstances.

#### 1.1 Scope of assignment

This review was commissioned by LGA, under the guidance of its Audit Committee. The review was commissioned as part of the LGA's ongoing response to the review by the Auditor General. We were asked to assist LGA in a broad ranging review of its local government indemnity Schemes and other insurance and risk arrangements including both insurance arrangements and brokerage arrangements. The focus is to ensure that services:

- Deliver value for money
- Are fit for purpose and cost effective
- Have robust governance arrangements in place.

One of the important factors in the review was the desire to maintain participation of all Councils in South Australia in the various Schemes.

While LGA commissioned the report we have sought to approach this project from the perspective of Councils, not the LGA entity in its own right.

#### 1.2 Information provided

As part of this review we sought and were provided with a wide range of information.

In addition to the information provided we had the benefit of meetings with:

- LGA Audit Committee
  - ▶ Rosina Hislop (Chair)
  - ▶ Yvonne Sneddon
  - ▶ Alan Tregilgas
  - ▶ Mayor David Parkin

- LGA staff
  - ▶ Kathy Jarrett - Executive Director Corporate & Member Services
  - ▶ Matt Pinnegar – Chief Executive Officer
- LGA CE Leadership Advisory Group
  - ▶ Brian Carr (Light Regional Council)
  - ▶ Michael Sedgman (Murray Bridge)
  - ▶ Paul Sutton (City of Charles Sturt),
  - ▶ Dr Helen McDonald (Naracoorte Lucindale Council)
  - ▶ Matt Pears (Mitcham)
- JLT staff: Gary Okely, Robyn Daly and others.

### 1.3 Finity Consulting and Rosey Batt & Associates

#### 1.3.1 Finity

Finity is the largest independent provider of actuarial consulting services to the insurance sector in Australia. Finity has more than 100 staff including actuaries, management consultants, statisticians, and data analysts and has been providing services to the general insurance and injury compensation markets for more than 30 years.

The Finity team works extensively in South Australia and Finity staff are currently appointed as the actuarial advisors to RTWSA, MAC, LSA, SAFA and RAAI. Finity has worked with almost every government compensation and insurance scheme across Australia and New Zealand over the last five years. We have also worked with a number of local government schemes in other jurisdictions and are familiar with the particular challenges of this sector.

Finity does not provide or place insurance for clients and so is able to provide an independent perspective on insurance related issues.

#### 1.3.2 Rosey Batt & Associates

Rosey Batt & Associates is an Adelaide based firm providing legal and business services to corporate clients. Rosey Batt is the principal of the firm and has over 30 years' experience in the commercial sector. Rosey has experience in the insurance sector both locally and internationally in management, provision of legal advice and from a Board perspective.

Rosey also has extensive experience in corporate governance in organisations both at management and Board level. She is a Fellow of the Institute of Company Directors and facilitates nationally in the company directors course on directors duties, governance, decision making and legal issues. She advises directors and organisations on directors' duties and obligations and best practice governance frameworks. Through her years of experience as a serving Board member on a wide range of Boards, she has significant experience in strategy and risk.



## 2 What do Councils need and value

The insurance and indemnity arrangements need to be assessed against the future needs of the local government sector and what Councils value in this regard.

Based on the input we have received and our own experience, the ideal insurance and indemnity arrangements will provide the following:

1. Simplicity – making it as straightforward as possible for Councils to deal with a technically complex subject
2. Sufficient cover – high limits, broad risks covered, minimal exclusions
3. High quality and accessible services:
  - (a) Insurance needs analysis, collation of exposure information, placement
  - (b) Risk management advice and services
  - (c) Claims management that responds to the needs of Councils and is non-litigious
  - (d) Paperwork and payments that are clear, efficient and no-fuss
4. A cost of insurance (i.e. premiums or contributions plus any self-insured retention) that is:
  - (a) As low as can be reasonably achieved while meeting the requirements listed above
  - (b) As stable as possible, to aid budgeting and avoid financial shocks
5. Confidence in the arrangements, so that officials and elected representatives do not spend an inordinate amount of time reviewing insurance and ensuring it is adequate
6. Open and transparent arrangements that are co-operative across the sector
7. Maintaining confidence of ratepayers, the public and other stakeholders such as the State Government that insurance risks have been properly dealt with.

Insurance is a high risk area and is technically complex. It is not the core business of Councils. Arrangements that meet the needs outlined above are valuable, often to the point where they are taken for granted until something goes wrong or confidence is shaken.

**Finding:** Input we received indicated that Councils value the 100% membership in the arrangements. Our own experience supports the view that suitable arrangements with 100% membership are generally superior to situations where not all Councils participate.

### 3 How insurance might be arranged

A fundamental requirement for Councils to operate is to have appropriate insurance in place. There are two key aspects to the process of arranging this insurance:

- What options are available in terms of the 'structure' of the insurance purchase?
- How might the structure be managed in practice?

This section explains the options in a conceptual or theoretical framework. It does not deal with the specifics of the current arrangements, which are addressed in later sections of the report.

#### 3.1 Options for obtaining insurance

There are three broad options available for Councils to obtain the insurance protection they need.

Figure 3.1 – Options for Purchasing Insurance

	Buying Individual Insurance	Group Buying of Insurance	Pool Risks and Buy Excess Cover (Mutual)
Advantages	<p>Purchase insurance specific to each Council's needs</p> <p>Each Council engages its own insurance broker</p>	<p>Works when risk profile is similar (e.g. council risks)</p> <p>Will get broader cover, higher limits at a lower overall price</p> <p>Opportunity to build expertise and experience level (i.e. track record)</p> <p>Less complicated and less expensive than if each individual Council was purchasing its own insurance</p>	<p>Should result in lower overall costs as only insuring risks in excess of risk appetite and lower level claims retained</p> <p>Can provide more stability as pool can manage year to year movements in costs</p> <p>Reduce "dollar swapping" with insurance market</p> <p>Less complicated for each council than individual purchasing</p> <p>Potential to provide broader cover than available from traditional insurance</p>
Disadvantages	<p>Relatively complex for Councils – requires expertise and relationship with broker</p> <p>Relatively expensive to purchase, by comparison with pooling risks or group buying of insurance</p>	<p>Does not work well for any Councils with substantially different risk profile to the average Council in the group</p>	<p>Requires greater sophistication of management 'at the centre' including possibly outsourcing</p>

**Buying individual insurance** is always an option and remains an option. Under current legal arrangements it is an option available to any Council. The issue is whether other options are superior.

**Group buying of insurance** is better than individual buying. The greater buying power will achieve real benefits in the insurance market.



**Pooling of risks and buying excess cover** is a logical extension and brings some further benefits as well as further management challenges to control the risks involved. A further benefit of this structure is that it is established as a 'mutual' meaning the funds belong to the members and any surplus funds are returned to (or otherwise used for the benefit of) members.

The current arrangement is the third option here. In this arrangement risks, up to specified limits, are pooled and insurance is purchased above these limits.

### 3.1.1 The Mutual structure

In our view Councils benefit from having their main insurance and indemnity arrangements in a mutual structure. The benefits include:

- Reduced margins in expenses and insurer profit margins
- Ability to achieve greater stability in premiums
- Potential to offer broader cover than is available from traditional insurance cover (and hence an enhanced claims 'experience')
- Any residual surplus (or profit) remaining the property of Councils.

There are risks involved with a mutual structure including:

- The mutual fund running out of money and needing to call on members for more contributions (or default on its indemnity obligations)
- The mutual taking on a 'life of its own' and extending its activities into areas outside its mandate
- Leakage of funds to service providers who may be able to establish non-commercial arrangements.

The mitigants to these risks are to be found in two areas:

- Robust governance (although, as described elsewhere in this report, there is need for substantial reform in relation to governance of the current structures)
- Prudent financial management, in line with actuarial advice.

**Finding:** The current structure for arranging insurance through a discretionary mutual fund with pooling of insurance risk and purchase of excess cover provides substantial advantages and should be continued.

### 3.1.2 Discretionary structure

Under the Insurance Act, insurance business may only be carried out by an APRA authorised insurer (Division 2, Section 12). If the products were covered by the Insurance Act then they would need to be provided by an APRA authorised insurer.

The current legal structures, referred to as a 'discretionary mutual fund' (DMF), are designed to provide insurance-like (indemnity) protection and provide an alternative to conventional general insurance products.

## LGA Insurance and Indemnity Arrangements

The DMF structure allows a mutual pool to provide indemnity that is not 'insurance business' for the purpose of the Insurance Act. For many decades the 'discretionary fund' structure has been used as an alternative. It has survived legal challenges in the UK as to whether it is legally 'insurance'. In the early 2000s (after the HIH failure) it was reviewed in Australia (the Potts review) and the Federal Government accepted the continuing use of the model subject to:

- Reporting to APRA in order to have visibility and in case future regulatory change was desired.
- Regulation by ASIC by way of the requirement to hold and abide by a suitable Australian Financial Services Licence (AFSL)
- Requirement to clearly disclose to customers that it is not a contract of insurance and that indemnity depends on the discretion of the fund.

We are not aware of any situation where a DMF has exercised discretion against the interests of a member in circumstances that are unreasonable relative to the 'promised indemnity'. There is also a benefit to the 'discretion' in a DMF. There are frequently boundary issues and disputes over insurance coverage, and litigation between insureds and insurers is common. It is reasonable to expect that the DMF will be less likely to take a strict and litigious approach. The DMF is more likely to use its discretion to err on the side of its members provided the overall arrangements and fairness to members are not prejudiced.

A financial consequence of the DMF structure is that there is no 'insurer' whose capital is at risk to meet adverse experience. There have been occasions when a DMF has had to call on its members to contribute additional funds.

**Finding:** A significant advantage of discretionary mutual funds for Councils is that they provide considerable flexibility and potentially wider coverage and fewer disputes than traditional insurance contracts.

### 3.2 Options for management of the pools

Assuming that LGA accepts the finding and wishes to continue to pool and then insure risks across Councils, then there are three broad management models that may be used.

Figure 3.2 – Options for Management of Pooled Risk

	Third Party Provider(s)	Internal Provider	Captive Insurance Company
	Current arrangement (variations of this are possible including multiple administration providers)	LGA (or a subsidiary to provide clarity of governance) manages arrangements directly.	APRA authorised insurer.
<b>Advantages</b>	Purchasing access to insurance expertise Access to subject matter experts Takes advantage of innovation in other jurisdictions.	Control – LGA would have direct access and control to all the arrangements	Provides very strong governance framework. Checks and balances on sound operation.
<b>Disadvantages</b>	Less control- must maintain effective oversight without hindering performance. May pay too much. May result in over reliance on third party provider.	Not core business – need to recruit, train and develop specialist staff; limited pool of insurance expertise on the ground in Adelaide. Would still need to use external experts and so limits savings. Limited ability to learn from what is happening elsewhere.	Not core business – will need to recruit, train and develop specialist staff High cost of initial set up (\$millions) Capital 'locked up' inside captive High expense overheads and ongoing regulatory compliance costs.

LGA currently uses the first of these options with JLT being the third party provider.

For the scale of the LGA arrangements, the current approach of engaging one or more third party providers to conduct the day to day management will generally have the lowest risk and provide the best quality of products and services. The disadvantages, which are outlined in the table above, need to be recognised and actively managed. In the current arrangements, LGA and JLT have expressed their relationship as a joint venture. This aspect of the third party arrangement is discussed further in Section 4.

In relation to the other options:

- Internal provider:** while there is no doubt that if LGA directly managed the arrangements there would be a greater degree of control and understanding (within LGA) of the insurance arrangements, we believe that there are a number of key disadvantages that would outweigh any perceived advantage. In particular, the need to train and develop a team of staff, without recourse to other resources in the organisation (as are available to a third party provider) are likely to limit any savings that might be available. Further, the pool of appropriately experienced staff in a small market such as Adelaide who would be attracted to this arrangement would be very limited.



## LGA Insurance and Indemnity Arrangements

- **APRA insurer:** it would be possible for LGA to establish an APRA licensed insurer, solely to manage its insurance risks. While this would provide a very strong governance framework, authorisation of an APRA licensed insurer is a very complex, time consuming and expensive process. Even after authorisation, operating an APRA authorised insurer would continue to be expensive and is unlikely to be in the best interests of councils, when considering what might optimise the 'value for money' of any arrangement.

**Recommendation:** Subject to the other recommendations made throughout this report covering legal and governance arrangements, the current business model of using a third party provider(s) for insurance services gives an appropriate balance of control and skills.

## Part III Governance, Contracts and Licensing

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This part of the report deals with the legal structures of the insurance arrangements, the governance systems and methods that are applied, the nature of the contracts among the parties and the government licences required.

### 4 Nature of the Joint Venture relationship between LGA and JLT

*As the nature of the relationship(s) between JLT and LGA is the subject of ongoing negotiations, this section has been omitted on commercial grounds.*

## 5 Current legal structures and licensing

*There are a number of aspects of the current legal structures and licensing proposals that are considered commercial in confidence at this time and so have been omitted from this report.*

### 5.1 Overall legal structures

The current legal structures for the provision of indemnity and insurance services are complex. There are four main insurance Schemes in place – two indemnity Schemes authorised by legislation and two mutual risk products operating under trust deeds:

- Workers Compensation Scheme (WCS)
- Mutual Liability Scheme (MLS)
- Asset Mutual Fund (AMF)
- Income Protection Fund (IPF).

Each scheme or trust has multiple legal documents governing its operation, which are often intertwined and they have all been amended over time. In addition to the formal legal documents, they all have rules and/or operational management agreements.

#### 5.1.1 The Local Government Act

The legal structures start with the Local Government Act 1999. The Act states<sup>1</sup> that

- LGA **will** conduct and manage the Schemes for Liability and Workers Compensation
- LGA **may** conduct and manage any other indemnity or self-insurance Scheme.

The current Liability and Workers Compensation Schemes are conducted in accordance with the Act. The Act imposes some requirements in terms of Scheme Rules, although they are not particularly onerous.

The current Asset and Income Protection funds are not specifically identified as Schemes under the Local Government Act. They operate on the basis that they are not Schemes under the Act, although there is no reason why they could not be.

**Sections 5.2 to 5.8 have been removed on commercial grounds**

<sup>1</sup> Schedule 1 Part 1 Clause 2

**Finding:** There are five distinct arrangements for insurance for Councils. These structures are:

- Complex and overlapping
- Do not meet modern governance standards

Overall, the current legal and governance structures do not reflect modern governance standards

## 5.9 The importance of contestability of services provided to Schemes

Insurance and related services are a modest part of Council finances, at approximately 2% of revenue, but are still a significant cost that needs to be managed. More importantly, the insurance coverage and related services must be fit for purpose. As discussed elsewhere in this report, maintaining 100% membership by Councils is an important element of the success of the Schemes.

As part of the review of the governance arrangements of the Schemes, provision for commercially practical contestability of services provided to the Schemes needs to be designed into the future arrangements. The design for contestability needs to be at a manageable level of components of the services.

**Finding:** The future arrangements should be structured in such a way that contestability of components of the arrangements can be market tested without disrupting the entire operation.

Contestability of services should be scheduled for set periods, with the components to be contested determined by the governing body/ies.

## 5.10 Government licences

There are two specific government licencing requirements which are essential for the operation of the insurance and indemnity arrangements:

- (a) An Australian Financial Services Licence (AFSL) to advise on, deal in and provide custodial services for the mutual risk products in the Schemes (issued by ASIC)
- (b) A self-insurance licence for workers compensation (issued by ReturnToWorkSA).

JLT holds the AFSL under which the Schemes are operated. LGA hold the workers compensation licence, as the representative employer of a group self-insurance pool.

## LGA Insurance and Indemnity Arrangements

The specific requirements for the licences are technical, and were covered separately in an appendix to the original report.

**Finding:** LGA is the current holder of the workers compensation self-insurance license and no change is necessary for this license.

**Recommendations:**

Current structures require change to meet modern governance standards

Distinct insurance schemes dealing with different insurance needs should remain, but with updated governance structures

Future contractual arrangements should allow for contestability of individual services and consistency across all Schemes.



## 6 Proposals for change

*There are a number of aspects of the proposals that are considered commercial in confidence at this time and so have been omitted from this report.*

### 6.1 Project Management

*Removed due to ongoing commercial negotiations.*

**Recommendation:** LGA should establish a project structure and plan which will include *inter alia*: negotiation, risk assessment, communication, resources and critical milestones.

## Part IV The Value for Money Equation

The focus of this part of the report is to examine whether the services are fit for purpose, cost effective and deliver value for money. We examine the current arrangements in three sections:

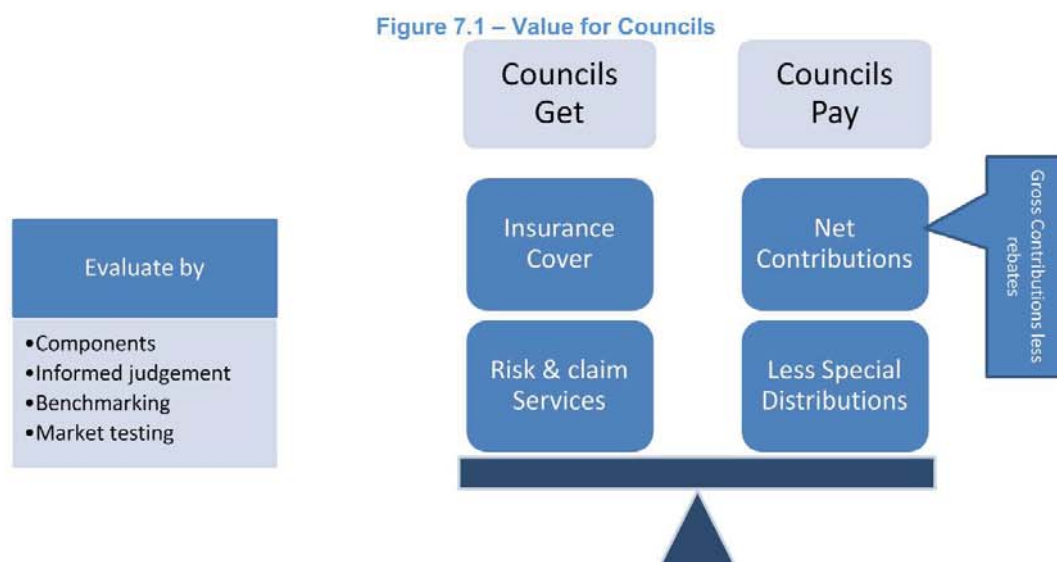
- Councils – what they pay and what they receive
- Financial management of the Schemes
- Revenue arrangements to JLT (omitted from this report) and LGA.

### 7 Value for Councils

The 'value for money' provided to the member Councils by the insurance and indemnity arrangements can be assessed in a number of ways. The way we have approached it in this report is as follows:

- What do Councils need and value from insurance coverage and related services? We dealt with this in Section 2.
- What is the quality of the insurance coverage?
- What is the range and quality of risk, claim and other services?
- What are the costs paid by Councils for the coverage and services?
- What is the expenditure profile of those costs?
- Is there wastage in the expenditure profile that results in reduced value for Councils?

Value for councils can be considered as follows:



## 7.1 Insurance cover

The coverage of insurable risks is broad and limits are high.

Our review of the coverage in each of the four Schemes and Funds did not identify any gaps in coverage or exclusions that are unreasonable. In some respects the cover is superior to that likely to be available in the commercial market, through the economies of scale advantage that JLT has in consolidating and reinsuring, for example, Local Government liability insurance risks across NSW, Victoria, South Australia and Western Australia.

The breadth of the cover is enhanced by the 'discretionary mutual' arrangements which can provide elements of cover that would be excluded in commercial insurance.

The longevity of the four self-insurance funds also provides JLT with an advantage in understanding the claims experience and development potential. In our view, all of these factors enable JLT to negotiate insurance coverages appropriate to the broad nature and scope of Council risks.

### 7.1.1 Mutual Liability Scheme

The coverage offered by the MLS is very broad – broader than would generally be available in the general insurance market place. In addition, the cover is effectively unlimited, given the Treasurer's Indemnity. While in practice it is highly unlikely that the Treasurer's Indemnity would be called on, it does provide an element of 'sleep easy' cover. In our view, the question of the limit of cover that should be purchased will be a question for the governance structure of MLS to consider as part of its risk appetite consideration.

The actual cover provided is for ...*"All sums which the Insured shall be legally liable to pay to third parties by reason of Civil Liabilities arising from and in connection with the Local Government business"*.

The Public & Products Liability Policy provides Members (i.e. Councils) up to \$300 million coverage for any one occurrence and in the aggregate, with a deductible of \$3,750 for each claim. Cover above \$300 million is provided by the Treasurer's Indemnity (see Section 8.3.4).

We note that the Minister for Local Government has recently advised that an amendment to the Local Government Financial Regulations will increase the minimum level of insurance for Councils from \$50 million to \$300 million. The current scheme meets this minimum requirement

Cover (for lower limits) is provided for other liability.

### 7.1.2 Workers Compensation Scheme

The WCS covers all of the liabilities of employer Councils under the RTW Act. In addition, the Scheme provides cover (insured by the Scheme) for fines and penalties imposed under workers compensation and WHS legislation, which is not a standard cover (but not a material impact on cost).

### 7.1.3 Asset Mutual Fund

The AMF provides \$40 million cover including protection for the usual exposures for material loss and damage, including theft or loss of money, computer crime, cyber security and data protection, privacy breach costs, cyber extortion threat and reward payments. AMF's exposure is limited (figures removed due to commercial confidentiality), with claims costs in excess of this insured in the external market.

### 7.1.4 Income Protection Fund

For the IPF, coverage provides 'top-up' benefits to 100% of wages in certain circumstances. Coverage to 100% of wages is not always commercially available because of the perception by insurers that there is too great an incentive to make and continue a claim.

This type of insurance has been under intense pressure in recent years, with increasing claims frequency and cost. Very substantial price increases have been experienced across the industry. Contribution increases for the IPF have been significantly less than typical commercial markets.

It is possible that the benefits in this fund may need some realignment with changes in industry practice to ensure their ongoing affordability.

### 7.1.5 Insurance outside the Schemes/Funds

The insurance needs of Councils vary in detail, and the risk appetite of Councils may lead to a desire to insure a particular risk when another Council chooses not to.

JLT provides a service to Councils to undertake an insurance needs analysis and to place any required insurances outside the mutual arrangements. While we did not review the details of any of these arrangements, we did not see any evidence that they might not be 'fit for purpose'.

The total volume of insurance placements is relatively small. It is appropriate that JLT receives normal market commissions for this insurance.

**Finding:** Coverage provided by insurance and indemnity arrangements is broad and the discretionary nature of the cover means in some cases broader than provided by traditional insurance.

Overall cover arrangements for Councils are 'fit for purpose'.

## 7.2 Risk and claim services

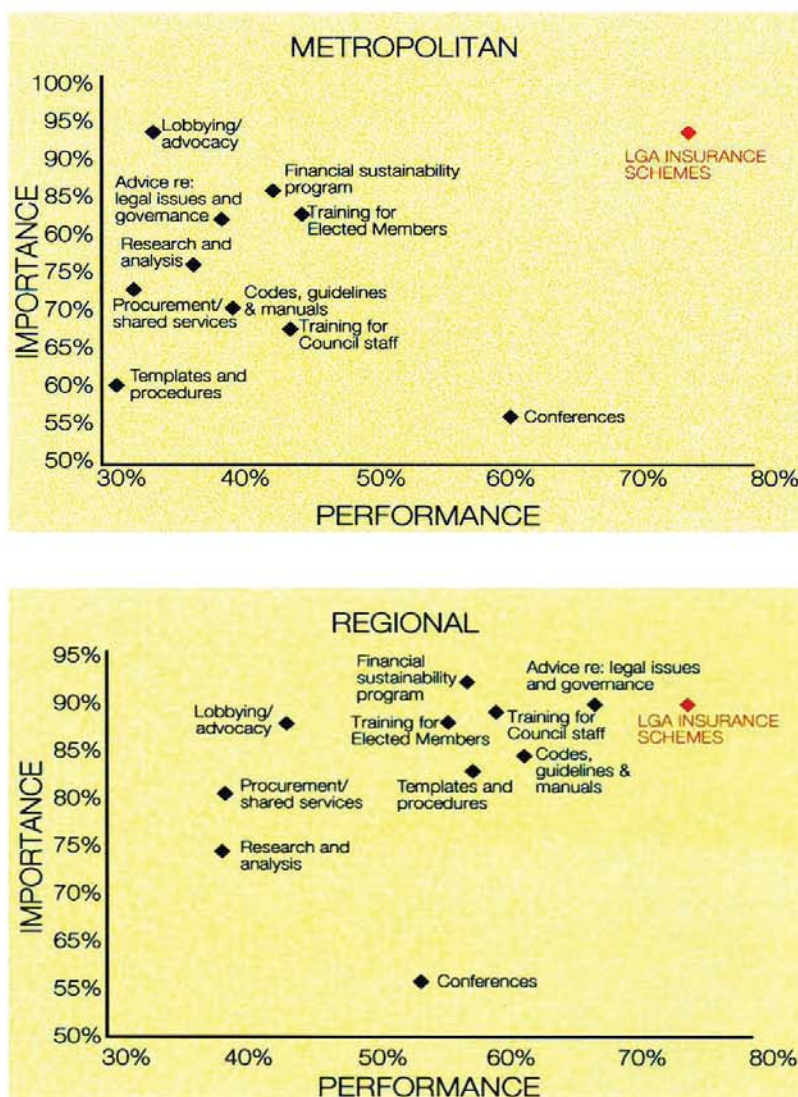
JLT provides a range of additional services to Councils that are focussed on risk management and mitigation across Councils:

- Climate change adaption – Mutual Liability Scheme
- Business resilience – Mutual Liability Scheme
- Health and Wellbeing programs – Workers Compensation Scheme
- Injury Management Compliance Audits
- One System Implementation Platform (OSIP), Essential Safety Platform (ESP) – Workers Compensation Scheme
- Regional Risk Coordinator Network comprised of LGRS employees (manager and nine risk coordinators) to share knowledge of changing requirements (e.g. with Work Health & Safety laws) – Mutual Liability Scheme and Workers Compensation Scheme.



### 7.2.1 User satisfaction

LGA member surveys and other feedback from Councils show a high degree of satisfaction with the services provided by JLT. The regional risk co-ordinators have generally been well received by Councils outside the metropolitan area.



The main area of dissatisfaction at present, especially from smaller Councils, is the high level of compliance activity needed for the Workers Compensation Scheme, including WHS arrangements. We understand that this is a consequence of the requirements to retain the self-insurance licence. Based on our other experience in South Australia, this is plausible. Note we have not approached RTWSA about this matter.

### 7.2.2 Risk management services

As noted above, JLT provides additional services such as the Regional Risk Coordinators.

The AMF, through LGRS, also provides members with thermographic inspections on selected assets, as part of its minimisation program. During these visits, onsite inspections were also performed, to confirm compliance of the electrical installations with Australia/NZ Wiring Rules (AS3000:2007).

We have reviewed some of the risk management services and acknowledge that these are positive steps that are being undertaken to mitigate and minimise risk. We believe there would be value in having more risk management activities directed at reducing claims or addressing high risk incidents.

In line with best practice we would expect that there may be opportunities to implement further governance processes around the risk management services currently offered.

### 7.2.3 Claims management

JLT provides claims management for all of the pooled arrangements.

Our review of the Workers Compensation Scheme gave us confidence that the claims management in that arrangement is of high quality. There is close liaison with the Council employer and the particular circumstances of Local Government are taken into account. The results of the Workers Compensation Scheme have been very good, and it is likely that the quality of claims management has contributed to this.

Feedback from the CE Leadership Group suggested that claims management is an area of strength in the overall structure and, coupled with the broad nature of the coverage, provides confidence and assurance to the Councils.

Overall, JLT's claims management expertise may be difficult to replicate, given its knowledge and experience in Local Government, particularly when combined with its risk management services deployed through the regional risk coordinators. However, claims management is one of the services that can be contestable and has a number of well qualified alternative providers operating in the market. If and when a decision is taken on market testing, this would be one of the services to be considered.

**Finding:** Overall the risk management and claim services are 'fit for purpose' and, with limited exceptions, are well regarded. There is always scope for improvement and components of risk management and claims management services could be contestable in the future.

## 7.3 Gross contributions less rebates

Under the current system of establishing contributions for each of the MLS and WCS, a gross contribution is established for the coming premium year. Following the commencement of the scheme year, a rebate (based in part on claims experience and in part on risk management activity) is paid to each council to arrive at a net contribution for the year. For the AMF and IPF, the accounts do not disclose whether any rebate was paid. Special distributions are considered separately in Section 7.4.2.



## LGA Insurance and Indemnity Arrangements

Table 7.1 summarises the recent gross and net contribution history.

**Table 7.1 – Summary of Recent Contributions**

	MLS			WCS			AMF			IPF		
	12/13	13/14	14/15	12/13	13/14	14/15	12/13	13/14	14/15	12/13	13/14	14/15
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Gross Contributions	13,185	13,645	13,880	27,758	29,480	31,501	14,404	15,125	15,368	4,793	5,299	5,834
Rebate	(3,002)	(3,156)	(3,156)	(10,489)	(10,604)	(11,915)	-	-	-	-	-	-
<b>Net Contributions</b>	<b>10,183</b>	<b>10,489</b>	<b>10,724</b>	<b>17,268</b>	<b>18,875</b>	<b>19,585</b>	<b>14,404</b>	<b>15,125</b>	<b>15,368</b>	<b>4,793</b>	<b>5,299</b>	<b>5,834</b>
<b>Rebate as % Gross</b>	<b>22.8%</b>	<b>23.1%</b>	<b>22.7%</b>	<b>37.8%</b>	<b>36.0%</b>	<b>37.8%</b>	-	-	-	-	-	-
<b>Inc % pa in Net Contribution</b>		<b>3.0%</b>	<b>2.2%</b>		<b>9.3%</b>	<b>3.8%</b>		<b>5.0%</b>	<b>1.6%</b>		<b>10.5%</b>	<b>10.1%</b>

Increases for MLS contributions have been modest for some years, reflecting a strategy of limiting contribution increases to movements annually in line with the SA Local Government Price Index. WCS gross contributions reflect movements in insured wages. Increases for the IPF have been substantial in recent years, reflective of the difficult environment for income protection generally, with rate increases of more than 10% per annum not uncommon.

Discussions with the CE Leadership Group highlighted:

- The current system of gross and net contributions is well understood
- The system of providing rebates based in part on the performance of individual Councils is well understood
- There is a very strong desire for stability in contributions from year to year
- Councils are prepared, at least in theory, to allow for some trade-off between lower contributions and year to year volatility in order to allow for stability in contributions.

### 7.3.1 Our Observations On The Current Approach

In our view, the current system of gross and net contributions for the MLS and WCS has three advantages:

- It gives a buffer for premium stability which, as highlighted above, is important for Councils
- It gives time to determine risk based premiums by Council and deliver by way of the rebate
- This optimises the chance that the rebate will act as an effective incentive.

In our view, however, the buffers are now too large; rebates have been more than 20% for a number of years. We believe that there is an opportunity to 'recalibrate' gross contributions at a lower level. In our experience, a buffer of say 10-20% generally provides an adequate allowance to provide some rebate for risk management incentives, as well as allowing some smoothing in contributions over time.

In making this observation, we also note that these Schemes have large accumulated surpluses and have provided additional special distributions in recent years (see below), suggesting that the current absolute level of contributions is more than adequate.

**Findings:** The current system of gross and net contributions provides incentives for risk management and allows for greater levels of year to year stability as increases/decreases can be 'smoothed'

however

the gross contributions for MLS and WCS could be reduced (with consequently lower rebates provided)

Note that further observations on the overall level of contributions, including in the Asset fund, are in Sections 8 and 9.

## 7.4 Accumulated Surplus Targets and Special Distributions<sup>2</sup>

### 7.4.1 Accumulated Surplus Position

Table 7.2 summarises the accumulated surpluses across the Schemes at June 2015.

**Table 7.2 – Accumulated Surpluses at June 2015**

	MLS	WCS	AMF	IPF	Total
	\$'000	\$'000	\$'000	\$'000	\$'000
Profit in Year	1,886	(3,187)	3,168	49	1,915
Special Distribution in Year	(1,500)	(1,500)	(505)	(170)	(3,675)
Surplus at Year End	27,243	24,946	13,855	2,852	68,896
<i>Net Contributions</i>	<i>10,724</i>	<i>19,585</i>	<i>15,368</i>	<i>5,834</i>	<i>51,511</i>
<i>Surplus as % Net Confs</i>	<i>254%</i>	<i>127%</i>	<i>90%</i>	<i>49%</i>	<i>134%</i>
<i>Net Outstanding Claims Provision</i>	<i>3,757</i>	<i>19,119</i>	<i>1,742</i>	<i>4,197</i>	<i>28,815</i>
<i>Surplus as % Net OSC</i>	<i>725%</i>	<i>130%</i>	<i>795%</i>	<i>68%</i>	<i>239%</i>

We note that the accumulated surplus policies for the MLS and WCS have been reviewed by their respective boards during 2016.

While a specific review of these policies is beyond the scope of this assignment, generally the funds are quite conservatively reserved and there may be opportunities to review the surplus retention policies, without materially impacting on Councils' security.

The total accumulated surplus across the four Schemes was \$69 million at 30 June 2015. Under the current governance structure, each Scheme/Fund is responsible for establishing and maintaining a separate accumulated surplus policy and target. While we support a conservative approach to financial management in mutual insurance Schemes, the historical approaches have, in aggregate, been more conservative than necessary.

<sup>2</sup> In other insurance contexts, these would often be referred to as Capital Adequacy or Solvency and Dividends respectively



**Finding:** Current accumulated surplus policies and level of surpluses are very conservative for MLS, WCS and AMF.

There is an opportunity to reduce overall surpluses without detriment to member Council security.

For IPF the current accumulated surplus is modest.

#### 7.4.2 Special distributions

Under the current accumulated surplus policies for each Scheme, if surplus is in excess of the agreed target range, a 'Special Distribution' can be paid to Councils. In some situations, rather than paying a special distribution, surplus assets may be used to fund specific program(s) or project(s). Table 7.3 summarises the special distributions paid in the three years to June 2015.

**Table 7.3 – Special Distributions**

	12/13	13/14	14/15
	\$'000	\$'000	\$'000
MLS	-	1,500	1,500
WCS	-	2,000	1,500
AMF	1,250	3,625	505
IPF	190	195	170
<b>Total</b>	<b>1,440</b>	<b>7,320</b>	<b>3,675</b>

In our view, payment of a special distribution in these circumstances is entirely appropriate. The surplus assets have been built up from Council contributions and experience, and the monies should be returned to them.

The fact that special distributions have become regular and substantial is further evidence that the financial management has been more conservative than it needs to be. With the exception of the IPF, net contributions in each of the other Schemes could be lower than at present, with the greatest potential reductions in the MLS and AMF because of the extensive reinsurance.

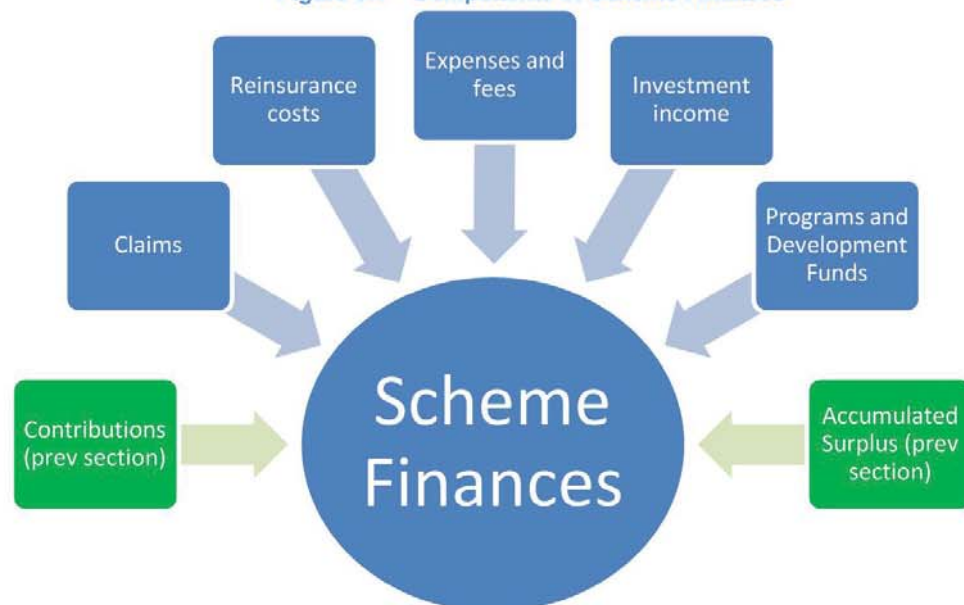
**Finding:** Regularity of special distributions highlights that contributions may be too high for MLS, WCS and AMF.

## 8 Financial management of the Schemes

*In this section we have used 'Scheme' to refer to any of the MLS, WCS, AMF or IPF.*

From the perspective of the Schemes themselves, there are a number of areas where value can be gained or lost.

Figure 8.1 – Components of Scheme Finances



Contributions and Accumulated Surplus have been dealt with in Section 7 due to their direct relevance to Councils.

### 8.1 Summary of observations

The 'value for money' issues associated with each of the components of Scheme income and expenditure are summarised in Table 8.1. For each of the relevant financial items outlined above the table describes the potential for poor value and our findings in relation to this.

Table 8.1 – Components of Scheme Finances

Item	Potential for poor value	Summary of our finding
Claim payments	Only to the extent that claims are poorly managed.	No evidence of poor management of claims.
Reinsurance Costs	If coverage is not necessary or 'above market' premiums are paid.	Access to pooled insurance is an advantage. Liability and Asset funds could retain more risk.
Expenses and Fees		
1. Remuneration to JLT	If JLT is paid amounts that are 'above market' for the services provided.	The revenue of JLT is considered commercial information and therefore is not disclosed in this report.
2. Money paid to LGA	If LGA is paid money from the Schemes that could be better utilised in another way.	Refer to Section 10 of the report for further discussion.
3. Government levies	Only if not necessary to pay them.	No evidence of unnecessary levy payments.
4. External service providers	If unnecessary services are bought, or 'above market' prices are paid.	No evidence of wastage.
Investment income	If there is a loss of value of investments or if returns are unnecessarily low	We support use of LGFA as the investment vehicle
Programs and development funds	If surplus funds are spent on programs that are not valuable to Councils and not relevant to insurance and indemnity.	Governing bodies need to be satisfied about a number of reinvestments and development funds currently in operation.

## 8.2 Claims

Section 7.2.3 discussed claims management from the perspective of Councils.

The discretionary nature of the insurance and indemnity arrangements means that there have been, and will be in the future, claims paid that would be 'outside' normal insurance contracts (Section 3.1.2).

While we have not examined claim files we have not observed, or been made aware of, any significant claim cost that is not of benefit to Councils.

## 8.3 Reinsurance

This section deals with:

- The cost of reinsurance and associated commissions
- The reinsurance coverage
- The Treasurer's Indemnity to the MLS

Technically the external protection of the Schemes is 'insurance' because the Schemes themselves are not insurers but are pools of risks. It is easier to understand, though, if it is referred to as 'reinsurance' which is what we do in this section.



### 8.3.1 Reinsurance costs

Table 8.2 – Reinsurance Costs

	MLS \$'000	WCS \$'000	AMF \$'000	IPF \$'000	Total \$'000
Net Contributions	10,724	19,585	15,368	5,834	51,511
Total Cost of RI	6,354	1,254	6,662	1,233	15,502
<b>Total Cost of RI as % Net Contributions</b>	<b>59%</b>	<b>6%</b>	<b>43%</b>	<b>21%</b>	<b>30%</b>

Reinsurance premiums, other than for IPF, have not been increasing much (if at all) in recent years, despite increasing exposure. This is largely a reflection of the very 'soft' reinsurance markets at the present time, with large volumes of capacity and very competitive pricing. In contrast, the market for disability type covers has had a very difficult few years and the cost of this reinsurance has been increasing rapidly.

The level of commission paid by each Scheme appears reasonable, given the nature of the cover purchased (see below), the complexities associated with the particular coverage and our understanding of reinsurance commissions in the market.

**Finding:** Reinsurance commission levels appear reasonable and broadly consistent with our understanding of reinsurance commission levels.

### 8.3.2 Reinsurance coverage

Reinsurance arrangements vary significantly by Scheme:

Table 8.3 – Summary of Arrangements

Scheme	Summary of Reinsurance	Finity comment
MLS	Essentially fully reinsured above Council deductibles. Part of 'group' reinsurance purchasing arrangement with SA, WA and NSW. Cover purchased to \$300 million and Treasurer's Indemnity (see Section 8.3.4) in excess of this amount.	Consistent with current arrangements in other states.  Very conservative program. The Scheme has the capacity to retain greater risk if market prices make it worthwhile.
WCS	Excess of loss, with retained cost of \$600,000 per claim (indexed).	Typical of reinsurance programs generally observed for self-insured WC.
AMF	Deductibles vary by claim type.  Overall retained limit of \$XXX million (removed on confidentiality grounds) per annum, with cover purchased to \$40 million per loss	Conservative program – the Fund has the capacity to retain greater risk if market prices make it worthwhile.



Scheme	Summary of Reinsurance	Finity comment
IPF	Cover for (up to) 104 weeks for most injuries (generally has a 10 day deductible), subject to annual aggregate of \$10 million per council and per accident  Exclusions for first year for WC claims	Recoveries have sometimes been greater than reinsurance expense.  Cost implications are discussed in Section 8.3.1

**Finding:** The extent of reinsurance is professionally reviewed each year and seems appropriate. The reinsurance programs for both MLS and AMF appear very conservative given the strong capital position of the Schemes.

### 8.3.3 Shared reinsurance for MLS

As outlined in Table 8.3, the reinsurance for MLS is purchased on a 'group' basis by JLT, with cover purchased for SA, WA and NSW, largely from the London market. The cost of cover is shared, although the basis of this sharing is not transparent. We understand the premiums are allocated based on actuarial advice in the London market.

In our view, the sharing of the reinsurance program is potentially a sound strategy, provided 'the price is right'. It can enable MLS to gain access to reinsurance at a lower cost than might otherwise be the case.

While beyond the scope of this assignment, in our view the current (and long term) strategy of seeking to fully insure all risks is a very conservative one. In our experience, it is not uncommon for discretionary mutual funds to retain up to say \$500,000 per claim, depending on their risk appetite and surplus position. Given the extremely strong surplus position of the MLS, there may be some opportunity to reduce the overall reinsurance program. This is discussed further in Section 9.

**Finding:** The shared purchase of liability reinsurance probably provides some savings relative to purchase by MLS alone.

### 8.3.4 Treasurers' indemnity for the MLS

The MLS (and only the MLS) has the benefit of a guarantee arrangement with SAFA, referred to as the Treasurers' Indemnity.

#### *History of the indemnity<sup>3</sup>*

The history dates back to the first Ash Wednesday bushfires of 1983. Stirling Council was found liable due its negligent management of a waste dump. With only a very small sum insured on its liability insurance policy, the Council was hopelessly insolvent.

The State Government bailed out the Stirling Council and in turn required the Local Government sector to acquire adequate liability insurance. The MLS was started in 1989 with the backing of a government

<sup>3</sup> As relayed to us

## LGA Insurance and Indemnity Arrangements

indemnity. The terms of the indemnity have been continuously updated since that time. Initially the Indemnity was provided above a relatively low limit but now provides coverage in excess of \$300 million.

### *The current indemnity arrangements*

The indemnity agreement places obligations on the MLS as well as providing benefits.

**Table 8.4 – Treasurers' Indemnity**

Obligations	Benefits
Must maintain minimum cover of \$300 million for General Liability (other lower limits apply for classes such as D&O)	Provides additional reinsurance protection to MLS: currently \$700 million for public liability giving total cover of \$1 billion In addition, if there is reinsurer failure in the MLS main program this additional cover would 'drop down' to protect MLS (this is a feature that is sometimes available in high level reinsurance covers)
MLS pays a fee of 3.9% of reinsurance premiums to SAFA for provision of the Indemnity	Access to reinsurance protection
Government nominates two Board members	Access to insurance knowledge in government

The indemnity agreement from the government requires that the MLS buy very high policy limits for liability coverages (i.e. to \$300m). While not part of the Indemnity, we note that under the Scheme Rules, the State government has two seats on the Board of the MLS.

**Finding:** The Treasurer's Indemnity is of benefit to the MLS, and the obligations are not particularly onerous provided placement of the minimum cover remains practical.

## 8.4 Expenses and fees

Total expenses (including compulsory government charges) for 2014/15 were as follows:

**Table 8.5 – Expense Rate**

	MLS	WCS	AMF	IPF	Total
	\$'000	\$'000	\$'000	\$'000	\$'000
Net Contributions	10,724	19,585	15,368	5,834	51,511
Total Expenses including all external fees, levies, etc (i.e. not just expenses paid to JLT)	3,974	8,377	3,513	1,267	17,131
<b>Total Expenses as % Net Contributions</b>	<b>37%</b>	<b>43%</b>	<b>23%</b>	<b>22%</b>	<b>33%</b>

Our observations on the total expenses are as follows:

- **MLS:** The expense rate of 37% is a little high. We note that this includes Risk Management expenses of around \$1.4 million (13%) suggesting total insurance expenses of around 20%, which is not unreasonable.
- **WCS:** The expense rate of 43% is a little high. However, this includes compulsory RTWSA levies of around \$1.7 million (8.7%) and also Risk Management expenses of a further \$1.7 million (8.7%). Overall expenses are not unreasonable.
- **AMF:** The expense rate of 23% is reasonable.
- **IPF:** The expense rate of 22% is reasonable.

**Finding:** The expense rates (after allowing for impact of risk management and compulsory charges) for all schemes are reasonable.

## 8.5 Investments and investment income

Investments are all placed with LGFA (the Local Government Finance Authority of South Australia), and have been for a considerable time. Investments are mainly in the form of term deposits.

We believe that this investment approach is appropriate because:

- It is low risk, with a minimum risk of loss of capital value
- It directly supports the local government sector by providing funds that LGFA can on-lend to the sector at favourable interest rates
- It enables the financial guarantee to be provided for the Workers Compensation scheme in a practical and cost effective manner.

Current investment returns are very low. However, the schemes do not rely on investment income for viability and there are risks with chasing higher returns. Those risks are exemplified in the losses many local government bodies suffered by investing in 'collateralised debt obligations' structured by the now insolvent Lehman Bros.



**Finding:** The current investment approach for all Schemes is appropriate even though returns are low. Funds are invested with LGFA and so indirectly supports Councils.

## 8.6 Accumulated surplus positions

In Section 7 we concluded that, with the exception of the IPF, the accumulated surplus policies and positions were more conservative than needed, and in this respect the Schemes could achieve better value for Councils.

## 8.7 Programs and development funds

There are many programs and development funds that have been funded by the Schemes in recent years. This is part of the benefit of the mutual structure, as all Councils can benefit from this pooled approach. These have included:

- All Schemes
  - ▶ Various sponsorships and awards
  - ▶ Development funds (other than IPF) which have been used to fund various projects, either at individual council or whole of program level
- MLS
  - ▶ Projects on adaptation to climate change (pre 2013)
- WCS
  - ▶ Health and well-being programs (in excess of \$0.5 million p.a.)

Detailed review of the programs is beyond the scope of this review. The funding and scope of programs is approved by the Boards and Oversight Committees.

**Finding:** The governing bodies should have active oversight over approval, funding and performance of various programs and development funds that are supported by the Schemes.



## 9 Individual Scheme issues

Sections 7 and 8 have covered a broad range of issues. In this section, we have summarised our observations as they relate to each of the Schemes and Funds individually.

*The figures in this section are sourced from the Annual Reports of each of the Schemes/Funds.*

### 9.1 Mutual Liability Scheme (MLS)

MLS financials over the last three years can be summarised as follows:

**Table 9.1 – MLS Financials**

	12/13	13/14	14/15
	\$'000	\$'000	\$'000
Member Contributions:			
Gross	13,185	13,645	13,880
Rebate	(3,002)	(3,156)	(3,156)
Net Contributions	10,183	10,489	10,724
Reinsurance	(6,102)	(6,526)	(6,354)
Net Income	4,081	3,962	4,370
Net Claims Expense	344	(394)	(73)
Base Administration Expense	(1,135)	(1,170)	(1,196)
Investment Income	1,276	998	1,126
Other Administration Expenses	(2,682)	(2,533)	(2,341)
<b>Operating Surplus</b>	<b>1,884</b>	<b>865</b>	<b>1,886</b>
<b>Net Assets of Scheme</b>	<b>27,492</b>	<b>26,857</b>	<b>27,243</b>

*Full financials can be found in Appendices of original report.*

Our observations and findings relative to the Liability scheme include:

- The system of gross and net contributions should be reviewed, with a view to reducing the level of gross contributions.
- Taken together, we believe there is a substantial opportunity to **review either or both** of the accumulated surplus and reinsurance policies as outlined in previous sections.

**Finding:** Given the current operating structure, with little risk retained by MLS, there is an opportunity to review contribution arrangements, the accumulated surplus policy and the extent of reinsurance protection

## 9.2 Workers Compensation Scheme (WCS)

WCS financials over the last three years can be summarised as follows:

**Table 9.2 – WCS Financials**

	12/13	13/14	14/15
	\$'000	\$'000	\$'000
Member Contributions:			
Gross	27,758	29,480	31,501
Rebate	(10,489)	(10,604)	(11,915)
Net Contributions	17,268	18,875	19,585
Reinsurance	(1,092)	(1,219)	(1,254)
Net Income	16,177	17,657	18,331
Net Claims Expense	(8,599)	(8,160)	(15,144)
Base Administration Expense	(1,893)	(1,988)	(2,096)
Investment Income	2,326	1,816	1,777
Other Administration Expenses	(5,624)	(6,166)	(6,056)
<b>Operating Surplus</b>	<b>2,385</b>	<b>3,159</b>	<b>(3,187)</b>
<b>Net Assets of Scheme</b>	<b>28,475</b>	<b>29,634</b>	<b>24,946</b>

*Full financials can be found in Appendices of original report*

The net claims expense increase in 2014/15 was due to an increase in the value of outstanding claims, as assessed by the actuary. We understand that this has been reduced at June 2016, with a corresponding reduction in claims expense (although noting that we believe these accounts are still being audited).

In respect of the Workers Compensation scheme our findings include:

- The operating loss in 2014/15 was due to an increase in the actuary's estimate of liabilities which has been largely reversed in 2015/16.
- The system of gross and net contributions should be reviewed, with a view to reducing the level of gross contributions.
- The Scheme retains a significant amount of risk, resulting in volatility of claims expense and operating surplus. Therefore it needs a strong accumulated surplus.
- Nonetheless, we regard the accumulated surplus policy as being at the conservative (high) end of a reasonable range.
- Expenses include compulsory license fees paid to RTWSA. There are substantial amounts spent on systems and compliance – given our experience of the workers' compensation system in South Australia this overall expenditure may well be required.
- Feedback from Councils was that this Scheme was a source of dissatisfaction, primarily arising from the heavy compliance burden attributed to the self-insurance licence conditions. There is an opportunity to address this concern by continuing ongoing consultation with RTWSA and further communication with Councils. This is something that LGA may wish to pursue regardless of its adoption of any other recommendations in this report.

**Finding:** The current level of accumulated surplus in WCS is conservative and there may be an opportunity to review this and the contribution structure.

Council dissatisfaction with compliance requirements should continue to be addressed.

### 9.3 Asset Mutual Fund (AMF)

AMF financials over the last three years can be summarised as follows:

**Table 9.3 – AMF Financials**

	12/13	13/14	14/15
	\$'000	\$'000	\$'000
Net Contributions	14,404	15,125	15,368
Reinsurance	(6,734)	(6,855)	(6,662)
Net Income	7,670	8,270	8,706
Net Claims Expense	(3,489)	(3,775)	(3,606)
Base Administration Expense	(1,430)	(1,507)	(1,535)
Investment Income	522	619	491
Other Administration Expenses	(773)	(1,052)	(889)
<b>Operating Surplus</b>	<b>2,500</b>	<b>2,554</b>	<b>3,168</b>
<b>Net Assets of Scheme</b>	<b>12,264</b>	<b>11,193</b>	<b>13,855</b>

*Full financials can be found in original report.*

Observations about the AMF include:

- Taken together, we believe there is a substantial opportunity to review either or both of the accumulated surplus and reinsurance policies

- **Finding:** Given current operating structure in the AMF, there is a clear opportunity to review the current contributions arrangements, accumulated surplus policy and extent of reinsurance protection purchased.

## 9.4 Income Protection Fund (IPF)

IPF financials over the last three years can be summarised as follows:

**Table 9.4 – IPF Financials**

	12/13	13/14	14/15
	\$'000	\$'000	\$'000
Net Contributions	4,793	5,299	5,834
Reinsurance	(841)	(1,121)	(1,233)
Net Income	3,953	4,178	4,601
Net Claims Expense	(2,835)	(3,346)	(3,764)
Base Administration Expense	(571)	(646)	(708)
Investment Income	169	187	204
Other Administration Expenses	(114)	(132)	(284)
<b>Operating Surplus</b>	<b>601</b>	<b>241</b>	<b>49</b>
<b>Net Assets of Scheme</b>	<b>2,927</b>	<b>2,973</b>	<b>2,852</b>

*Full financials can be found in original report.*

In contrast to the other funds, the overall level of accumulated surplus in this fund is quite modest.

Observations about the IPF include:

- Overall level of surplus is relatively modest and the fund has broken even only because reinsurance has been profitable for the Fund.
- Experience in the general market in relation to disability insurance in recent years has been very adverse and substantial increases in premiums have been observed across the market. This can be seen in the increased costs of reinsurance for the IPF, which has increased by almost 50% in two years, compared to a 22% increase in contributions
- Our understanding is that the external market is still experiencing substantial increases and hence further material increases in contributions should be expected by Council members
- The smaller level of accumulated surplus makes it much more difficult for this fund to absorb 'shocks'
- It may be necessary for the Fund to consider reducing the scope of benefits offered if claims experience and insurance market conditions continue to be difficult.

**Finding:** The current external market conditions suggest that future substantial increases in contributions may be required in the IPF to maintain solvency and meet costs of reinsurance.



## 10 Remuneration for JLT and LGA

This section considers in more detail the remuneration arrangements in place for both JLT and LGA.

As these arrangements are currently the subject of ongoing commercially sensitive negotiations, the majority of this section has been omitted. As noted elsewhere in the report, the overall level of expenses in the Schemes are not unreasonable.

### 10.2 LGA revenue from insurance and indemnity arrangements

The Association itself (LGA) receives revenues from the insurance and indemnity Schemes, comprising:

- Payments from the Schemes (variously named)
- A % of commissions paid by insurers to JLT
- Rent for LGA House.

The costs to LGA include:

- Management time in working with the Scheme manager and with Councils on insurance issues
- Management time on Scheme Boards and Committees
- Dealing with other stakeholders such as the Auditor-General and SAFA
- Property cost of the space rented to JLT.

The revenue that LGA receives from the arrangements (including the full amount of office rent) was about \$2.9 million in 2014/15.

#### 10.2.1 Are the LGA arrangements appropriate?

It is normal practice for a 'sponsoring organisation' such as LGA to receive revenue from any group insurance arrangements that it promotes or provides. The 2014/15 amount of \$2 million (excluding rent) is about 4% of the total amount paid by Councils, and this level of revenue is about typical in the marketplace.

Leaving aside the rent, the contribution to LGA finances is roughly the same as the total of member subscriptions to LGA. If this revenue was removed and not replaced by any alternative, this would have a significant impact on LGA's financial sustainability.

While there is nothing inherently wrong with LGA being partially funded from the insurance and indemnity arrangements there are risks that must be considered and governance needs to be suitable.

Governance arrangements that will mitigate risks in the arrangement would include:

- oversight of the LGA revenue and activities in respect of the Schemes
- The 'contract management' function for LGA including a focus on remuneration – validation, transparency and review

## LGA Insurance and Indemnity Arrangements

- Transparency in communication to Councils about the significance of the revenue source to LGA finances.

**Finding:** Remunerations arrangements for LGA could be more transparent.

It is normal practice for a sponsoring organisation to receive revenue from arrangements such as LGA has in place for the councils.

**Recommendation:** We would recommend greater transparency of the JLT and LGA remuneration arrangements.

## Part V Other Aspects of the Review

There are further parts of the scope of the review and completeness of our reporting that are included in this part:

- Market testing and benchmarking
- The extent to which our findings respond to the issues raised in the Auditor General's report of 2015 and the KPMG review of 2013
- Reliances and limitations relating to our project and report.

### 11 Market testing and benchmarking

When we started this project, there was some expectation that a form of market testing might be recommended. In the present situation, where there has been a long-standing service provider relationship, testing the market is a logical approach and would accord with good governance.

#### 11.1 A decision about market testing needs to be deferred

We have concluded that any decision about market testing needs to be deferred until other reforms have been completed, with the Schemes being structured to make components of the products and services more readily contestable.

There are a number of reasons for this finding which, when combined, led us to the conclusion:

- Market testing would not be legally possible within the current structures.
- JLT is the market leading provider to local government; we are satisfied that there is no alternative provider in the Australian market that could currently bring a complete single offering for the current range of products and services.
- The need to ensure continuity of support to Councils. There is great value in retaining 100% membership by Councils.
- A full market testing process would be a project of such size and complexity that the time and cost involved would be hard to justify in light of the other findings.

The reforms that would be needed before market testing is undertaken include:

- Reform of the overarching agreements with JLT.
- Restructure the individual agreements so that components of the services can be separated and made contestable.
- Improve governance arrangements so that LGA is well placed to manage any market testing.

**Recommendation:** LGASA should continue its broad relationship with JLT on insurance and indemnity arrangements. Any decision on potential market testing should be deferred until revised legal and governance arrangements are in place, with the Schemes being structured to make components of the products and services more readily contestable.

## 11.2 Benchmarking of products, services and costs

An alternative way of assessing the arrangements would be to conduct a benchmarking exercise that considers the products and services provided, and the costs of providing them, with other similar arrangements.

**Finding:** It is worth considering some benchmarking with other state local government associations, although this process would have its own difficulties and needs to be approached carefully.



## 12 Responses to external reports

After completing our review we thought it would be helpful to document how it is responsive to the Auditor-General's report published in September 2015.

An analysis of our findings and recommendations relative to the 2013 independent review by KPMG is also included later in this section.

### 12.1 Auditor General Report

It is important to note that the scope of our work is not the same as the Auditor General, in fact being broader in some respects such as covering all the insurance and indemnity arrangements not just the two Schemes. The Auditor General's scope<sup>4</sup> referenced 'governance, administrative and financial arrangements' for the two Schemes.

An analysis of our findings and recommendations relative to the 2013 independent review by KPMG is also included later in this section.

Topic	Recommendation	Our position
4.1 Contract management policy	Develop, adopt and apply a contract management policy framework	We agree – see section 6 for recommendations
4.2 Monitoring and evaluation	Review roles and responsibilities in this regard. Formalise performance based arrangements	Much of this report directly responds to this recommendation
4.3.1 Contracts and documentation	Review the contractual documentation	We have reviewed the contractual documentation and our findings are in Section 5
4.3.2 Performance based arrangements	Establish clear, relevant and measurable performance indicators	A future responsibility of the Board(s)
4.4 Scheme manager remuneration	Ensure clear wording on fees, review calculations and sign off	See sections 8.4 and 10 for our findings
	Fix GST problems and uncertainty	Revised contracts to be explicit about GST. Advice re any (existing) overpayment still to be sought.
	Authorise and document all fee variations	Recommended contract structure and processes respond to this
	Define 'gross contributions' and link management fee correctly	We recommend the use of net contributions and a shift towards fixed dollar amounts  In the interim, detailed schedule of fee payments currently being prepared with the view to confirming interpretation.
4.5 Reporting to LGA Board	Comply with the Rules – report as required	We recommend greater use of the Audit Committee and less detail reported to LGA

<sup>4</sup> Section 1.1, page 1; a more complete statement of scope is in Section 2, page 4

## LGA Insurance and Indemnity Arrangements

Topic	Recommendation	Our position
	Confidentiality protocols	Board than suggested.  Checklist of reports required as per the current Agreements has been developed. Audit Committee will be reviewing end of year audit report for the Schemes, as part of the LGA's end of year audit processes.
4.6 Perceived conflict of interest and role	Reconsider JLT position; improve processes	Our extensive recommendations are in Section 6
4.7 Committee roles and responsibilities	Fix Overview Committee and working parties	See Section 6
4.8 Delegations of authority	LGA adopt formal delegations, including internal	Board(s) will ensure this occurs
4.9 Framework of policies	Untimely review of investment policy	We support continuation of LGFA investment policy – see Section 8.5
	Untimely review of accumulated surplus policy	Policies tend to be on the conservative side – see Section 0
	Risk management policy and assessment for Schemes	Governance arrangements for Board(s) will include these activities
	Improve documentation of policies	We agree – not difficult to do. Include in Governance Manuals
4.10 Address KPMG review	Complete actions and improve documentation	We believe that all of the issues from KPMG have now been dealt with or subsumed by the AG review and/or this review

We have been advised that LGA have provided a copy of the full report to the Auditor General's office, and have been providing updates, and will continue to do so as necessary.

## 12.2 Response to KPMG report

The independent review of the self-insurance services provided by JLT was conducted by KPMG in 2013. The findings of the report were expressed mainly in the form of 'potential opportunities for improvement'. A summary of our assessment of progress and the relationship with relevant parts of our report is below.

## LGA Insurance and Indemnity Arrangements

Opportunity	Our position
1. Formal strategies for the Schemes	Satisfactory
2. Formal operating plans for Schemes	Satisfactory
3. Evolve to performance based arrangements	We are cautious about moving to performance based remuneration based on our experience with similar situations see Section 6
4. Formalise procurement processes	Forms part of the contract management function established within LGA to work with the Schemes
5. Framework for rebates, distributions and programs	Specific recommendations in the report
6. Evolve Board arrangements	Specific recommendations in the original report
7. Balance of Scheme and council interests	See Section 7.2.3 for comments on Workers Compensation
8. Formalise Scheme to council communication	We don't see any further need
9. Regional risk co-ordinator function	Broadly it is well regarded
10. Efficiency opportunities	Future Board(s) well placed to pursue these opportunities.

We believe that reference to following through recommendations on the KPMG report can now be closed. Actions are either completed or subsumed into this review.



## 13 Reliances and Limitations

### 13.1 Distribution and use

This report is provided for the sole use of LGA for the purpose stated in Section 1 of this report.

It is not intended, or necessarily suitable, for any other purpose. This report should only be relied on by LGA for the purpose for which it is intended.

You can provide this report (and/or the original report) to the Auditor General and other relevant ministers and departments of the Crown in South Australia. If you do this, you should provide the report in full.

You can provide relevant sections of this report to the boards of the Mutual Liability Scheme, the Workers Compensation Scheme and the Trustees and Oversight Committees of the Asset Mutual Fund and the Income Protection Fund. You may also provide relevant sections of this report to JLT.

You can provide this report to Councils (but not the original report). No other distribution of the report is allowed, unless we give our approval in writing. Councils and any third parties receiving this report should not rely on it, and this report is not a substitute for their own due diligence. We accept no liability to third parties relying on our advice.

Please read the report in full. If you only read part of the report, you may miss something important. If anything in the report is unclear, please contact us. We are always pleased to answer your questions.

### 13.2 Data provided

We relied on the completeness and accuracy of the information we received. If the information provided to us is inaccurate or incomplete, please let us know as we may need to change our advice.

We did not audit or verify the information provided to us, but have reviewed it for general reasonableness and consistency.

### 13.3 Uncertainty

Many things may change in the future. We have formed our views based on the current environment and what we know today. If future circumstances change, it is possible that our findings may not prove to be correct.



LGA Insurance and Indemnity Arrangements

## Part VI Appendices

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*For the sake of brevity, the appendices to the full report have been omitted from this report.*

## **7.2 Internal Financial Controls Monitoring Risk Based Methodology**

### **Brief**

This report presents the City of West Torrens Financial Internal Controls Self-Assessment Methodology to be applied as part of the external audit Internal Financial Controls Opinion.

### **RECOMMENDATION(S)**

It is recommended to the Audit and Risk Committee that this report be received.

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### **Introduction**

As part of the external audit financial internal controls opinion process, the City of West Torrens (CWT) undertakes a Financial Internal Control Self-Assessment (FICSA). Historically, this has been undertaken via the assessment of each core control matched against the Better Practice Model. This requires the CWT to undertake an annual self-assessment of some 323 internal controls regardless of the level of risk associated with each core control.

### **Discussion**

As part of the approved 2016/17 Internal Audit Program, Galpins was engaged to complete a review of the FICSA process. The review identified that the application of risk-based methodologies to the FICSA would:

- streamline the process;
- result in efficiencies; and
- resource savings could be made.

Essentially, using this risk based methodology will reduce the number of controls to be self-assessed from 323 to 87 controls.

The results from the internal audit review into the FICSA process is available in the Internal Audit Program Update report contained in this agenda. However, Tim Muhlhausler from Galpins has been invited to present the key findings of this review to the Committee and explain how the risk-based methodology will be applied to future FICSAs.

### **Conclusion**

Tim Muhlausler, Galpins, has been invited to present the key findings of the review of the FICSA approach along with information about the new approach to Council's financial internal control self-assessment which will be applied to future FICSAs.

### **Attachments**

Nil

## **8 REPORTS OF THE CHIEF EXECUTIVE OFFICER**

### **8.1 FINANCIAL REPORTING AND SUSTAINABILITY**

#### **8.1.1 Financial Reporting**

##### **Brief**

This report lists those finance related reports which were considered by Council between 8 February 2017 and 16 May 2017

##### **RECOMMENDATION(S)**

It is recommended to the Audit and Risk Committee that the Financial Reporting report be received.

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##### **Introduction**

The Audit and Risk Prescribed General Committee (the Committee) is presented with a list, at each ordinary meeting, of those finance related reports considered by Council since the Committee's last ordinary meeting. These reports and associated minutes, which are detailed below, are available on Council's website at [www.westtorrens.sa.gov.au](http://www.westtorrens.sa.gov.au).

##### **Discussion**

The following reports were considered by Council/Council Committee between 8 February 2017 and 23 May 2017.

##### **21 February 2017**

- Creditor Payments
- Taxi Voucher Usage
- Elected Members Telephones
- Register of Allowances and Benefits - Six Months to 31 December 2016
- Council Budget Report - Seven Months to 31 January 2017
- Budget Review - December 2016

##### **21 March 2017**

- Creditor Payments
- Council Budget Report - Eight Months to 28 February 2017

##### **4 April 2017**

- Budget and Annual Business Plan 2017/18

##### **18 April 2017**

- Creditor Payments
- Property Leases
- Council Budget Report - Nine Months to 31 March 2017
- Mendelson Financial Report march 2017

##### **02 May 2017**

- Nil

**16 May 2017**

- Creditor Payments
- Taxi Voucher Usage
- Elected Members Telephones
- Register of Allowances and Benefits - 9 Months to 31 March 2017
- Council Budget Report - Ten Months to 30 April 2017
- Budget Review - March 2017

**Conclusion**

This report lists those finance related reports which were considered by Council between 8 February 2017 and 16 May 2017.

**Attachments**

Nil

**8.2 INTERNAL CONTROLS AND RISK MANAGEMENT SYSTEMS**

Nil

**8.3 INTERNAL AUDIT****8.3.1 2016-17 Internal Audit Program Update****Brief**

This report presents the status of the 2016-17 *Internal Audit Program*.

**RECOMMENDATION(S)**

It is recommended to the Audit and Risk Committee that this report be received.

**Introduction**

An update report is provided to each ordinary meeting of the Audit and Risk Prescribed General Committee (the Committee) on the status of current and, if appropriate, the previous Internal Audit Program.

**Discussion**

This report summarises the status of all audits contained in the 2016-17 *Internal Audit Program* (the Program) to date as follows:

<b>Audit Status</b>	<b>Number</b>
Complete	7
In Progress	5
Deferred / Rolled Over	0
<b>Total Audits Programmed (excluding staged audits)</b>	<b>12</b>
Cancelled	1*
Staged Audits Complete	1
Staged Audits in Progress	3



\*The planned Safety Data Sheets Management Audit is cancelled in order to bring forward a Contractor Management Audit.

The 2016/17 *Internal Audit Program* Report, as at 15 May 2017, is attached (**Attachment 1**).

### **Audits Completed**

Seven (7) of the twelve (12) programmed audits and one (1) of the four (4) staged/facilitative audits are complete. Therefore, eight (8) audits are now complete as follows:

<b>No.</b>	<b>Audit Description</b>	<b>Meeting Presented</b>
1.	Probity Audit	October 2016
2.	Lease and Licence Management	October 2016
3.	Third party audit - Vic Roads	Not Applicable
4.	Security Vulnerability Assessment - Part 1	October 2016
5.	Event Management	February 2017
6.	Lease Royalties - Third Party Audit	February 2017
7.	Business Continuity Plan - Review and Exercise Event	February 2017
8.	Internal Financial Control Review	May 2017

### **Compliance Audits in Progress**

1. Accounts Payable - this audit, undertaken by the contract internal auditor is in progress with data collection underway.
2. Staff Health and Safety - Internal Controls from the WHS Hazard Register - this audit, undertaken by the contract internal auditor is in progress with an opening meeting scheduled during April 2017.
3. Section 7 Statements - this audit, undertaken by the contract legal auditor is in progress with an opening meeting held during May 2017.
4. Food Act 2001 - this audit, undertaken by the contract legal auditor is in progress with an opening meeting held during May 2017.
5. Contractor Management Audit - this audit, to be undertaken by the contract internal auditor is in progress with an opening meeting scheduled for June 2017.

### **Facilitative Audits Underway**

A facilitative audit aims to add value by assisting stakeholder(s) to put improved governance mechanisms in place. This is an outcome driven audit, working with the stakeholder(s) to establish objectives and agreed outcomes via facilitation, advice and consultation.

The following two (2) audits are facilitative audits spanning multiple internal audit programs:

1. *Debtor Management* - this facilitative audit is in progress.
2. *The Maintenance of Plant and Equipment - City Works* - stage one is currently underway and an update is provided within this agenda.

\*The gap analysis for both facilitative audits was completed and presented to the July 2016 Committee meeting.

### ***Continuous (Staged) Audits Underway***

A continuous audit is a larger audit with many interrelated components that may be segmented into key test stages to track and record assurance/completion and to add value throughout the project/activity over time.

One continuous audit spanning multiple internal audit programs is in place:

1. *Continuous Audit - Procurement Roadmap (CAPR)*

Stage 1 of the CAPR audit is complete and was presented to the April 2015 meeting of the Committee while Stage 2 has yet to commence.

### ***Audits Not Started***

All Audits have commenced

### ***Audits Cancelled***

1. *The Safety Data Sheets Management Audit is cancelled and has been substituted with a Contractor Management Audit.*

### ***Audit Plan Progress***

Seven (7) of the twelve (12) planned audits are complete (58%) excluding staged audits. As at May 2017 all 12 planned audits (100%) are either complete or in progress. One (1) of the four (4) facilitative/continuous audits is complete while three (3) remain in progress with activity spanning over multiple internal audit programs.

### **Conclusion**

This report presents a status update of the 2016-17 *Internal Audit Program* and indicates that the program is back on track.

### **Attachments**

1. **Internal Audit Program Update as at May 2017**
2. **Legislative Audit Scope - Land and Building (Sale and Conveyancing) Act 1994**
3. **Legislative Audit Scope - Food Act 2001**
4. **Internal Audit Scope - Contractor Management**
5. **Internal Financial Control Monitoring Methodology**
6. **Proposed Financial Control Monitoring letter of support from BDO**



## 2016/17 Internal Audit Program

Report as at 15 May 2017

Audit Number	Internal Audit	Audit Objectives	Quarter	Status	Comments
3	Event Management	<ul style="list-style-type: none"> <li>The review of two significant and one minor event across the organisation since July 2015.</li> <li>Design, undertake and present the results of a stakeholder survey to measure current performance, strengths, weakness and opportunities to improve efficiency.</li> <li>Identified opportunities for the introduction of better practices and process improvement</li> </ul>	1	Complete	The audit, undertaken by the Contract Internal Auditor, is complete and the final report was presented to the 14 February 2017 meeting of the Committee.
<b>Status of 2016/17 Internal Audits</b>					
<b>Assurance Audits</b>					
4	Business Continuity Plan - Review and Exercise Event.	To assess the level of compliance with the: <ul style="list-style-type: none"> <li>A surprise mock event or scenario designed to test the effectiveness of the Business Continuity Plan (BCP) when dealing with the event/scenario.</li> </ul>	1	Complete	The BCP 'crypto locker' exercise event, facilitated by Deloitte, was completed during November 2016 and the summary report was presented to the February 2017 meeting of the Committee.
5	Accounts Payable	<ul style="list-style-type: none"> <li>An appropriate approval process is in place and in line with the CEO sub-delegations and Administration Policy: Financial Authorities</li> <li>Internal controls are assessed and operating effectively, including separation of duties</li> <li>Expenditure registers are maintained where applicable, including the Local Government Act 1999 (s79 Register of allowances and benefits and s105</li> </ul>	2	In Progress	Audit scope is approved and was presented to the February 2017 meeting of the Committee. The Audit commenced during February 2017 and electronic data continues to be collated.

Not Started	In Progress	Complete	Deferred	Cancelled
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Page 2 of 8



## 2016/17 Internal Audit Program

Report as at 15 May 2017

Audit Number	Internal Audit	Audit Objectives	Quarter	Status	Comments
		Register of remuneration, salaries and benefits) • Alignment with the Enterprise Risk Management Framework/operational risk register • Audit will also undertake data analysis of accounts payable data using data analytics software in order to analyse accounts payable data over an extended period.			
6	Security Audit	A twelve month audit designed to: • Undertake security vulnerability assessment • Consult on results/outcomes • 12 month access to 'BeSecuritySmart' security awareness videos • Audit and continuous improvement - conduct a secondary vulnerability assessment.	12 months	Complete	The 'vulnerability assessments' was completed by CQR Consulting during July 2016. A summary of the audit findings and Information Services post-review action was presented to the October 2016 meeting of the Committee.
<b>Legislative Audits</b>					
7	Section 7 Statements	• To be defined	4	In Progress	Audit scope has been approved ( <b>Attachment 2</b> ), this audit, undertaken by the Contract Legal Auditor commenced during May 2017.
8	Food Act 2001.	• To be defined	4	In Progress	Audit scope has been approved ( <b>Attachment 3</b> ), this audit, undertaken by the Contract Legal Auditor, commenced during May 2017.
<b>Third Party Audits</b>					

	Not Started	In Progress	Complete	Deferred	Cancelled
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Page 3 of 8

## 2016/17 Internal Audit Program

Report as at 15 May 2017

Audit Number	Internal Audit	Audit Objectives	Quarter	Status	Comments
9	Vic Roads Annual Audit	Self-assessment mandated as part of the agreement with Vic Roads	1	Complete	Program Leader Internal Audit and Risk completed this audit during August 2016.
<b>WHS Audits</b>					
10	Hazard Register - WHS Controls Audit	<p>The objectives of this audit are to evaluate and report on:</p> <ul style="list-style-type: none"> <li>Audit will sample departmental hazards from the each departments hazard register and review the: <ul style="list-style-type: none"> <li>completeness and existence of hazard registers and associated risk assessments</li> <li>processes and controls in place to ensure legitimacy</li> <li>linkage with the Enterprise Risk Management Framework through the use of the risk matrix.</li> </ul> </li> </ul>	2	In progress	Audit scope is approved and was presented to the February 2017 meeting of the Committee. The audit commenced during April 2017.
11	Safety Data Sheets (SDS) Management	<ul style="list-style-type: none"> <li>To be defined</li> </ul>	3	Cancelled	The Safety Data Sheets (SDS) Management audit is cancelled to be replaced by a broader Contractor Management Audit (below).
11 (new)	Contractor Management Audit	<p>The purpose of this audit is to:</p> <ol style="list-style-type: none"> <li>document progress against the 2012 audit findings and re-evaluate the overall compliance rating</li> <li>establish policy compliance against the WHS Act and Regulations</li> <li>report on departmental compliance against the current version of CWT Contractor Management Policy with</li> </ol>	4	In Progress	<p>A contractor management audit occurred in 2012, issuing a compliance rating of non-compliant.</p> <p>A review audit was scheduled in the next Internal Audit Plan, but will be brought forward to align with the WHS policy review update.</p> <p>The audit scope is approved (<b>Attachment 4</b>) and will be undertaken by the Contract Internal Auditor, supported by Adelaide OHS Consultants.</p>

	Not Started	In Progress	Complete	Deferred	Cancelled
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## Report as at 15 May 2017

## 2016/17 Internal Audit Program

Audit Number	Internal Audit	Audit Objectives	Quarter	Status	Comments
		emphasis on contractor induction, monitoring and evaluation. 4. report on compliance with the WHS aspects of contractor engagement as part of the procurement process, specifically the WHS information being provided and evaluated as part of the tender/quotation.			
12	Lease Royalties - Third Party Audit	To assess: <ul style="list-style-type: none"> <li>The accuracy of royalty payments made during the 2014/15 financial year.</li> <li>Insurance and indemnity cover complies with the lease agreements.</li> </ul>	1	Complete	The audit, undertaken by the Contract Internal Auditor, is complete and the final report was presented to the 14 February 2017 meeting of the Committee.
<b>Facilitative Audits (Long term duration).</b>					
13	Maintenance Plant and Equipment - Operational Sites	<p><b>Stage 1 - Develop Solution Action Plan</b> An objectives and agreed outcomes report will replace the traditional audit findings report. This report will use internal resources to investigate those gaps previously identified and use a 'cause and effect' approach to identify and document:</p> <p><b>Gap Analysis (Internal Work Group)</b></p> <ul style="list-style-type: none"> <li>What should be done;</li> <li>What is currently being done;</li> <li>Significant differences between 'what should' and 'what is' being done;</li> <li>Assess the current residual risk in respect</li> </ul>		In Progress	Phase 1 is in progress. The gap-analysis was presented to the July 2016 meeting of the Committee.

	Not Started	In Progress	Complete	Deferred	Cancelled
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## Report as at 15 May 2017

## 2016/17 Internal Audit Program

Audit Number	Internal Audit	Audit Objectives	Quarter	Status	Comments
		<p>of continuing to operate in the current state.</p> <p><b>Outcomes (Internal Work Group)</b>            The Audit objectives will be the benchmark from which to develop outcomes (solutions). The work group will design a project plan for management approval which identifies:</p> <ul style="list-style-type: none"> <li>Proposed solutions against the relevant audit objective(s);</li> <li>An implementation plan which assigns roles, responsibilities, deliverables and timeframes;</li> <li>A future risk assessment reflective of the proposed solution.</li> </ul>			
14	Debtor Management	<p>Stage 1: The objectives of the audit are to work with stakeholders to:</p> <ul style="list-style-type: none"> <li>Undertake a risk assessment against the process of debt management in its current state.</li> <li>Undertake high level benchmarking of debt management policies and debt ratios within the local government sector to propose methodologies which are effective and efficient in managing debt.</li> <li>To assess the current state of debt management and document a risk-based gap analysis which proposes findings for implementation.</li> </ul>		In Progress	Phase 1 is in progress. The gap-analysis was presented to the July 2016 meeting of the Committee.

	Not Started	In Progress	Complete	Deferred	Cancelled
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## 2016/17 Internal Audit Program

Report as at 15 May 2017

Audit Number	Internal Audit	Audit Objectives	Quarter	Status	Comments
		<b>Roles and responsibilities - the audit will assess the:</b> <ul style="list-style-type: none"> <li>• Roles and responsibilities are available and understood</li> <li>• Sufficiency of training to undertake procurement activity in accordance with the procurement policy and using the procurement processes, contracts and templates.</li> </ul>			
16	Internal Controls Self-Assessment	Stage one - propose a risk based approach to the financial internal control self-assessment for the approval of the Executive and subsequently negotiation with the external auditors. Stage one aims to reduce the number of controls requiring self-assessment and review.	Staged	<b>Complete</b>	Internal Financial Control risk-based methodology is attached ( <b>Attachment 5</b> ) and was endorsed by the Executive Management Team during January 2017.  Tim Muhlhauser, Galpins was engaged to present the proposed methodology to BDO and this approach was subsequently endorsed by BDO ( <b>Attachment 6</b> ).

	Not Started	In Progress	Complete	Deferred	Cancelled
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Page 8 of 8



## Internal Audit Scope

# Legislative Audit: Land and Building (Sale and Conveyancing) Act 1994.

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### Introduction

The South Australian *Land and Building (Sale and Conveyancing) Act 1994* (the Act) and *Land and Building (Sale and Conveyancing) Regulations 2010* (the Regulations) outlines the processes which must occur when people buy or sell land or property. The City of West Torrens (CWT) has obligations under the Act to provide applicant's i.e. real estate agents, within eight clear business days, 'information reasonably required as to:

- a) *any charge or prescribed encumbrance over land within the council's area of which the council has the benefit; or*
- b) *Insurance under Division 3 of Part 5 of the Building Work Contractors Act, 1995, in relation to a building on land within the council's area.'*

In order to meet its obligations under the Act, CWT prepares Section 12 Certificates to applicants that contain all known information as required by legislation about land/property.

### Audit Objectives

The objectives of the review are to evaluate and report on the level of compliance with the:

- *Land and Building (Sale and Conveyancing) Act* South Australian Food Regulations 2002
- *(Sale and Conveyancing) Regulations 2010* (the Regulations)
- Opportunities for the introduction of better practices and process improvement

### Approach

The Program Leader Internal Audit and Risk will discuss the scope and overview of work, to be performed, with the contract internal auditor prior to the commencement of testing.

The key components of this audit are to:

1. Review available documentation e.g. legislation, policies, Section 12 applications/certificates, procedures, manuals, performance reports, working documents, correspondence and files etc. used in fulfilling CWT's responsibilities under the Act to determine compliance with the Act.
2. Conduct interviews with key managers, staff and stakeholders to establish any issues, concerns and potential improvements.

## **Risks**

Potential risks associated with administering the Act as identified by Internal Audit include, but are not limited to:

- Non-compliance with legislation
- Inappropriate fees and charges
- Failure to provide accurate information statements which may result in:
  - a customer complaint
  - investigation by an external agency
  - litigation or prosecution

## **General Administration**

This audit will be performed by Council's contract legal auditors, Wallmans Lawyers.

Initial planning, interview and scoping commenced during January with fieldwork and reporting to be conducted between May and June 2017.

A draft report is required to:

- Include an excel spreadsheet or word table that contains recommendations/assessments
- Be issued to the Internal Auditor for comment, and
- Allow for corrections of fact and incorporation of managers comment and risk assessment using CWT approved Risk Management Framework and tools.

The final report will be issued to the Executive Management Team and Manager City Development. This report will also be tabled at the Audit and Risk Committee meeting for information.

A draft report for management consideration should be completed by the end of June 2017.

## **Audit Findings and Recommendation Ratings**

### *Compliance Rating*

*Findings are classified as having a good level of compliance, a partial level of compliance, a substantial level of compliance or as being not compliant.*

*Recommended actions are classified as corrective where they relate directly to legislative, policy or procedural requirements and/or present an unacceptable level of risk to Council and improvement where they are in response to generally accepted industry standards or better practice.*



*Definitions are as classified in the table below.*

<i>Non-compliant</i>	<i>There is no evidence of compliance with legislation, policy, procedure and/or internal controls.</i>
<i>Partial level of compliance</i>	<i>There is partial evidence of compliance with legislation, policy, procedure and/or internal controls.</i>
<i>Substantial level of compliance</i>	<i>There is a substantial level of compliance with legislation, policy, procedure and/or internal controls.</i>
<i>Good level of compliance</i>	<i>There is a good level of compliance with legislation, policy, procedure and internal controls.</i>

### *Control Risk Rating*

*Findings/issues are classified in accordance with a risk rating consistent with Council's Risk Management Framework so that recommendations are reported as:*

- *Extreme risk recommendations*
- *High risk recommendations*
- *Moderate risk recommendations*
- *Low risk recommendations*
- *Better practice or improvement recommendations*

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### **Sign Off**

I have read the above Internal Audit Scope and I am satisfied the objectives and approach meet the expectations for this audit.

Signed



General Manager Business and  
Community Services

Date 16/5/17



## Internal Audit Scope

# Legislative Audit: Food Act 2001.

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### Introduction

The South Australian *Food Act 2001* (the Act) protects the health of the public of South Australia by legislating measures to ensure food for sale is both safe and suitable for human consumption.

The City of West Torrens (CWT) meets the definition of an 'enforcement agency' under part 2 of the South Australian *Food Regulations 2002*. Therefore, CWT has responsibility to take action to protect public health in relation to food matters and the Environmental Health team administers a number of key activities which include but are not limited to: investigating food complaints, food inspection/audits and assessing food business notifications.

### Audit Objectives

The objectives of the review are to evaluate and report on the level of compliance with the:

- *South Australian Food Act 2001*
- *South Australian Food Regulations 2002*
- Australian Food Safety Standards
- Opportunities for the introduction of better practices and process improvement

### Approach

The Program Leader Internal Audit and Risk will discuss the scope and overview of work, to be performed, with the contract internal auditor prior to the commencement of testing.

The key components of this audit are to:

1. Review available documentation e.g. legislation, policies, inspection records/plans, procedures, manuals, performance reports, working documents and files etc. used in fulfilling CWT's responsibilities under the Act to determine compliance with the Act.
2. Conduct interviews with key managers, staff and stakeholders to establish any issues, concerns and potential improvements.

## Risks

Potential risks associated with administering the Act as identified by Internal Audit include, but are not limited to:

- Non-compliance with legislation
- Inadequate records management and review processes
- Failure to act on a food health matter that compromises the reputation of the CWT such as:
  - a customer complaint
  - investigation by an external agency
  - litigation or prosecution

## General Administration

This audit will be performed by Council's contract legal auditors, Wallmans Lawyers.

Initial planning, interview and scoping commenced during January with fieldwork and reporting to be conducted between May and June 2017.

A draft report is required to:

- Include an excel spreadsheet or word table that contains recommendations/assessments
- Be issued to the Internal Auditor for comment, and
- Allow for corrections of fact and incorporation of managers comment and risk assessment using CWT approved Risk Management Framework and tools.

The final report will be issued to the Executive Management Team and Manager Regulatory Services. This report will also be tabled at the Audit and Risk Committee meeting for review.

A draft report for management consideration should be completed by the end of June 2017.

## Audit Findings and Recommendation Ratings

### *Compliance Rating*

*Findings are classified as having a good level of compliance, a partial level of compliance, a substantial level of compliance or as being not compliant.*

*Recommended actions are classified as corrective where they relate directly to legislative, policy or procedural requirements and/or present an unacceptable level of risk to Council and improvement where they are in response to generally accepted industry standards or better practice.*

*Definitions are as classified in the table below.*

<i>Non-compliant</i>	<i>There is no evidence of compliance with legislation, policy, procedure and/or internal controls.</i>
<i>Partial level of compliance</i>	<i>There is partial evidence of compliance with legislation, policy, procedure and/or internal controls.</i>
<i>Substantial level of compliance</i>	<i>There is a substantial level of compliance with legislation, policy, procedure and/or internal controls.</i>
<i>Good level of compliance</i>	<i>There is a good level of compliance with legislation, policy, procedure and internal controls.</i>

### *Control Risk Rating*

*Findings/issues are classified in accordance with a risk rating consistent with Council's Risk Management Framework so that recommendations are reported as:*

- *Extreme risk recommendations*
- *High risk recommendations*
- *Moderate risk recommendations*
- *Low risk recommendations*
- *Better practice or improvement recommendations*

---

### **Sign Off**

I have read the above Internal Audit Scope and I am satisfied the objectives and approach meet the expectations for this audit.

Signed



General Manager Business and  
Community Services

Date 16/5/17





## Internal Audit Scope

# Contractor Management Audit

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### Introduction

The approved Audit Program 2017-18 provides for an internal audit of *Contractor Management*. A previous audit occurred during 2012 which resulted in a finding of Non-Compliant. This audit has been brought forward as part of the 2016/17 Audit Program at the request of the CEO.

The *Work Health Safety Act, SA 2012* (the Act), requires the Person Conducting a Business or Undertaking (PCBU) to provide a safe work environment for its workers and others so that they are not put at risk by the work carried out by or on behalf of the City of West Torrens (CWT). CWT has the responsibility to ensure contractors engaged to undertake work on their behalf have established their own WHS safe systems of work. The CWT must have processes that ensure contractors engaged to undertake work on their behalf are appropriately insured and fully inducted, monitored and evaluated during the course of the contracted work.

The purpose of this audit is to:

1. document progress against the 2012 audit findings and re-evaluate the overall compliance rating
2. establish policy compliance against the WHS Act and Regulations
3. report on departmental compliance against the current version of CWT Contractor Management Policy with emphasis on contractor induction, monitoring and evaluation.
4. report on compliance with the WHS aspects of contractor engagement as part of the procurement process, specifically the WHS information being provided and evaluated as part of the tender/quotation.

This audit exempts from the audit the non-WHS related aspects of procurement such as the approach to market and the number of quotations being sought.

### Audit Objectives

The objectives of this audit are to evaluate and report on the level of compliance of the overall contractor management activity against the requirements of the Act and Regulations and Policy in order to identify any existing gaps and to identify opportunities for the introduction of better practices and process improvement.

## **Audit Scope**

The audit is to evaluate and report on the level of compliance of the overall contractor management methodology against the Act and Regulations. The auditor(s) will review documents, not limited to the following:

- Contractor Management Policy
- Contractor induction, monitoring and evaluation templates
- Procurement Policy (contractor engagement)
- Procurement Contracts (WHS provisions and principal contractor)
- Procurement RFQ/T documents and schedules
- WHS Intranet pages & WHSIM plan (overview only)
- KPI Audit results (overview)
- Procurement Intranet Pages
- Australian Standards Contracts and Consultant led engagements

In addition to the above the Audit will also include field testing to determine the level of departmental compliance with the requirements against the current version of the Contractor Management Policy. The auditor(s) will review documents, not limited to the following:

- the completeness and quality of WHS aspects of tender/quotation responses received from suppliers, to demonstrate safe systems of work
- contractor inductions at contractor award (prioritise high risk contractors)
- contractor ongoing monitoring
- contractor evaluation
- completeness of contractor management documentation
- engagement of a principal contractor
- evidence of contractor pre-starts/toolbox meetings, internal auditing, site hazard registers, site inductions etc.

## **Approach**

The Program Leader Internal Audit and Risk will distribute the scope and overview of work to be performed with the management team prior to the commencement of testing.

A key component of the audit is to conduct interviews with managers and staff with the responsibility of engaging and or overseeing contracted work, to establish any issues, concerns or opportunities for improvements. Field-testing will be undertaken to establish if controls are implemented that are effective in addressing high to extreme risks.

A review of will be undertaken of available documents including CWT policies, documentation, procedure manuals, performance reports, correspondence etc. will be undertaken. This is critical in supporting audit recommendations and providing evidence to support audit conclusions.

The audit is to be assessed using CWT approved Risk Management Framework and tools.



## Risks

Potential risks associated with *Contractor Management* identified through Internal Audit include, but is not limited to:

- Non-compliance with WHS legislation specific to contractor management resulting in:
  - a notifiable incident resulting in external investigation by the regulator
  - injury or incident involving staff, contractor or members of the public
  - in ability to enforce contract conditions/pass on liability provisions
  - poor quality workmanship
- Inadequate monitoring, follow up and review of contractor performance

## General Administration

This audit will be performed by Galpins engaging Adelaide OHS Consultants.

Initial planning, interview and scoping commenced during May 2017 with fieldwork and reporting to commence by negotiation during June of 2016-17. The audit shall identify findings specific for each CWT division/department as well as form an overall compliance rating.

A draft report will be completed for Management Comment by 31 July 2017 to allow for corrections of fact and management comments to be incorporated. The final report will be issued to the Executive Management Team for review.

## Audit Findings and Recommendation Ratings

### *Compliance Rating*

*Audit must provide a compliance rating. Compliance ratings are classified as having a good level of compliance, a substantial level of compliance, a partial level of compliance or as being not compliant.*

*Recommended actions are classified as corrective where they relate directly to legislative, policy or procedural requirements and/or present an unacceptable level of risk to Council and improvement where they are in response to generally accepted industry standards or better practice.*

*Definitions are as classified in the table below.*

<i>Non compliant</i>	<i>There is no evidence of compliance with legislation, policy, procedure and/or internal controls.</i>
<i>Partial level of compliance</i>	<i>There is partial evidence of compliance with legislation, policy, procedure and/or internal controls.</i>
<i>Substantial level of compliance</i>	<i>There is a substantial level of compliance with legislation, policy, procedure and/or internal controls.</i>
<i>Good level of compliance</i>	<i>There is a good level of compliance with legislation, policy, procedure and/or internal controls.</i>

### *Control Risk Rating*

*Findings/issues are classified in accordance with a risk rating consistent with Council's Risk Management Framework so that recommendations are reported as:*

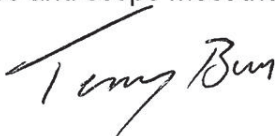
- *Extreme risk recommendations*
- *High risk recommendations*
- *Moderate risk recommendations*
- *Low risk recommendations*
- *Better practice or improvement recommendations*

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### **Sign Off**

I have read the above Internal Audit Assignment Plan and I am satisfied the objectives and scope meet the expectations for this audit.

Signed



Chief Executive Officer

Date 24 1 5 1 2017



# **City of West Torrens**

## **Internal Financial Control Monitoring Methodology**

Prepared September 2016 by



Accountants, Auditors & Business Consultants

Liability limited by a scheme approved under Professional Standards Legislation



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## Contents

1.1 Introduction and Context.....	3
1.2 Methodology for Selection of Controls to be Monitored .....	5
Output 1 - Identification of Key Business Cycles and Risks.....	6
Rationale for Key Business Cycle Selection.....	7
Output 2 - Identification of Specific Internal Controls to be Monitored .....	8
1.3 Number of Controls to be Included in Control Self-Assessment (CSA) Program.....	10
Appendix 1 – Listing of Controls to be Included in CSA .....	11



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## 1.1 Introduction and Context

This section provides an overview of the methodology to be applied by Council in undertaking its internal financial control monitoring program.

There are 5 key components of internal control which are expected to be present, functioning effectively and working together, namely:

- ✓ **Control Environment**
- ✓ **Risk Assessment**
- ✓ **Control Activities**
- ✓ **Information and Communication**
- ✓ **Monitoring Activities**

This methodology applies only to the 5<sup>th</sup> component of internal control – Monitoring Activities. These activities, whilst important, are not the primary consideration of effective internal control, and must be resourced effectively but not excessively. With this in mind, this methodology is a risk based methodology which seeks to ensure that Council is prioritising the focus of its monitoring activities towards the most significant risks. This methodology also seeks to target monitoring at controls for which monitoring activities provide the greatest value to Council in terms of both risk management and continuous improvement.

## The Three Lines of Defense Model

The Three Lines of Defense Model provides a framework for viewing risk management as a series of components which build upon each other to provide layers of defense to manage risk.

The first line of defense contains functions that own and manage risk, with the responsibility to maintain controls, identify and manage risks, implement corrective actions for control deficiencies. The second line contains functions that oversee risk and with responsibility to monitor the 1st line and ensure it is properly designed, in place and operating as intended. The third line provides independent assurance i.e. internal audit. The three lines of defense are internal to Councils, and are supported by external components including external audit and LGA Guidance.

Monitoring activities form an important component of Council's lines of defense for managing risk. The *Better Practice Model – Internal Financial Controls for South Australian Councils* identifies monitoring activities as being within the second line of defense for Councils. Importantly, monitoring activities such as Control Self-Assessment form only part of the Councils overall risk management strategy, and should be risk based so as not to be over-resourced.

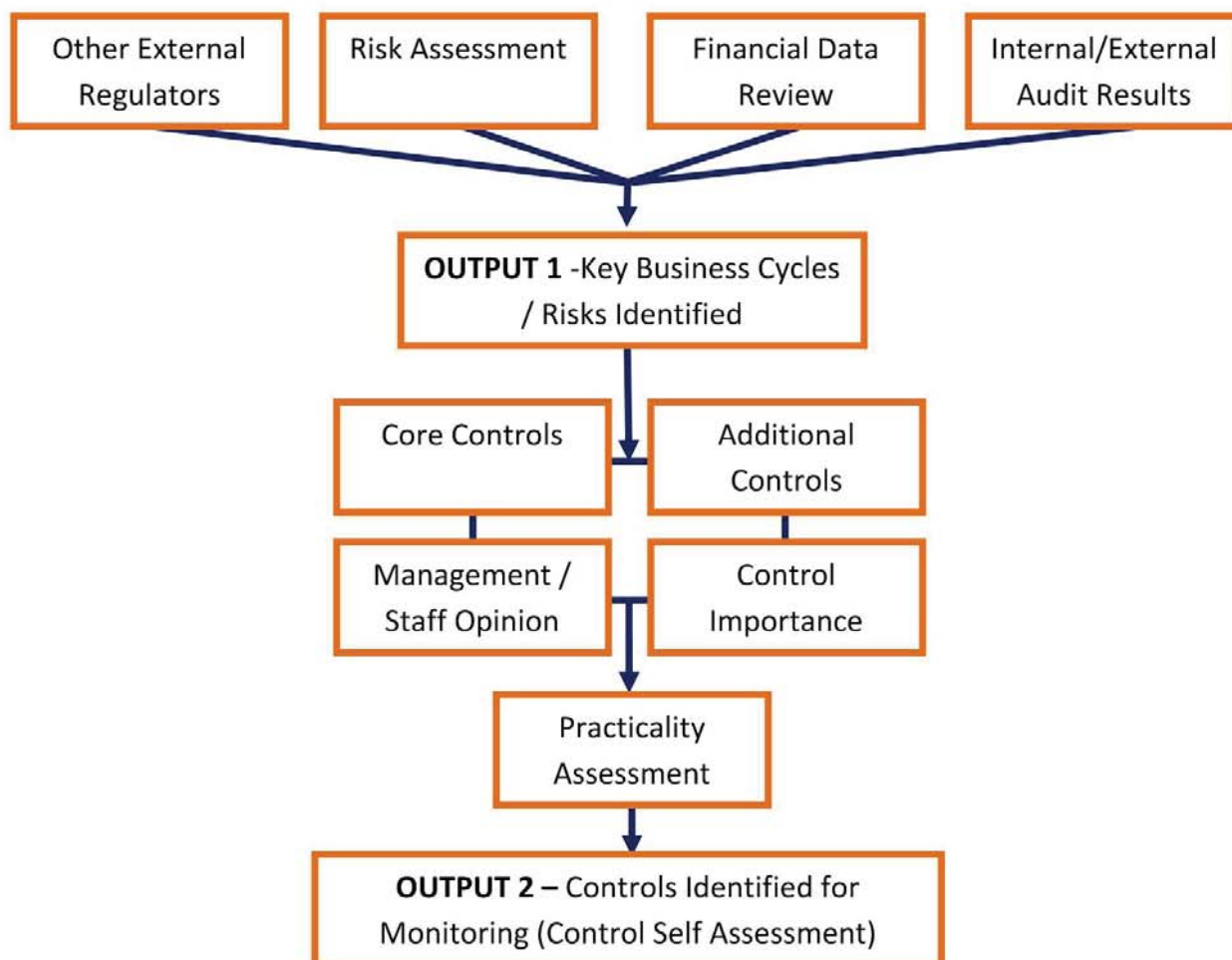


Source: SALGFMG *Better Practice Model – Financial Internal Control for South Australian Councils* published April 2012 (Diagram 1)



## 1.2 Methodology for Selection of Controls to be Monitored

The following Diagram illustrates the methodology used to select control activities for inclusion in Council's control monitoring program. Details of each component of the methodology are provided in the following pages.



(Diagram 2)



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## Output 1 - Identification of Key Business Cycles and Risks

The results of this assessment determine the key business cycles, and key risks within these business cycles, that will be the focus of the control self-assessment program.

**Risk Review** – A review of Council’s inherent risk assessment for internal financial controls is performed to identify key financial risks, focusing on extreme and high risk.

**Financial Statement Review** – A high level financial statement review is performed to identify key accounts and transaction streams.

**Internal / External Audit Results Review** – The findings and recommendations of internal / external financial audits are reviewed to identify known areas of weakness, and areas known to be attracting audit attention.

**Other External Regulators** – Consideration is given to the activities of other external regulators including the Auditor General’s Department (AG) and Independent Commissioner Against Corruption (ICAC) to identify potential focus areas for these entities.

## Key Business Cycles

The following key business cycles have been identified for inclusion in Council’s monitoring activities to ensure effective risk management:

- **Accounts Payable**
- **Banking**
- **Budgets**
- **Contracting**
- **Credit Cards**
- **Debtors**
- **Fixed Assets**
- **General Ledger**
- **Grants**
- **Payroll**
- **Project Costing**
- **Purchasing and Procurement**
- **Rates / Rates Rebates**
- **Receipting**



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## Rationale for Key Business Cycle Selection

The following table summarises the rationale for including or excluding business cycles:

Business Cycle	Included / Excluded	Rationale
Accounts Payable	Included	High dollar value, includes high risks. ICAC / AG focus area.
Accrued Expenses	Excluded	Low value, no high / extreme risk identified.
Banking	Included	Includes high risks and fraud risks.
Borrowings	Excluded	Council currently has no borrowings.
Budgets	Included	Includes high risks. Significant activity underpinning control of multiple finance functions.
Cash Floats & Petty Cash	Excluded	Low value, no high / extreme risk identified.
Contracting	Included	High dollar value, includes high risks. ICAC / AG focus area.
Credit cards	Included	ICAC / AG focus area.
Debtors	Included	Includes high risks.
Elected Members Expenses	Excluded	Low value, recently subject to internal audit.
Employee provisions	Excluded	No high / extreme risk identified.
Employee Reimbursements	Excluded	Low value, no high / extreme risk identified.
Fees for Service	Excluded	Low value, no high / extreme risk identified.
Fixed Assets	Included	High dollar value, includes high risks.
General Ledger	Included	Includes high risks and fraud risks.
Grants	Included	Includes high risks.
Inventory	Excluded	Low value, no high / extreme risk identified.
Investment/Interest Income	Excluded	Low value, no high / extreme risk identified.
Investments	Excluded	No high / extreme risk identified. Controls duplicated in other business cycles (e.g. General Ledger)
Loans / Grants to clubs	Excluded	Low value, no high / extreme risk identified.
Management Reporting	Excluded	No high / extreme risk identified.
Other Expenses	Excluded	Low value, no high / extreme risk identified.
Other Revenue	Excluded	Low value, no high / extreme risk identified.
Payroll	Included	High dollar value, includes high risks. ICAC focus area.
Prepayments	Excluded	Low value, no high / extreme risk identified.
Project Costing	Included	High dollar value, includes high risks.
Purchasing and Procurement	Included	High dollar value, includes high risks. ICAC / AG focus area.
Rates / Rates Rebates	Included	High dollar value, includes high risks
Receipting	Included	High dollar value, includes high risks
Statutory reporting	Excluded	No high / extreme risk identified.
Taxation	Excluded	No high / extreme risk identified.





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## Output 2 - Identification of Specific Internal Controls to be Monitored

Within the business cycles identified in output 1, the following methodology is used to determine the most important controls to address the risks within these business cycles. These controls form the population of controls to be assessed as part of Council's CSA program.

**Review of Core Controls** – within the business cycles and risks identified, the internal financial control self-assessment monitoring program is focused on Core controls as these have been assessed as those that external auditors may place the greatest focus on when conducting audit procedures. Consideration is also given to the "CSA importance weighting" provided in the Better Practice Model, with a focus on those controls with an importance weighting of 5.

**Review of Additional Controls** – For completion, additional controls are reviewed to identify any additional controls which are of particular importance to Council in managing the risks identified.

**Control Importance** – professional judgment is applied to reviewing the suite of controls that address each risk, and identifying which of these controls are the most important or have the biggest influence in managing the risk. This professional judgment is informed by the following principals:

- The number of risks mitigated by an individual control – generally speaking, the more risks a particular control is mitigating, the higher the importance weighting applied to that control.
- The inherent risk rating of the risk being addressed by the control – controls which are addressing Extreme risks are given greater weight, followed by those addressing High risks.
- Control type – the control type has an influence on the importance rating. For example, preventative controls are generally given a higher importance weighting than detective or directive controls, on the basis that prevention is better than cure.
- Nature of Control (Input, Processing, Output) – the nature of the control can influence the relative importance of the control, depending on the characteristics, culture and maturity of an organisation. Input controls often require human intervention and are generally dependent on the quality of staff. If staff are experienced, capable and well trained, a greater degree of reliance can be placed on input controls. Processing controls are generally IT based, and are reliant on the quality and reliability of the system in question. Output controls have greater importance if actual or perceived weaknesses in input controls exist.
- IT controls are generally given a higher importance weighting, as they often influence segregation of duties and are often relied on heavily by management to provide comfort that processes are performed properly.
- A higher degree of importance is placed on controls directly mitigating fraud risks, e.g. those protecting against management override of controls, providing segregation of duties, or mitigating a lack of segregation of duties (e.g. independent review of reconciliations, master file changes and key reports).
- The risk of control failure is considered, with those controls with a higher risk of control failure being more important to monitor. Factors considered include the degree of manual intervention, volume/frequency of the control activity, complexity of the control (e.g. any specialist IT/system knowledge required) and level of staff turnover or system changes.





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**Management / Staff Opinion** – Discussions are held with Council managers and staff responsible for managing business cycles or performing control activities to determine the controls they view as most important. These opinions are critical in achieving the best outcome for the monitoring program, as these managers and staff will have the best understanding of how the controls operate together, and what controls are important to them in achieving their work objectives and getting comfort that their risks are managed.

**Practicality / Value Assessment** – by their nature, some controls are better suited to a formal self-assessment monitoring program than others. For example, it is difficult to rate the effectiveness of a control of “suitably competent staff” in a self-assessment program. Conversely, it is simple to confirm that a reconciliation has taken place, or that a particular policy has been reviewed.

For some other controls, the self-assessment process adds little value because once the control has been implemented, it is unlikely to change without management consciously redesigning the control. For example, assessment of some system controls such as “Rates are automatically generated by the rate system” or “System does not allow posting of unbalanced journals” require yes/no answers that are unlikely to change, and so regular review provides little benefit.



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### 1.3 Number of Controls to be Included in Control Self-Assessment (CSA) Program

Within the selected Business Cycles, the following table illustrates the number of controls have been selected for inclusion within the CSA program:

Business Cycle	Number of Controls		
	Existing Control Self-Assessment Program	Refined for Key Business Cycle & Risk Assessment	Refined for Control Importance, additional controls added etc.
Accounts Payable	16	10	7
Accrued Expenses	1	0	0
Banking	11	6	6
Borrowings	14	0	0
Budgets	12	2	1
Contracting	13	7	6
Credit Cards	11	4	4
Debtors	12	4	3
Elected Members Expenses	4	0	0
Employee Provisions	8	0	0
Employee Reimbursements	2	0	0
Fixed Assets	29	13	10
General Ledger	12	9	7
Grants	10	1	1
Inventory	9	0	0
Investment/Interest Income	3	0	0
Investments	15	0	0
Loans/Grants to Clubs & Community Groups	7	0	0
Management Reporting	12	0	0
Other Expenses	4	0	0
Other Revenue	5	0	0
Payroll	35	15	11
Petty Cash	11	0	0
Prepayments	3	0	0
Project Costing	5	2	2
Purchasing and Procurement	9	4	3
Rates/Rate Rebates	21	8	9
Receipting	7	2	2
Statutory Reporting	10	0	0
Taxation	4	0	0
User Pay Income (Fee for Service)	8	0	0
<b>Total</b>	<b>323</b>	<b>87</b>	<b>72</b>



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## **Appendix 1 – Listing of Controls to be Included in CSA**

BUDGET				
Risks				
R1	Budgets do not reflect strategic objectives			
R2	Unrealistic Budgets			
RISKS				
	Control	Changes in the Description	Control Type	CSA Importance Weighting Code
R1	On-going review by management of actual performance against budget and ensure consistency of budget in relation to initiatives /objectives of Annual Business Plan and Strategic Management Plans.	On-going review by management of actual performance against budget	Core	5 STR-BUD-0002



PROJECT COSTING					
Risks					
R1	Projects are either inaccurately recorded or not recorded at all. / Over-expenditures on Projects may not be detected.				
R2	Over-expenditures on Projects may not be detected.				
RISKS					
R1	Control Actual project costs are regularly compared to budgets; significant variances are investigated by management.	Changes in the Description No changes	Control Type Core	CSA Importance Weighting 4	Code ASS-PRO-0002
R1	Rigorous process for establishing budgets for projects. Project budgets must be approved in accordance with Delegations of Authority.	No changes	Core	5	ASS-PRO-0008

## FIXED ASSETS

## Risks

R1	Fixed asset acquisitions, disposals and write-offs are fictitious, inaccurately recorded or not recorded at all.
R2	Fixed assets are inadequately safeguarded.
R3	Fixed Assets are not valued correctly
R4	Depreciation charges are either invalid not recorded at all or are inaccurately recorded.
R5	Fixed Asset maintenance and/or renewals are inadequately planned.

RISKS	Control	Changes in the Description	Control Type	CSA Importance Weighting	Code
R1	Regular verification of fixed assets are conducted and reconciled to the FAR.	Physical verification and condition assessment of infrastructure assets and buildings are performed during the revaluation process at least every five years.  A stocktake of plant & equipment and library items is performed on an annual basis. Infrastructure assets - City Assets is responsible to update the unit rates, useful lives and condition ratings in the system. Updates are based on revaluation reports and annual third party reports for unit rates.	Core	4	ASS-FIX-0014
R1	Recorded changes to the FAR and/or masterfile are approved by management, compared to authorised source documents and General Ledger to ensure accurate input.	Buildings - Finance Services is responsible to update useful lives, buildings components and depreciation rates based on revaluation reports and/or condition assessments.  Plant and Equipment / Furniture & Fittings - Financial Services is responsible to update useful lives and depreciation rates at the time asset additions are processed.	Core	5	ASS-FIX-0015
R1	All fixed asset acquisitions and disposals are approved in accordance with Delegation of Authority and relevant Procurement and Fixed Asset Policies.	No changes	Core	5	ASS-FIX-0016
R1	Access and on-going maintenance of the fixed asset register is performed by authorised officers only.	No changes	Core	4	ASS-FIX-0030
R1	Reconciliation of fixed assets to the General Ledger is performed regularly. Asset maintenance schedules are prepared, updated, and monitored by management and activity per the asset maintenance schedule. Changes to the asset maintenance history register are compared to source documents to ensure that they were input accurately.	Reconciliation of fixed assets to the General Ledger is performed on an annual basis.  No	Core	4	ASS-FIX-0007
R1	Management regularly reviews valuation of fixed assets - methodology and useful lives, to ensure valuation is appropriate and in accordance with reporting requirements. Where appropriate, Council may engage an expert to perform valuations.	Council engages external valuers to review valuation of fixed assets - methodology and useful lives, to ensure valuation is appropriate and in accordance with reporting requirements.	Core	4	ASS-FIX-0027
R3	Management reviews depreciation rates and methodology (at least annually) to ensure that methods used to value fixed assets are still appropriate.	Manager, Finance Services reviews depreciation calculations and compares current against previous FY depreciation. On revaluation of assets, Manager, Finance Services obtains reasons for variances in the levels of depreciation after the revaluation is performed.	Core	5	ASS-FIX-0019
R3	The annual review of assets includes reviewing the appropriateness of categories of assets and impairment testing. Asset Management Plans exist for all major asset classes and all changes to the asset management plan must be approved by Council.	Manager, Finance Services obtains impairment declarations signed off by relevant managers responsible for assets.  No changes	Core	5	ASS-FIX-0020
R3			Core	4	ASS-FIX-0009
R5			Core	5	ASS-FIX-0008

## Purchasing and Procurement

## Risks

R1	Council does not obtain value for money in its purchasing & procurement.				
R2	Purchases of goods and services are made from non-preferred suppliers.				
R3	Purchase orders are either recorded inaccurately or not recorded at all.				
R4	Purchase orders are placed for unapproved goods and services.				
RISKS					
	Control	Changes in the Description	Control Type	CSA Importance Weighting	Code
R1	Council has a comprehensive Contract and Procurement Policy that is reviewed regularly.	Council has a comprehensive Procurement Policy which specifies a review period. Purchase orders are issued and approved electronically in the system in accordance with the Delegations of Authority.	Core	5	EXP-PUR-0001
R1, R2, R4	Employees must ensure all purchase orders are approved in accordance with the Delegations of Authority and relevant policies.	Manager, Finance Services reviews the delegations included in the system for issuing and approving purchase orders on an annual basis.	Core	5	EXP-PUR-0004
R3	Purchase orders and invoice data are compared; inaccuracies are investigated and actioned.	Invoices are matched to purchase orders automatically by the system. The AP officer reviews a list of outstanding purchase orders periodically, and forwards to relevant Manager for follow up.	Additional	4	EXP-PUR-0002

## RATES / RATES REBATES

## Risks

R1	Council does not raise the correct level of rate income.
R2	Rates and rate rebates are either inaccurately recorded or not recorded at all.
R3	The Property master file data does not remain pertinent
R4	Pensioner concessions and self-funded retirees are either inaccurately recorded or not recorded at all.

RISKS	Control	Changes in the Description	Control Type	CSA Importance Weighting	Code
R1, R2	Management regularly reviews the calculation methodology within the rate application system and for a sample of ratepayers to ensure correct calculation and methodology has been used.	Rates officer selects a sample of rate payers and performs a manual recalculation of the rates to ensure the system calculated the rates, concessions and rebates correctly. A sample is selected for each one of the rate types. The recalculation is performed on an adhoc basis.	Core	4	REV-RAT-0002
R1	All software changes to rate modelling functionality fully tested and reviewed by qualified personnel.	Rate modelling spreadsheet is prepared by the Manager, Finance Services to determine dollar values of rates and level of rate income. Rates modelling is compared to the rates raised in the pathway system for completeness and accuracy.	Core	5	REV-RAT-0003
R1	New control	Manager, Finance Services reconciles the total capital value recorded in the Pathway system to the total capital value from the VG report prior to generation of the rates notices.	N/A	N/A	
R1	New control	Manager, Finance Services reconciles the number of properties, rate in the dollar, rebates, total rates raised and total capital value for the rates raised in Pathway to the modelling spreadsheet before sending rates notice to the residents.	N/A	N/A	
R2	Regular review of exempt properties to ensure still valid, interest flag switched off and rate rebates.	Manager, Finance Services signs off a list of exempt properties before raising rates to ensure still valid.	Core	5	REV-RAT-0021
R2	Council approves rate rebates to rate payers in accordance with Delegations of Authority and as per the legislation.	Mandatory rebates are approved by the Manager, Finance Service.	Core	4	REV-RAT-0017
R2	Regular independent review of the rates aged receivables reports and independent check of rates payable by rates staff.	Discretionary rebates are approved by the general manager.	Core	4	REV-RAT-0018
R3	Recorded changes to property master file data are compared to authorised source documents or confirmed with ratepayers to ensure that they were input accurately. An audit trail is maintained for all changes.	No changes	Core	4	REV-RAT-0011
R3	Access to the Property master file is restricted to appropriately designated personnel, with significant changes to the Property master file approved by management.	A list containing changes to the valuations (e.g. write offs, changes in the type of properties, capital value changes, unit rates) is reviewed on a monthly basis by the Manager, Finance Service.	Core	4	REV-RAT-0011
R3		No changes	Core	5	REV-RAT-0019



## BANKING

## Risks

R1 R2	Banking transactions are either inaccurately recorded or not recorded at all. Fraud.					
RISKS	Control	Changes in the Description	Control Type	CSA Importance Weighting	Code	
R1, R2	Blank cheques and/or cheque-signing machine are adequately safeguarded.	Blank cheques are adequately safeguarded.	Core	5	ASS-BAN-0005	
R1, R2	Access to EFT Banking system restricted to appropriately designated personnel.	No changes	Core	5	ASS-BAN-0006	
R1, R2	Bank reconciliations are performed on a predetermined basis and are reviewed by an authorised officer. Any identified discrepancies are investigated immediately.	Bank reconciliations (Formal) are performed on a monthly basis and reviewed by an authorised officer. Outstanding items are investigated.  Financial transactions (e.g., Deposits, cheques, payments, receipt) are cleared, matched and reconciled to the general ledger and the bank statements throughout the month on an ongoing basis.	Core	5	ASS-BAN-0007	
R1, R2	All cash held securely in safe/registers with access restricted to appropriately designated personnel.	No changes	Core	5	ASS-BAN-0002	
R2	Cash transfers between bank accounts and investment bodies are approved by authorised officer.	Cash transfers between bank accounts and investment bodies are approved in accordance with EFT banking system process established by the Council.  Transfers between LGFA accounts and from the LGFA accounts to the councils bank account are approved via an email sent to LGFA. LGFA maintains a register of officers authorised to perform these transfers.	Core	5	ASS-BAN-0009	
R2	Procedures are in place to ensure that all cash collected is banked and properly recorded.	Cash is banked on a regular basis (typically daily). Finance Services reconciles the amounts banked and recorded in the bank statement to the receipts recorded in Finance 1.	Core	5	ASS-BAN-0010	

## RECEIPTING

**Risks**

R1	Receipts are either inaccurately recorded or not recorded at all.
R2	Receipts are not deposited at the bank on a timely basis.

<b>RISKS</b>	<b>Control</b>	<b>Changes in the Description</b>	<b>Control Type</b>	<b>CSA Importance Weighting</b>	<b>Code</b>
R1,R2	Cash is stored securely at all times including the duration of the cash management process.	No changes	Core	5	REV-REC-0002
R1	Officers who create debtors invoices do not have access to receipting payments and/or reversing receipt transactions.	No changes	Core	5	REV-REC-0012

## PAYROLL

## Risks

R1	Payroll expense is inaccurately calculated.
R2	Payroll disbursements are made to incorrect or fictitious employees
R3	Time and/or attendance data is either invalid, inaccurately recorded or not recorded at all.
R4	Payroll master file does not remain pertinent and/or unauthorised changes are made to the payroll master file.
R5	Voluntary and statutory payroll deductions are inaccurately processed
R6	Salary sacrifice transactions are inaccurately processed.
R7	Employees are terminated in breach of statutory and enterprise agreements.

RISKS	Control	Changes in the Description	Control Type	CSA Importance	Weighting	Code
R1, R3	Overtime hours worked and payments for such overtime are authorised by management for all eligible employees.	A form approving overtime hours is signed by supervisor/manager. Payment of overtime hours is conditional on the receipt of this form.	Core	5	5	EXP-PAY-0018
R2	The transfer of the bank file should be restricted to authorised officers who are not involved in the preparation of the pay run.	No changes	Core	5	5	EXP-PAY-0022
R2	Payroll system generates exception reports detailing all payroll changes that are regularly reviewed by management who investigate & approve variances.	Manager, Finance Services approves the following exception reports before processing a payroll payment: - report comparing current pay against previous pay; - report containing total hours paid to each employee; - report containing a break down of gross amount, tax withheld, deductions applied to each employee; - report containing superannuation payments per employee; and - online banking system report containing amount to be paid per employee.	Core	5	5	EXP-PAY-0024
R2	Employee records to include employment details and/or contract terms and conditions, authorisations for payroll deductions and leave entitlements.	No changes	Core	5	5	EXP-PAY-0004
R2	Employees made inactive in payroll records immediately upon termination. Termination report provided as supporting documentation with request for an EFT. Comparison of subsequent current employee listings made by independent person to verify correctness.	A termination checklist is filled every time a employee is terminated. The employee is made inactive in the payroll system when a termination data is included in the system.	Core	5	5	EXP-PAY-0008
R2	All employee deductions must be substantiated with documented approval provided by employee.	No changes	Core	5	5	EXP-PAY-0030
R3	Total of payment summaries for the year is reconciled to general ledger and payroll.	General ledger is reconciled to CHRIS 21 on an annual basis.	Core	4	4	EXP-PAY-0011
R3	Relevant staff are required to complete timesheets and/or leave forms, authorise them and have approved by the supervisor/manager.	Outside staff are required to complete daily timesheets with work orders allocations. Timesheets are approved by coordinators.	Core	5	5	EXP-PAY-0039
R5	Access to the payroll deduction listing is restricted to authorised officers.	Hours worked recorded in CHRIS 21 are compared to the timesheets.	Core	5	5	EXP-PAY-0031
R6	All original salary sacrifice transactions must be approved by the relevant employee. Payroll staff must ensure that such approval has been obtained prior to processing transactions into the payroll system.	No changes	Core	5	5	EXP-PAY-0032
R7	Establish employee termination policies and procedures, including statutory regulation and union requirements. Regularly review and update these policies and procedures.	Termination payments are calculated by the Human Resource department by an officer independent from the Finance Services department.	Core	4	4	EXP-PAY-0034

## GENERAL LEDGER

## Risks

R1	General Ledger does not contain accurate financial information				
R2	Data contained within the General Ledger is permanently lost.				
RISKS					
R1, R2	Control	Changes in the Description	Control Type	CSA Importance Weighting	Code
R1, R2	All updates and changes to General Ledger programmes are authorised, tested and documented.	No changes	Core	5	STR-GEN-0013
R1, R2	Access to General Ledger maintenance is restricted to authorised personnel.	No changes	Core	5	STR-GEN-0010
R1	General Ledger reconciliations (including control and clearing accounts) are prepared on a regular basis; all reconciliations independently reviewed.	Finance Services performs banking, accounts payable and accounts receivable reconciliation on a monthly basis.	Core	4	STR-GEN-0005
		Investments and borrowings from LGFA are compared to the LGFA audit certificate on a monthly basis.			
		Finance Services performs annual leave, long service leave, salaries & wages and fixed asset reconciliations on an annual basis.			
R1	Manual journal entries recorded in the register are authorised by the officer preparing the journal and an independent reviewer.	Finance Services maintains a register of all manual journal entries entered in the system. Each journal item is signed by a preparer and a reviewer. Manager, Finance Services reviews the register on a monthly basis.	Core	5	STR-GEN-0007
R1, R2	Off-site backup of data, program and documentation.	No changes	Core	4	STR-GEN-0012
R1	Amendments to the structure of the General Ledger framework are approved by an authorised officer.	Amendments to the Chart of Accounts are approved by the General Manager once a year as part of the budgetary process.	Core	5	STR-GEN-0003
R2	Formal disaster recovery plan adopted by Council or Senior Executive	No changes	Core	5	STR-GEN-0011



## DEBTORS

## Risks

R1	Debtors are either inaccurately recorded or not recorded at all.					
R2	Rebates and credit notes to debtors are either inaccurately recorded or not recorded at all					
R3	An appropriate provision for doubtful debts is not recorded					
R4	Debtors are either not collected on a timely basis or not collected at all					
R5	The Debtors master file data does not remain pertinent.					
RISKS	Control	Changes in the Description	Control Type	CSA Importance	Weighting	Code
R2, R3, R4	Management and/or Council review and approve all rebates, credit notes, bad debt write-offs and movements in the provision for doubtful debts, in accordance with delegations of authority and Local Government Act.	The Rates Officer, Rates Coordinator and Manager, Finance Services have delegation to write off fines. CEO has delegation from Council to write of debt up to a fixed dollar value. Anything over this value is approved by Council.	Core		5	ASS-DEB-0010
R3, R4	Management reviews debtors ageing profile on a regular basis and investigates any outstanding items.	No changes	Core		4	ASS-DEB-0008
R5	Access to the debtor's master file is restricted to appropriately designated personnel and is reviewed by management for accuracy and on-going pertinence.	No changes	Core		5	ASS-DEB-0013

## ACCOUNTS PAYABLE

## Risks

R1	Accounts payable amounts and disbursements are either inaccurately recorded or not recorded at all
R2	Credit notes and other adjustments to accounts payable are either inaccurately recorded or not recorded at all
R3	Disbursements are not authorised properly.
R4	Accounts are not paid on a timely basis
R5	Supplier master file data does not remain pertinent and/or unauthorised changes are made to the supplier master file.

RISKS	Control	Changes in the Description	Control Type	CSA Importance Weighting	Code
R1	Invoices received are authorised and accompanied by appropriate supporting documentation.	No changes	Core	5	LIA-ACC-0010
R1	Payments (Cheques and EFT's) are endorsed by authorised officers separate to the preparer who ensure that they are paid to the specified payee.	No changes	Core	5	LIA-ACC-0017
R2	Access to the supplier master file is restricted to authorised officers.	No changes	Core	5	LIA-ACC-0021
R2, R5	Separation of Accounts Payable and Procurement duties.	No changes	Core	5	LIA-ACC-0022
R3	All disbursements must be approved by an authorised officer in accordance with relevant policies and/or Delegations of Authority. Purchase Orders must be raised for the purchase of goods and services in line with the Council's Procurement policy or over a predetermined amount where applicable.	No changes	Core	5	LIA-ACC-0014
R3	Individuals who authorise payment of suppliers are authorised officers who are independent of the processing of invoices.	No changes	Core	5	LIA-ACC-0001
R3		No changes	Core	5	LIA-ACC-0015

GRANTS				
Risks				
R1	Council loses recurrent Grant funding to provide existing service.	Changes in the Description	Control Type	CSA Importance Weighting
R2	Grant funding is not claimed by Council on a timely basis or not claimed at all.			
R3	Grants are either inaccurately recorded or not recorded at all.			
RISKS				
R1,R3	Management performs regular review of all grant income and to monitor compliance with both the terms of grants and Council's Grant policy (including claiming and collecting funds on a timely basis).	No changes	Core	REV-GRA-0004

## CONTRACTING

**Risks**

R1	Council is not able to demonstrate that all probity issues have been addressed in the Contracting process.
R2	Council does not obtain value for money in relation to its Contracting.

<b>RISKS</b>	<b>Control</b>	<b>Changes in the Description</b>	<b>Control Type</b>	<b>CSA Importance Weighting</b>	<b>Code</b>
R1,R2	Robust and transparent selection processes to ensure effective and qualified suppliers / contractors are selected by Council, including compliance with Code of Conduct, Conflict of Interest and procurement Policies.	Council maintains policies and procedures with robust and transparent selection processes to promote suitable and qualified suppliers / contractors are selected by Council, including compliance with Code of Conduct, Conflict of Interest and Procurement policies.	Core	5	EXT-CON-0006
R1,R2	New control	Results of tender procedures are documented in evaluation forms.	N/A	N/A	
R1, R2	Suitably qualified/independent personnel to sit on Selection Panel to ensure that informed and objective decision is made when selecting suppliers / contractors.	Selection Panels are used to ensure that informed and objective decisions are made when evaluating tenders.	Core	4	EXT-CON-0008
R1	Council to maintain a contract register.	No changes	Core	4	EXT-CON-0013
R2	Council does not release milestone payments to suppliers / contractors until they meet all their associated objectives.	Council does not release milestone payments until the invoice is signed by the relevant manager and it is checked as OK to pay by the AP officer as evidence that the milestone and the associated objectives were met.	Core	5	EXT-CON-0012
R2	Tender Documents are kept locked up when they are not being reviewed for evaluation purposes.	Tender Documents are kept secure when they are submitted prior to closing date. Alternatively, Council uses Tenders SA / Vendor Panel to issue tender requests and securely receive tenders from suppliers.	Core	4	EXT-CON-0011



## CREDIT CARDS

## Risks

R1	Credit Cards are issued to unauthorised employees.
R2	Credit Cards are used for purchases of a personal nature.
R3	Credit Card limits are set at inappropriate levels.

RISKS	Control	Changes in the Description	Control Type	CSA Importance Weighting	Code
R1, R2	Employees sign a declaration confirming compliance with Council policy and procedures prior to the Credit Card being released.	Not applicable to the Council	Core	5	EXP-CRE-0003
R2	Council staff must check their statement to ensure all transactions are correct, and identify any transactions of a personal nature which must be reimbursed to Council and to contact bank as soon as possible to cancel any invalid transactions.	Not applicable to the Council	Additional	4	EXP-CRE-0008
R2	All credit card statements sent directly to person independent from the credit card holder. Independent officer matches all transactions from the statement to valid tax invoices prior to approval.	Not applicable to the Council	Additional	4	EXP-CRE-0009
R3	All credit card limits are set in accordance with Delegations of Authority and reviewed by management for operational efficiency.	Not applicable to the Council	Core	5	EXP-CRE-0010



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Mr Terry Buss  
Chief Executive Officer  
City of West Torrens  
165 Sir Donald Bradman Drive  
HILTON SA 5033

16 March 2017

Dear Mr Buss

#### **PROPOSED INTERNAL FINANCIAL CONTROL MONITORING METHODOLOGY**

I appreciate the opportunity of having recently met with your staff Norm Biggs and Darryl Whicker, and your consultant Tim Muhlhausler, in relation to Council's proposed new Internal Financial Control Monitoring Methodology.

At the meeting Tim provided a draft document setting out the details of this methodology, and spoke to the background of this. This risk based methodology will, if adopted, result in a significant decrease in the number of controls to be included in the control self-assessment program.

I am comfortable that the proposed methodology is consistent with the requirements of the Better Practice Model - Internal Financial Controls for South Australian Councils, and would not compromise our ability to provide an unqualified opinion on the controls established by Council in relation to financial transactions relating to the receipt, expenditure and investment of money, acquisition and disposal of property and incurring of liabilities.

In discussion with Tim and Norm we noted that the current draft of the methodology does not include a mechanism for re-assessing the key business cycles and risks, and the specific internal controls to be monitored within these. We recommend that consideration be given to this. Future events or changes in circumstances will impact the assessment of significant risks, and the methodology needs to provide for this. We also recommend a regular overall review of the selected controls - every few years - to provide an opportunity for a fresh look at the assessment.

Please let me know if there is anything that you would like to discuss.

Yours sincerely

**BDO Audit (SA) Pty Ltd**

A handwritten signature in blue ink, appearing to read 'G Edwards', is written over a faint, light blue circular stamp.

**G K Edwards**  
Director

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#### **8.4 EXTERNAL AUDIT**

Nil

#### **8.5 COMMITTEE PERFORMANCE AND REPORTING**

Nil

## **9 OUTSTANDING REPORTS/ACTIONS**

### **9.1 Open Actions Update**

#### **Brief**

This report presents an update on the current status of open actions from previous meetings of the Audit and Risk Prescribed General Committee.

#### **RECOMMENDATION(S)**

It is recommended to the Audit and Risk Committee that it notes the status of current open actions.

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#### **Introduction**

A report is presented to each ordinary meeting of the Audit and Risk Prescribed General Committee (Committee) detailing the status of open actions from previous Committee meetings.

#### **Discussion**

This report provides an update of the current status of open actions (**Attachment 1**). Of the four (4) outstanding actions, three (3) are complete and one (1) is progressing with an information technology solution pending.

#### **Conclusion**

This report provides details of the status of the Committee's open actions from previous meetings.

#### **Attachments**

##### **1. Open Actions Report Update as at May 2017**



## Audit and Risk Committee Open actions

May 2017

EMT = Executive Management Team  
 CEO = Chief Executive Officer  
 GMB&CS = General Manager Business & Community Services  
 GMCR = General Manager Corporate & Regulatory  
 GMUS = General Manager Urban Services  
 PLIA&R = Program Leader Internal Audit and Risk

	Target date	RO	Status		Meeting/s where item originally raised/reported
			Actions taken	Status	
OPEN ACTIONS					
1	<b>Agreed Actions</b> The CEO agreed to report back to the next meeting of the Committee on which actions contained in the 'Internal Audit Recommendation and Actions Report' are able to be deleted on the basis they are within tolerance levels and not being progressed.	Oct-2016 June 2017	PLIA& R	Information Services are assisting audit to automate this report. It is important that audit findings are not simply withdrawn from all reporting but rather that reports are able to be customised based on an agreed criteria such as: level of risk, overdue escalations, per department etc. and that those long term actions, such as for policy reviews can be reported closer to the policy review schedule.	In Progress  Jul 2016
COMPLETED ACTIONS					
2	<b>Accounts Payable Audit</b> That the accounts payable scope be broadened, in light of creditor fraud in Brisbane City Council to consider vendor creation and changes to bank details.	Apr 2017	PLIA& R	Vendor creation will be reviewed as part of the Accounts Payable Audit.	Complete  Feb 2017

## Audit and Risk Committee Open actions

May 2017

EMT = Executive Management Team  
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	Target date	RO	Status		Meeting/s where item originally raised/reported
			Actions taken	Status	
<b>3 Insurance and Indemnity Arrangements: Report to Councils</b> The CEO committed to provide the LGA commissioned Insurance and Indemnity Arrangements: Report to Councils to Committee members out of session and that the report is presented to the Committee's April 2017 meeting.	Apr 2017	PLIA&R	Report distributed & sent to Committee members out of session during February 2017 and listed as an Agenda item to the April 2017 meeting of the Committee.	<b>Complete</b>	Feb 2017
<b>4 Strategic Risk Review</b> That administration considers industry trends/incidents as part of its Annual Strategic Risk Review.	Jun 2017	PLIA&R	Methodology and instruction reflected in Risk Framework	<b>Complete</b>	Feb 2017

**10 OTHER BUSINESS**

**11 CONFIDENTIAL**

Nil

**12 NEXT MEETING**

8 August 2017, 6.00pm in the Mayor's Reception Room.

**13 MEETING CLOSE**