



Institute of
Public Works
Engineering
Australia
(NSW Division)

IPWEA (NSW) ROADS & TRANSPORT DIRECTORATE

Email to DLG

Internal Audit Discussion Paper – Initial Response

Background

The Institute of Public Works Engineering Australia (IPWEA) is a not for profit membership based professional organisation representing engineers and others involved in the provision of public works and services predominantly in the local government sphere.

The Roads & Transport Directorate has been set up by IPWEA (NSW) in conjunction with the Local Government and Shires Associations to provide support to its members working in local government across the state.

The range of issues that have been identified by the Directorate since it commenced operations in October 2004 include:

- Asset Management
- Sources of Road Funding
- The Development of Road Asset Management Plans
- Support of the ARRB Road Deterioration Study
- Monitoring of the IPWEA National Asset Management Strategy (NAMS) “Asset Condition & Financial Reporting Guidelines” Project and implement the outcomes
- Sustainability
- Road design standards
- Timber Bridge Management
- Road and Transport planning issues
- Airport runway management

By far the most urgent and important issue confronting Local government at the present time is asset management.

Asset Management

The Local Government Act 1993 clearly recognises that asset management should play a major role in the activities of each council. Section 8 of the Act sets out the Council’s Charter as follows:

“8 The council’s charter

(1) A council has the following charter:

- **to provide directly or on behalf of other levels of government, after due consultation, adequate, equitable and appropriate services and facilities for the community and to ensure that those services and facilities are managed efficiently and effectively**
- **to exercise community leadership**
- *to exercise its functions in a manner that is consistent with and actively promotes the principles of multiculturalism*
- **to promote and to provide and plan for the needs of children**
- **to properly manage, develop, protect, restore, enhance and conserve the environment of the area for which it is responsible, in a manner that is consistent with and promotes the principles of ecologically sustainable development**
- **to have regard to the long term and cumulative effects of its decisions**
- **to bear in mind that it is the custodian and trustee of public assets and to effectively account for and manage the assets for which it is responsible**
- *to facilitate the involvement of councillors, members of the public, users of facilities and services and council staff in the development, improvement and co-ordination of local government*
- *to raise funds for local purposes by the fair imposition of rates, charges and fees, by income earned from investments and, when appropriate, by borrowings and grants*
- *to keep the local community and the State government (and through it, the wider community) informed about its activities*
- *to ensure that, in the exercise of its regulatory functions, it acts consistently and without bias, particularly where an activity of the council is affected*
- *to be a responsible employer.”*

The points that are shown in bold above specifically relate to the need for Councils to employ sound asset management principles to ensure that the vast portfolio of community assets are cared for and passed on to the next generation in a satisfactory condition.

To put this issue into some sort of context it is estimated that Councils in New South Wales are responsible for over 80% of all roads in the State. The best estimate of the value of this asset is \$13.2billion .

Despite these facts, there are no implemented industry standards covering asset management and little attention is paid to this area in the external audit process. There is no requirement for councils to develop asset management plans or to prepare long term financial plans covering the management of their infrastructure assets.

AAS27 and the International Accounting Standard provides an accounting framework for the financial reporting of assets but there are no practice standards for implementing this framework. The fact that depreciation of assets is written back in the financial statements means that depreciation is not funded and therefore has no impact on the operating budget. Annual Reports show that assets are being consumed at a faster rate than asset renewal is being funded but there is no incentive to do anything about it. The net result is an increasing funding liability for infrastructure assets. This situation is clearly not in accordance with the principles of ecologically sustainable development. We are creating an ever increasing liability for future generations.

The Management Need

The management of infrastructure assets is essentially an operational issue which should be a major item dealt with by the internal audit programme. This is currently not happening since the majority of Councils do not have formal asset management plans and there are no industry wide standards implemented against which to benchmark. Financial reporting consists of data reported in Special Schedule 7 which is an

aggregated report prepared by each Council in accordance with each Council's own standards. There is a lack of consistency across the state in reporting this information and there are no accepted standards against which to audit this data.

A Suggested Solution

The following section deals with a possible solution to the urgent and crucial need for the implementation of strategic asset management in all Councils across NSW. The sub headings used correspond to the issues listed in the "Your views and opinions" section of the Discussion Paper.

➤ Whether there is a need for best practice standards for internal audit in NSW local government

For the reasons outlined above, it is essential that auditable standards for asset management be developed and implemented across local government in NSW. There is a need for each council to develop and adopt asset management plans for each class of asset for which it is responsible. These plans must be based on a set of principles which are common across the state.

The International Infrastructure Management Manual (IIMM) has already been developed to meet this need. This provides a set of standards for asset management which have now been accepted internationally. This manual needs to be adopted and implemented by local government in NSW. It also provides a sound basis for the ongoing auditing of the asset management function.

➤ Whether councils develop their own internal audit guidelines

In terms of asset management there is a need for each council to tailor its asset management services to meet the needs of its community. The IIMM recognises this as a critical element of the asset management process by defining a means of determining the level of service expected by the community. Thus, each council's asset management plans will be different in outcome since their communities are not identical. In terms of audit, however, the process followed by each council should be the same and the implementation of the resulting asset management plan will be the same.

In terms of asset management, it is considered essential the local government industry adopt a set of asset management principles that can be implemented to meet the needs of each council and can be audited as part of both the internal and external audit processes.

➤ Whether and to what extent there is a need for legislative support

AAS27, the International Infrastructure Management Manual and the need to manage infrastructure assets have all existed for a considerable period of time without asset management becoming a serious matter for consideration by the majority of councils. From this point of view, I consider that there needs to be some form of legislative assistance. I would suggest that this should not be in a rigid and prescriptive form but should be more along the lines adopted in the Victorian Roads Act which suggests that the development of a road asset management plan is a prudent risk management strategy. Such legislation should embody reference to appropriate standards / guidelines.

➤ Who the internal auditor should report to and how

It is difficult to disagree with the logic contained in the paper. As the Local Government Act is currently stated it would be inappropriate to report to the Mayor or Council directly. It is suggested that the requirement should be to report to the General Manager with a further requirement that the General Manager report quarterly to council on actions that have been taken to address issues identified by the internal audit.

➤ **Whether all councils should have a designated internal auditor and / or audit committee**

Again, because local government has not embraced asset management it is considered essential that each council have an audit committee. One of the functions should be to determine how internal audit should be delivered for the council.

➤ **What should be the role and make-up of audit committees**

The role of the audit committee should be to make sure that internal audit is effectively carried out and that this function forms part of council's overall audit function.

The committee should have representatives from each of the functional areas of council including, library, community services, administration, planning and development, finance and engineering. The committee should also contain senior managers and councillor representatives.

➤ **What are the options for small councils wanting to establish an internal audit function**

Some of the options available are to carry out internal audit on a contract basis or to look at appointing a regional auditor to provide the service to a number of smaller councils.

➤ **What strategies can be implemented to support the internal audit role**

The strategies raised in the paper would seem adequate. The essential elements are that each council determines its priorities, determines the levels of service it wishes to provide and allocates the resources necessary to provide those services. For the planning and auditing processes to be effective there must be full commitment of council for the process and for those responsible for implementation.

➤ **What requirement is there for a charter outlining the jurisdiction and authority of the internal auditor and audit committee**

It is essential that an internal charter is developed and adopted by council if the internal audit process is to be effective. This charter must document the aims and objectives of the internal audit and provide guidelines for implementation of the process.

➤ **Any other issues relating to internal audit in local government which have not been addressed in this discussion paper**

It is apparent that the financial and legal liability risk resulting from poor or inadequate asset management planning is not understood by councils. There is the potential for local roads in NSW to become as serious a problem as the issues surrounding maintenance of the rail network.

The solution to this problem is to develop guidelines and operating systems for implementation by councils. The internal audit process is the means by which councils and their communities can be confident community infrastructure assets are being managed in an efficient and sustainable manner. The internal audit process is also the means by which operational audits can be linked to the external audit information reported by councils.

Conclusion

IPWEA (NSW) and the Roads & Transport Directorate would appreciate the opportunity to work with the Department to implement appropriate internal audit systems in local government across New South Wales. The Directorate is particularly interested in progressing the introduction of asset management across the

state. Should you wish to discuss any of these matters further please contact me on phone (02) 8267 3000 or by email at: msavage@ipwea.org.au.

A handwritten signature in blue ink, appearing to read 'Savage', with a large, stylized initial 'S'.

Mick Savage
Manager Roads & Transport Directorate

30 September 2005