



# Orange City Council Audit and Risk Management Committee review of risk processes associated with FFTF merger option

## Abstract

An independent review of the identified risks  
associated with the FFTF merger with Cabonne and /  
or Blayney Councils option

OCC Audit & Risk Committee

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## Background

The NSW Government Fit for the Future (FFTF) assessment of local government report by the Independent Panel identified that Orange, Cabonne and possibly Blayney should merge in order to deliver the sustainability it seeks in local government.

The General Manager has asked the Audit and Risk Management Committee (ARMC) to assess the risk issues identified in his report to the Council of 19 May 2015 on Council's assessment of the proposed merger and the processes Council has undertaken to assess risk via a variety of independent and internal assessments.

## Limitation

This review is limited to the documents and information provided to the ARMC and is a consensus view of the ARMC.

## Outcome

The Committee is asked to provide its independent advice on:

- The processes used to identify and assess risk issues in the Fit for Future program overall
- The fiduciary duties of the Council and staff regarding the Fit for Future program
- Adequacy of the process in assessing risks in terms of a due diligence approach
- Risk issues raised in the General Manager's report to Council dated 19 May 2015 and letters to the Office of Local Government and Independent Pricing and Regulatory Tribunal relating to the assessment of proposals in the Fit for Future program
- Any additional risk issues the Council could consider in assessing the Fit for Future Program

## Documents provided

1. Audit & Risk Committee Brief
2. CCL 19 May 2015 Fit for Future Late Item
3. Letter to Office of Local Government raising concerns around Fit for the Future
4. Orange City Council (OCC) Submission to IPART Methodology
5. IPART Methodology Review Report (Draft)
6. Report on Desktop Review
7. Final Report Cabonne and Orange Council Merger Business Case Modelling
8. Summary of Obligations of Council in relation to merger case
9. ERM Risk Plan for ARMC

## Current Situation

The ARMC understands the philosophy of using the identified ratios in an effort to measure and compare the performance of Councils who are at different maturity levels. However, the use of pre-defined templates forces Council to rely on unaudited data and in fact to accept this data as accurate in the assessment process, is a risk to Council that it has no control over.

In the area of asset management, valuation and life cycle costing, the template system appears to disadvantage those Councils, such as OCC, by ignoring the variations in maturity of the asset management and risk management systems of those Councils being considered for merger.

Whilst each Council's existence is based on the provision of services to its community, the level of service being agreed through consultation with its community, the service levels of various prospective merger partners are not considered. The impact of this will be felt by the communities involved when the new body attempts to align these services. Any reduction of service levels will be hard to defend and poorly accepted by the community and the cost of increased service levels has not been considered and may not be affordable. Under this current approach this service alignment will not be known until after a merger.

Given the appropriateness of the OLG system is outside of the scope of the review and is accepted as the system within which OCC must operate, the Committee provides the following comments:

### *The overall processes used to identify and assess risk issues in the Fit for the Future program*

#### Observation

Council has implemented a structured and detailed Enterprise Risk Management (ERM) system to allow a consistent approach in managing organisational risks.

From the documentation provided Council has assessed the risks to OCC by using its ERM system to identify the risks of a merger, rate and assess those risks and where it is within its control, develop mitigation strategies to reduce or eliminate those risks. Secondly, the identification of risk appears to be limited to within OCC and doesn't factor in any greater knowledge that would be available through the involvement of all merger partners.

#### Comment

Much of the risk mitigation is not within the control of OCC and would be largely reduced with further investigative assessment of the merits and impact a merger would have on the merger partners.

The committee supports Council comments as set out in their letter to the Office of Local Government dated 21 May 2015.

The Merger Risk Assessment Report assesses the inherent risks as severe and further identifies mitigation strategies. However, all risk treatment strategies have medium term completion dates up to 2017 which is outside the timeline for the determination of the FFTF as set out by the Office of Local Government.

### *The fiduciary duties of the Council and staff regarding the Fit for Future program*

#### Observation

The fiduciary obligations of Councillors and staff to exercise the rights and power in good faith for the benefit of their constituents is supported by case law and embodied in the Local Government Act 1993.

In essence the Act requires the governing body to direct and control the affairs of the Council in accordance with this Act (S223). Further, (S232) defines the role of a Councillor as:

- “(1) The role of a councillor is, as a member of the governing body of the council:*
- to provide a civic leadership role in guiding the development of the community strategic plan for the area and to be responsible for monitoring the implementation of the council’s delivery program*
  - to direct and control the affairs of the council in accordance with this Act*
  - to participate in the optimum allocation of the council’s resources for the benefit of the area*
  - to play a key role in the creation and review of the council’s policies and objectives and criteria relating to the exercise of the council’s regulatory functions*
  - to review the performance of the council and its delivery of services, and the delivery program and revenue policies of the council.*
- (2) The role of a councillor is, as an elected person:*
- to represent the interests of the residents and ratepayers*
  - to provide leadership and guidance to the community*
  - to facilitate communication between the community and the council.”*

OCC Code of Conduct also requires at (S7.6) for Councillors and staff to properly examine and consider all information provided to them to make decisions in accordance with OCC Charter.

#### Comment

From the information provided to the Committee, the Committee believes Council staffs have fulfilled their obligation by engaging independent reviews, for example the Morrison Low report and the Review of IPART Assessment Criteria. Similarly, based on the CCL 19 May 2015 Fit for Future Late Item Councillors too have fulfilled their obligation by considering these reports and raising Council’s concerns about the Fit for Future process with the Office of Local Government and making its submission to IPART on the assessment methodology.

#### *Adequacy of the process in assessing risks in terms of a due diligence approach*

##### Observations

The limitation with the OLG template and subsequently the Morrison Low report is that they take a high level view focused primarily on the ratio analysis and perceived long term sustainability. This conceptual view of the proposed merger may be sufficient for Government to consider the way forward but is lacks detail which may support or negate that decision. This situation places Council in a conflicting situation of complying with the FFTF process as directed by the Minister for Local Government and the OLG and meeting its obligations to the OCC stakeholders as defined in the Local Government Act 1993.

The adequacy of diligence by the decision makers is a matter for those charged with making that decision, which can be judged by the question, ‘are they satisfied they have applied sufficient care as they would in making decisions for their own affairs’?

## Comment

OCC appears to have provided Councillors with a thoughtful commentary of its requirement in the process and the concerns and shortcomings of that process. To add rigor around these concerns Council have received an independent review.

If we accept the shortcomings of the system it does not follow that a poorly constructed methodology to assess individual Council performance should deliver a poor decision. Through its endeavors to review their concerns by independent reviews Council has gone a long way to ensure any decision will be based on sound information or an understanding of the shortcomings of the methodology.

The perception that the system is faulty would not excuse the making of poor decisions that may not allow Council to meet its obligations under the Act. Additionally the ability of Councillors to make an informed decision will need to have regard to the long term effects of that decision and demonstrate how their decisions are in the best interests of residents and rate payers as well as demonstrating prudent management of Council's (residents and rate payers) assets.

The Committee agrees with the high level risks consequent to any merger decision identified in the Morrison Low but highlights to Council that their risks could be paraphrased as the risk that the identified benefits of any merger are not realised.

*Risk issues raised the General Manager's report to Council dated 19 May 2015 and letters to the Office of Local Government and Independent Pricing and Regulatory Tribunal relating to the assessment of proposals in the Fit for Future program*

## Observations

Council has been provided with a comprehensive report from the General Manager which draws together the identified issues arising from other aspects of the FFTF Program and presents Council with a summary of the potential risks to Council in each of the three (3) scenarios envisaged under the current methodology. These risks have been identified in Council's ERM Register and rated at the high end of the inherent risk rating. Risk treatment plans have been identified but these are a 'work in progress' which until implemented, leaves Council with a residual risk from the FFTF Program which is outside Council's risk tolerances.

Reference has been made to the impediments inherent in the assessment of Council's FFTF assessment from the seven (7) 'one size fits all' benchmarks in the independent review undertaken by Intentus Chartered Accountants. Specific concern is the inability of the assessment process to identify the consequential financial impact of variations in asset management strategies, condition assessments and asset management plans.

The independent desktop review of the potential merger partner Councils confirmed that the level of maturity in methodologies and management approaches was variable. The FFTF Program process is a quantitative evaluation rather than a qualitative evaluation which precludes robust integrity checks on the high level data.

## Comment

Council has properly identified that the significant long-term financial gains in any restructuring of local government from the FFTF Program is in the benefits from detailed asset systems providing efficiency and efficacy in strategic planning and management. The inability of the FFTF Program evaluation to assess this impact in any merger proposal could expose OCC to unquantified financial commitments.

Where Council finds itself in terms of scale and capacity once the NSW Government determines the outcome of the FFTF Program is a potential risk for Council. The potential risks in a merger which is not subject to proper due diligence have been articulated. Equally, whilst a stand-alone option is manageable under the terms of the current evaluation process, further regionalisation of inter-government relations could threaten Council's long term capacity to stand-alone.

## *Any additional risk issues the Council could consider in assessing the Fit for Future Program*

### **Conflicted decision making.**

This situation places Council in a conflicting situation of complying with the FFTF process as directed by the Minister for Local Government and the OLG and meeting its obligations to the OCC stakeholders as defined in the Local Government Act 1993.

### **Long term contracts**

Consider the impact of any current long term contracts and Council's ability to cancel or amend such as the water supply arrangements between the merger partners and Central Tablelands Water.

### **Commercial operations**

Consider the operational and financial risks of any commercial ventures managed by the merger partners, such as the quarry operated by Cabonne Council.

### **Financial modelling**

Look at the financial modelling with and without financial assistance, this will show the likely scenario should the financial incentive be withdrawn or not available.

## Summary

1. Risks that are not within the control of OCC and would be largely reduced with further investigative assessment of the merits and impact a merger would have on the merger partners.
2. The Committee supports Council comments as set out in their letter to the Office of Local Government dated 21 May 2015.
3. The Merger Risk Assessment Report assesses the inherent risks as severe and further identifies mitigation strategies. However, all risk treatment strategies have medium term completion dates up to 2017 which is outside the timeline for the determination of the FFTF as set out by the Office of Local Government.

4. The Committee believes Council staff have fulfilled their fiduciary obligations
5. Similarly, Councillors too have fulfilled their obligation.
6. OCC appears to have provided Councillors with a comprehensive commentary of the FTFF process and the concerns and shortcomings of that process.
7. Council has ensured any decision will be based on sound information and an understanding of the shortcomings of the FTFF methodology.
8. Councillors in making an informed decision will need to comply with the Act by having regard to the long term effects of that decision and demonstrate how their decisions are in the best interests of residents and rate payers as well as demonstrating prudent management of Council's (residents and rate payers) assets. Any perceived shortcomings in the FTFF methodology should not compromise the Councillors' obligations.
9. The Committee agrees with the high level risks consequent to any merger decision identified in the Morrison Low report.
10. The inability of the FTFF Program evaluation to assess the benefits of detailed asset systems could expose OCC to unquantified financial commitments.
11. Whilst a stand-alone option is manageable under the current FTFF evaluation process, further regionalisation of inter-government relations could threaten Council's long term capacity to stand-alone.
12. The Committee considers that Council has sufficient information upon which to support a stand-alone option.
13. The Committee considers that Council does not have sufficient information to support a merger option without further due diligence of the merger partners.
14. The FTFF process places Councillors in a conflicting situation of complying with the directions of the Minister for Local Government and the OLG, and meeting its obligations to the OCC stakeholders as defined in the Local Government Act 1993.
15. Council should consider the impact of any current long term contracts and its ability to cancel or amend, such as the water supply arrangements between the merger partners and Central Tablelands Water.
16. Council should consider the operational and financial risks of any commercial ventures managed by the merger partners, such as the quarry operated by Cabonne Council.
17. Council should determine the impact of the withdrawal of government financial assistance on the current modelling of the proposed merger.