



Government
of South Australia

Report of the Auditor-General

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Second Session, Fifty-Third Parliament

Examination of the local government indemnity schemes: September 2015

By authority: P. McMahon, Government Printer, South Australia

2015

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Dear President and Speaker

**Report of the Auditor-General: Examination of the local
government indemnity schemes: September 2015**

Pursuant to section 32(3) of the *Public Finance and Audit Act 1987*, I present to each of you a copy of my Report on the 'Examination of the local government indemnity schemes: September 2015'.

Content of the Report

In accordance with section 32(1)(c) of the *Public Finance and Audit Act 1987* the Auditor-General may examine accounts relating to a local government indemnity scheme and the efficiency and cost-effectiveness of the scheme. I have completed an examination of the two local government indemnity schemes, established under Schedule 1, clause 2 of the *Local Government Act 1999* and this report communicates the findings from that examination.

Acknowledgements

The audit team for this Report was Andrew Corrigan and the Local Government audit team.

I would like to record my appreciation for the cooperation and assistance provided by the staff of the Local Government Risk Services and the Local Government Association of South Australia during the course of the audit.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Richardson'.

Andrew Richardson
Auditor-General

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Examination of the local government indemnity schemes: September 2015

1 Executive summary

1.1 Introduction

From 1 September 2013 amendments to section 32 of the *Public Finance and Audit Act 1987* (PFAA) gave the Auditor-General wider discretionary powers to examine the accounts, economy and cost-efficiency of a publicly funded body or project or local government indemnity scheme. In effect this extends the statutory remit of the Auditor-General into the local government sector.

Pursuant to section 32(1)(c) of the PFAA, we have conducted an examination of the efficiency and cost-effectiveness of the local government indemnity schemes, with regard to sound governance, administrative and financial arrangements.

A local government indemnity scheme is a scheme conducted and managed under Schedule 1, clause 2 of the *Local Government Act 1999* (LG Act). The following two local government indemnity schemes (the schemes) have been established:

- Local Government Association Mutual Liability Scheme (MLS) – the MLS provides members with risk, claims and legal services for civil liabilities
- Local Government Workers Compensation Self-Insurance Scheme (WCS) – the WCS provides a scheme for self-insurance against work related injuries to scheme member employees.

These schemes are managed by the Local Government Association of South Australia (LGASA) and are mutual risk products which offer discretionary indemnity to its members. The schemes collectively manage outstanding claims of \$30.8 million and total assets of \$121.6 million as at 30 June 2014.

This Report provides the details of the examination conducted, including the audit scope, overview of the schemes' governance and administrative arrangements, results of the examination and audit recommendations made to LGASA, together with responses for those matters.

1.2 Outcome of the examination

In accordance with the LG Act, LGASA has established separate boards of management (Scheme Boards) to administer the individual schemes. The Scheme Boards report to the LGASA Board. Further, LGASA has appointed a scheme manager (the Local Government Risk Services (LGRS)), an entity of Jardine Lloyd Thompson (JLT). The purpose of LGRS is to assist the Scheme Boards to manage and administer the schemes. These scheme management arrangements have been in place since the late 1980s.

Every five years these governance arrangements are reviewed by an independent consultant. Given the very longstanding arrangements between LGASA and the scheme manager, this periodic independent review is an essential governance element to assess the ongoing efficiency and effectiveness of the schemes. The schemes were not subject to market testing of an indicative scope of services.

The most recent independent review was completed in December 2013. The independent reviewer confirmed that it is unlikely that another single provider could provide a similar breadth of services at a similar cost based on the services provided by the current scheme manager. This opinion largely reflected JLT having a competitive advantage from JLT's presence in local government at a regional and national level.

The December 2013 independent review noted that the schemes have provided significant benefits to member councils over the years in terms of premium savings and contribution stability, contributing to risk management and risk mitigation programs and training. The review made a range of observations and recommendations relating to the future scheme arrangements, setting strategic objectives and mechanisms to drive future performance. In particular, recommendations included formalising strategic objectives and operating plans for each scheme, transferring to performance based arrangements with the scheme manager, considering evolving Board arrangements and formalising procurement processes (for non-scheme services) to help ensure transparency, value-for-money and fairness.

In response, the Scheme Boards are taking positive action to address these recommendations. Strategic plans have been developed for 2014-17. Annual and operational plans will also be developed for both schemes for the first time in 2015-16, and will be linked to the annual budget and financial plans of each scheme.

Both schemes have reached financial maturity with sufficient funds to meet the estimated claim liabilities (\$13.8 million and \$16.9 million for MLS and WCS respectively, as at 30 June 2014). Consistent with actuarial advice and the independent reviewer, the Scheme Boards were advised to review their longstanding policies on accumulated funds, contributions and investments.

In view of the strategic nature of the independent review findings and related recommendations, we consider it would be valuable for the next review to be performed on a three year basis, ie by December 2016. This would provide a timely opportunity to confirm that LGASA's actions effectively address the reported matters and, if applicable, emerging issues, particularly where the services have not been subject to market testing.

Given the longstanding arrangement with the scheme manager, it is critical that LGASA has sound contract management practices. Our examination of the schemes identified key shortcomings in managing the contractual arrangements with the scheme manager, where there is:

- a lack of a contract management policy framework
- informal monitoring and evaluation of contract performance
- uncertainty and potential overpayment of the scheme manager's remuneration fees
- unauthorised variations to contractual arrangements
- a lack of documented delegations of authority.

Our examination also identified key issues and opportunities for improving the management of the schemes, including:

- non-compliance with the Scheme Rules about providing reports to the LGASA Board
- management of perceived conflict of interest/role
- a lack of a documented risk policy and assessment process in managing the schemes' risks
- untimely review of specific policies.

Section 4 of this Report provides detailed commentary on these key issues and recommendations to improve future processes.

LGASA has accepted the recommendations arising from the examination. Specifically, LGASA has acknowledged the examination findings regarding the shortcomings in contract management and there is an opportunity to modernise the scheme arrangements. The modernisation of the schemes would include a review of the agreements(s) with the scheme manager, board governance and contract management. LGASA stated that this modernisation program will ensure that the schemes continue to be managed and administered in a value-for-money, efficient and transparent manner. Further, LGASA advised that it has resolved to receive a report on the establishment of an audit committee to strengthen the governance arrangements.

1.3 Audit conclusion

The current governance and administrative arrangements of the schemes have been in place for nearly three decades. This includes the contractual arrangements with the scheme manager, JLT. The recent independent review of the schemes confirmed that it is unlikely that another single provider could provide a similar breath of services at a similar cost. The independent review did not include a detailed evaluation or quantification of alternative providers as this would most appropriately be achieved through a formalised market testing approach. Such an approach would confirm whether the current governance and administrative arrangements are the most cost-effective.

In the absence of market testing, it is critical that LGASA has implemented effective practices to manage the contracts with the scheme manager. LGASA has not implemented essential elements of contract management practices. A key shortcoming was the absence of a contract management policy framework. This key shortcoming has contributed to a number of issues and increased risk that value-for-money is not achieved and maintained throughout the contract term.

While recognising the independent assessor's finding on the schemes' services and costs, these issues significantly limit assurance that the schemes are continually managed efficiently and cost-effectively.

The Scheme Boards' have taken positive action to address the outcomes of the independent review and are continuously improving their management practices to increase services and benefits to scheme members. LGASA has committed to modernising the schemes. These actions are key to the ongoing efficiency and cost-effectiveness of the schemes.

2 Audit mandate and scope

Part A: Audit Overview of the Auditor-General's Annual Report to Parliament for the year ended 30 June 2014 provided comment on the new role for the Auditor-General in the local government sector and outlined the Auditor-General's responsibilities under section 32 of the PFAA.

In brief, from 1 September 2013 section 32 of the PFAA was amended to significantly extend the role of the Auditor-General to the local government sector.

Pursuant to section 32(1)(c) the Auditor-General may examine accounts relating to a local government indemnity scheme and the efficiency and cost-effectiveness of the scheme.

We have completed an examination of the efficiency and cost-effectiveness of the MLS and WCS. The objective of the examination was to determine whether the schemes are being managed efficiently and cost-effectively with regard to sound governance, administrative and financial arrangements, including aspects related to the following matters:

- compliance with legislative requirements
- sound policy frameworks to manage the key activities of the schemes (for example policies supporting contributions, accumulated surplus, risk management)
- clear administrative and financial accountability arrangements and delegations of key stakeholders (including strategic planning and reporting arrangements, monitoring performance and conflict of interest protocols)
- management of the scheme manager's agreement(s)
- financial performance of the schemes' operations.

The examination included a detailed review of documentation and discussions with the former Chief Executive Officer, LGASA (CEO) and General Manager, LGRS (GM). The audit management letter was forwarded to the Presiding Member, LGASA Board in early July 2015. LGASA responded to the audit recommendations on 7 August 2015.

3 Indemnity schemes overview

3.1 Legislative framework

A local government indemnity scheme is a scheme conducted and managed under Schedule 1 clause 2 of the LGA. Two local government indemnity schemes have been established, the MLS and WCS.

These schemes are managed by LGASA in accordance with the respective Scheme Rules. Pursuant to Schedule 1 clause 5 of the LGA, the LGASA may transfer the management of a scheme to another body.

The Scheme Rules provide for the governance and administrative arrangements of the schemes as described below.

3.2 Governance and administrative arrangements

In accordance with the LGA and Scheme Rules, LGASA has established separate boards of management (Scheme Boards) to administer the individual schemes. LGASA has delegated certain powers, function and duties to the Scheme Boards. The Scheme Boards are accountable to the LGASA Board.

Further, LGASA appointed a scheme manager, LGRS, to assist the Scheme Boards to manage and administer the schemes. This arrangement has been in place since the establishment of the schemes and is reflected in the following contract documents:

- 30 June 1997 – WCS Self-Insurance Joint Venture Agreement (WCS Management Agreement). This agreement supersedes and replaces the 1986, 1991 and 1996 agreements between LGASA and JLT.
- 30 June 1997 – WCS Joint Venture Operations Agreement (WCS Operations Agreement).
- 1 July 2001 – MLS Joint Venture Management Agreement (MLS Management Agreement). This agreement supersedes and replaces the 1989 agreement between LGASA and JLT.
- 1 July 2001 – MLS Management Joint Venture Operations Agreement (MLS Operations Agreement).
- 27 June 2008 – MLS Deed of variation.
- Additional services on a fee for service basis.

3.3 Independent review of the schemes

Every five years LGASA arranges an independent review of the self-insurance services provided by the scheme manager. This includes an assessment of the arrangements for delivering services to members as implemented by LGASA. The most recent independent review was completed in December 2013.

The assessment was based on the independent reviewer's industry knowledge and insights, high-level market scanning and understanding of the JLT services provision under the current arrangements. It did not include formalised market testing where nominated organisations are invited to make submissions against an indicative scope of services.

The independent reviewer concluded that it is unlikely that another single provider could provide a similar breadth of services at a similar cost in the short term. Important elements supporting this opinion were JLT having a competitive advantage from its national presence in the local government insurance market, the scope of services offered and JLT's regional network. The review reported that the schemes have provided contribution stability for member councils where the insurance market can be volatile. Contribution rates before rebates were considered to be at or below market premiums for similar products. In particular, it was noted that the WCS actuary had estimated total savings from the WCS at approximately \$220 million since inception in 1986, based on the related WorkCover rate. This has increased to approximately \$236 million at 30 June 2014.

The independent reviewer made recommendations to address key issues and potential opportunities for improvement. These recommendations included:

- formalising strategic objectives and operating plans for each scheme
- transferring to performance based arrangements with the scheme manager
- evolving Board arrangements
- formalising procurement processes (for non-scheme services) to help ensure transparency, value-for-money and fairness.

In addition an independent actuary annually assesses the liabilities and financial performance of the schemes. The actuary is involved in outstanding claim reviews, assessment of unearned contributions, setting contributions and assessing the outstanding claim reserves. Further commentary on the actuarial review is provided under sections 3.4.2 and 3.4.3 of this Report.

The actuary's assessment of the schemes was peer reviewed by an independent actuary. The independent actuary concluded that nothing came to their attention to lead them to believe that the actuary's assessment is unreasonable.

Finally, the Scheme Boards have appointed independent external auditors (private accounting firms) to audit the financial statements of the schemes. Both schemes were issued an unmodified independent auditor's report for 30 June 2014.

3.4 Scheme objectives and financial performance

3.4.1 Membership

As outlined in the Scheme Rules, a member of a scheme is an eligible body admitted at the discretion of the respective Scheme Board (a power delegated by the LGASA Board). Eligible body includes councils and subsidiaries¹ constituted pursuant to the LG Act, LGASA, the Local Government Finance Authority of South Australia (LGFA) and other prescribed bodies. While membership is discretionary, all 68 local government councils are members of both schemes. In total there are 95 and 87 members of the MLS and WCS respectively at September 2015.

3.4.2 Local Government Association Mutual Liability Scheme

The MLS has been in operation since 1989 (26 years). Its objective is to provide assistance to members with their potential and actual civil liabilities including:

- advice to minimise the occurrence and severity of all civil liabilities
- assistance in the administration, investigation, management and resolution of all claims
- legal representation for all claims
- financial assistance by way of discretionary grants.

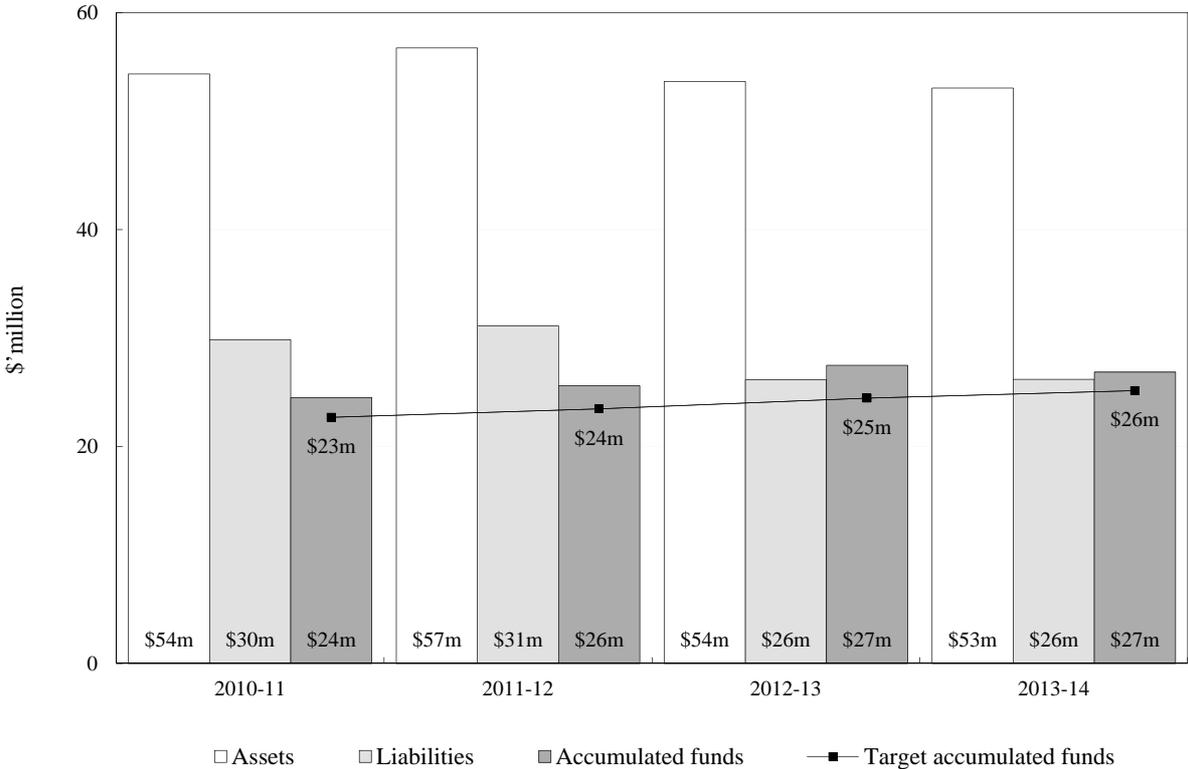
¹ Subsidiaries includes a subsidiary of the council and a regional subsidiary for which the council is a constituent council as defined under section 4(1) of the LG Act.

The MLS operates with the support of the Treasurer’s indemnity as provided in the Deed of Indemnity between the Treasurer of South Australia and LGASA. The Treasurer’s indemnity applies above an agreed layer of risk (which is to be retained by the MLS) for losses suffered from paying admitted claims made against scheme members for civil liability.² This provides members access to unlimited cover(s) which is not available through traditional insurance policies.

The MLS is in a sound financial position with continuous and steady growth in accumulated funds.

In 2008-09 the MLS Scheme Board adopted a policy which provided an accumulated funds target amount of \$20 million (indexed annually for the South Australian Local Government Price Index (LGPI)). This policy indicated that any amounts in excess of the target would be returned to members at the discretion of the MLS Scheme Board, including special distributions. The chart below shows that the actual accumulated funds exceed the target amount for the four years shown. As at 30 June 2014 the excess was \$1.3 million. The accumulated funds balance allows for special distributions. A total of \$6 million was returned to members over the four year period.

The following chart also analyses the assets and liabilities of the MLS for the four years to 2014.



The financial information presented in the chart has been obtained from the MLS audited financial reports.

² The State’s annual reinsurance program arranged by the South Australian Government Financing Authority includes the risks arising from the indemnity provided for the MLS.

Over the four year period accumulated funds have increased by \$2.4 million (10%) to \$26.9 million as at 30 June 2014.³ Over the same period investments have increased by 7% to \$30.5 million and the outstanding claims liability has decreased by 25% to \$13.9 million as at 30 June 2014. The surplus for a year depends significantly on:

- member contributions
- actuarial estimate of the outstanding claims provision. The reduction in the outstanding claims provision is mainly due to an increase in current reinsurance receivables. Claims for accident years 2004 and later are fully reinsured except for some unrecoverable claims and excesses on small claims
- investment returns. The MLS funds are invested in deposits at call and term deposits with LGFA. The short-term interest rate on deposits is relatively stable with volatility experienced in long-term interest rates.

An actuarial review as at 30 June 2014 reported the accumulated funds have built up almost entirely from member contributions (since 2004) in excess of insurance and operational costs. Further, the capital of the fund is over seven times its net liabilities and is projected to increase significantly upon closure of a large outstanding claim expected to be paid in 2016-17. The actuary considered that this ratio is far in excess of the prudential capital margins typically observed in similar schemes. The accumulated funds at 30 June 2014 were sufficient to cover the reinsurance outstandings and full reinstatement premium.

Over this four year period, gross member contributions (before bonus distributions) have increased by 11% to \$13.6 million⁴ in 2013-14. Gross member contributions are annually increased in line with the LGPI. Over the same period a total of \$10.9 million has been provided in bonus distributions to members. The bonus distributions are based on an assessment of members' claims experience and risk management practices and deducted from the member's contribution for the following year's membership renewal.

3.4.3 Local Government Workers Compensation Self-Insurance Scheme

The WCS has been in operation since 1986 (29 years). Its objective is to provide assistance to members with their potential and actual liabilities for any claim for the rehabilitation of and/or payment of compensation to member employees for work related injuries. Assistance includes:

- advice to minimise the occurrence and severity of all compensable disabilities
- assistance in the administration, investigation and resolution of any claim
- assistance in the rehabilitation of employees suffering from compensable disabilities
- legal representation for any claims
- financial assistance by way of discretionary grants.

³ At the time of preparing this Report the audited figures for the financial year ending 30 June 2015 were not available.

⁴ The financial information has been obtained from the 2013-14 Local Government Association Mutual Liability Scheme Annual Report.

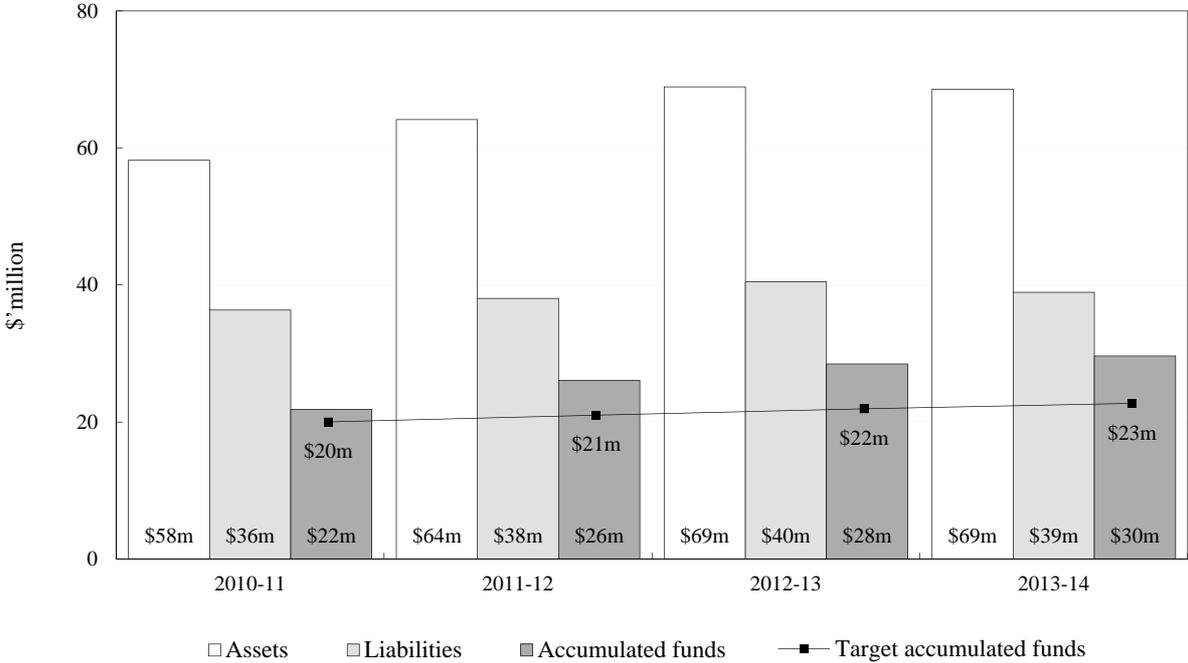
The members of the scheme are registered as a group of self-insured employers for the purpose of the *Workers Rehabilitation and Compensation Act 1986 (SA)* (WRCA). LGASA represents the group as the nominated employer for the purposes of the WRCA and holds the WCS licence on behalf of the members. On 9 September 2014 the former WorkCover SA (now ReturnToWorkSA) advised LGASA that a three year renewal of its self-insurer licence to 30 September 2017 had been granted.

Like the MLS, the WCS Scheme Board provides a bonus distribution to members on their contributions based on claim performance and risk management practices. These bonuses aim to provide financial incentives to council members to comply with legislative requirements and implement good risk management practices.

The WCS is in a sound financial position with continuous and steady growth in accumulated funds.

In June 2011 the WCS Scheme Board adopted a policy which provided an accumulated funds target amount of \$20 million (indexed annually for the South Australian average full-time ordinary earnings). Any amounts in excess of the target would be returned to members at the discretion of the WCS Scheme Board, including special distributions. The chart below shows that the actual accumulated funds exceed the target amount. As at 30 June 2014 the excess was \$6.9 million. The accumulated funds balance is after allowing for special distributions. A total of \$2 million has been paid to members over the four year period.

The following chart also analyses the assets and liabilities of the WCS for the four years to 2014.



The financial information presented in the chart has been obtained from the WCS audited financial reports.

Over the four year period accumulated funds have increased by \$7.8 million (36%) to \$29.6 million as at 30 June 2014.⁵ Over the same period investments have increased by

⁵ At the time of preparing this Report the audited figures for the financial year ending 30 June 2015 were not available.

\$7.7 million (20%) with minimal change in the outstanding claims liability. The surplus for a year depends significantly on:

- member contributions
- actuarial estimate of the outstanding claims provision. Since 1990 the scheme has experienced a reduction in claim numbers leading to a significant reduction in total incurred costs. The actuary reports that since 2010 both claim numbers and costs have stabilised possibly due to claim management and mitigation strategies. The scheme has had a relatively stable claims experience with costs increasing broadly in line with average wage earnings
- investment returns. The WCS funds are invested in deposits at call and term deposits with LGFA. The short-term interest rate on deposits is relatively stable with volatility experienced in long-term interest rates.

Over this four year period, gross member contributions (before bonus distributions) have increased by 16% to \$29.5 million⁶ in 2013-14. Gross member contributions are based on a percentage of the member's audited employee remuneration as defined by ReturnToWorkSA. Over the same period a total of \$41.1 million has been provided in bonus distributions. As at 30 June 2014 member contributions (after bonus distribution) were \$18.9 million. The actuary has reported that the member contributions continue to be sufficient to meet operating costs and overheads.

An actuarial review as at 30 June 2014 reported that the WCS's net assets are in excess of Australian Prudential Regulation Authority calculated capital benchmarks which suggests a very strong capital base to support the WCS's future claim experience.

4 Detailed examination findings, comments and recommendations

4.1 Lack of a contract management policy framework

Effective contract management provides a number of benefits which are often underestimated by organisations. To realise these expected benefits it is essential that sound contract management and monitoring practices are applied throughout the term of a contract.

For more information regarding recommended contract management policy framework practices refer to the Appendix of this Report.

Audit's examination revealed inadequacies in the contract management practices applied in managing the contracts with JLT. In particular, the examination revealed that:

- the former CEO was responsible for managing the scheme manager's contracts without any administrative support within LGASA
- there was no contract management plan (CMP) or system in place to guide effective management of the contracts with JLT

⁶ The financial information has been obtained from the 2013-14 Local Government Workers Compensation Self-Insurance Scheme Annual Report.

- the former CEO and GM had established an effective working relationship. Informal and regular meetings were held to discuss scheme related matters/issues. The MLS Operations Agreement, however, requires an Overview Committee comprising the LGASA Executive Director and Jardine State Director (SA). The activities of the Overview Committee were not formalised as intended by the MLS Operations Agreement. Section 4.7 of this Report outlines the functions of the Overview Committee.
- consistent with the independent review findings, there were informal practices in monitoring, evaluating and reporting of the scheme manager's performance. Further commentary on this matter is provided under sections 4.2 and 4.3.2 of this Report
- there was a lack of documentary evidence that the contract risks of the scheme manager's contractual arrangements were identified, monitored and regularly assessed.
- an accurate management record of formal meetings and performance assessment outcomes was not being maintained. Variations to contracts and associated approvals were also not readily available.

Risk exposure

The absence of adequate contract management policies and procedures increases the risk that contracts are not being managed effectively, leading to increases in the risks that:

- significant contract terms and conditions are not met
- better quality outcomes are not identified and achieved through continuous improvement in service delivery
- performance is not adequately monitored and issues remain unidentified or not identified timely and/or inappropriately managed
- contract risks are not identified and appropriately managed
- value-for-money is not achieved and maintained throughout the contract term.

Audit recommendation

We recommended that LGASA management develops, for LGASA Board endorsement, a contract management policy framework encompassing all the preceding elements of monitoring performance and risks and maintaining evidentiary records. The policy framework should be applied in managing the contractual arrangements with the scheme manager.

Local Government Association of South Australia response

LGASA acknowledged that there has been under-investment in contract manager capabilities and resourcing in recent times. After a period of nearly three decades since commencement of the schemes, there is an opportunity to modernise the scheme arrangements. This would include reviewing:

- the current agreement(s) and related documentation for the MLS and WCS

- the Board governance arrangements including the overall purpose, role and responsibility of the Scheme Board, including the Overview Committee. The role of the LGASA Board will be considered with a view to strengthening its role in relation to the governance of the schemes
- contract management in light of the examination findings and recommendation regarding policy framework, CMPs and contract management activities to cover monitoring and reporting and strengthening of performance based arrangements.

The modernisation program will assist LGASA to review, refine and strengthen scheme arrangements to ensure the schemes continue to be managed and administered in a value-for-money, efficient and transparent manner. Further, it will ensure that the needs of member councils continue to be met.

LGASA will assess roles and responsibility requirements for contract management over the agreements with JLT for the MLS and WCS. In addition, LGASA will develop a plan to acquire the requisite capabilities for the organisation.

LGASA advised that the above action will be implemented by 30 June 2016.

4.2 Informal monitoring and evaluation of contract performance

Clause 3 of the MLS Operations Agreement provides for an Overview Committee to be established, comprising the LGASA Executive Director and Jardine State Director (SA). The Overview Committee has advisory functions only and is required to monitor the performance of JLT. It is noted that the WCS Operations Agreement does not provide for an Overview Committee.

Discussions with the former CEO revealed that the proceedings of the Overview Committee are not formalised as the MLS Operations Agreement may have initially intended. The former CEO and GM indicated they have regular and informal meetings to discuss scheme activity and matters requiring action for the schemes. The proceedings of these meetings are not formally documented.

Further, the MLS Operations Agreement does not provide a clear description of the responsibilities and reporting requirements of the Overview Committee. For example, it is unclear to whom the Overview Committee is providing advice, the criteria against which the scheme manager's performance is assessed and how the Overview Committee is to monitor performance.

The Overview Committee, at least once every five years, will engage independent consultants to assess and review the performance of the scheme manager. It is unclear who has responsibility for monitoring, evaluating and reporting on the performance of JLT between these independent reviews.

Audit notes that the Management Agreements require JLT to manage the schemes in accordance with the respective Scheme Rules. Consequently, a majority of the Operation Agreement's terms and conditions are aligned with the Scheme Rules requirements. As provided in the Scheme Rules, the Scheme Boards are responsible for reviewing the

performance and function of the schemes. The GM indicated that the Scheme Board is a mechanism used by LGASA to monitor the performance of the scheme at least quarterly and annually via external independent reviews, such as actuarial, audit and ReturnToWorkSA.⁷

Notwithstanding this, the Management and Operations Agreements may include service requirements which are in addition to the Scheme Rules requirements. In addition, a formal performance assessment should be undertaken and clearly documented.

Risk exposure

Informal processes to monitor, evaluate and report on contract performance increase the risk that:

- performance issues/defaults remain undetected or unresolved adequately and/or in a timely manner
- value-for-money is not being achieved or maintained throughout the contract term
- significant contract terms and conditions are not met
- contract risks are not appropriately managed.

Audit recommendations

We recommended that the LGASA Board reviews the role and responsibilities of the Overview Committee, the Scheme Boards and/or contract manager with regard to monitoring, evaluating and reporting on the scheme manager's performance. The roles and responsibilities should be formalised and clearly documented in a CMP. Further commentary is provided under section 4.7 of this Report.

Consistent with the independent reviewer's recommendation, LGASA management should review current arrangements and formalise performance based arrangements.

Local Government Association of South Australia response

Refer to the response and agreed action under section 4.1 of this Report.

4.3 Contractual arrangements and documentation

The scheme management arrangements have been in place for nearly three decades. The current contractual documentation has been in place for nearly 20 years for WCS and 14 years for MLS (with a variation made in 2008).

The agreements do not have an expiry or review date and may be ended by either LGASA or JLT invoking the termination provisions. In light of this and the longstanding arrangement, it is essential that the agreements be reviewed regularly to ensure the contractual provisions remain current and relevant through the life of the agreement(s).

⁷ ReturnToWorkSA was formerly WorkCover SA. ReturnToWorkSA is responsible for providing work injury insurance and regulating the South Australian Return to Work scheme.

The examination revealed that the agreements are not being reviewed regularly and instances of non-compliance with contract provisions. Further commentary is provided under the following sections of this Report:

- 4.3.1 Inadequate review of contract documentation
- 4.4.1 LGA MLS – management fee formula is unclear
- 4.4.2 Overpayment in remuneration fees – goods and services tax
- 4.7 Administrative arrangements – unclear roles and responsibilities of committees.

4.3.1 Inadequate review of contract documentation

A review of the agreements with JLT indicated that the following have not been reflected in the agreements:

- changes in administrative practices
- provision of additional services and remuneration fee paid to the scheme manager
- improvements in contract documentation with regard to governance and administrative arrangements. For example, conflict of interest protocols and internal control requirements of the LGASA Board and/or Scheme Boards.

Further, there is inconsistency where the WCS Management Agreement does not include certain provisions as provided in the MLS Management Agreement. For example, rights to the fund upon termination, acknowledged ownership of the fund, access rights to the system and a dispute resolution process.

Risk exposure

The lack of regular review of contractual documentation increases the risk that provisions become irrelevant, ineffective and potentially unclear. This may result in increased uncertainty in the event of a dispute.

Audit recommendation

We recommended that LGASA management reviews the contractual documentation to ensure the provisions are current, relevant and, where applicable, consistent between the two schemes. This includes reviewing the structure and format of the contractual documentation and considering developing one management agreement, which covers the management of both schemes. Any specific requirements of the individual schemes may be reflected in the agreement schedules.

Local Government Association of South Australia response

Refer to the response and agreed action under section 4.1 of this Report.

4.3.2 Performance based arrangements

The independent reviewer recommended that the current arrangements with the scheme manager be more formalised performance based arrangements. The LGASA Board and Scheme Boards have agreed to this recommendation.

A progress update report to the MLS Scheme Board in February 2015 indicated that the recommendation had been implemented, with performance measures included in the schemes' 2014-17 strategic plans. These performance measures are relevant in evaluating the performance of the schemes. The measures, however, may not be appropriate to evaluate the performance of the scheme manager against the contracted service requirements.

Performance measures should be outlined in the contractual documentation and directly linked to the services to be provided. Further, contractual documentation should provide the necessary reporting on service delivery to enable LGASA to monitor and assess the service provider's performance and contract outcomes.

Risk exposure

The absence of performance measures increases the risk of not realising better quality outcomes through continuous improvement and value-for-money is not achieved and maintained throughout the life of the contract.

Audit recommendations

We recommended that LGASA management considers consulting with the scheme manager to establish clear, relevant and measurable performance indicators. The contractual documentation should be amended to include the agreed performance indicators together with the nature and timing of information LGASA requires to monitor and evaluate the scheme manager's performance.

LGASA management should assign responsibility to a relevant LGASA officer to monitor and evaluate the scheme manager's performance and report the outcome to the relevant stakeholders. Where applicable, the process should be documented in a CMP.

Local Government Association of South Australia response

Refer to the response and agreed action under section 4.1 of this Report.

4.4 Scheme manager's remuneration

In accordance with the Management Agreements, the scheme manager is required to provide all the self-insurance services necessary for the continuance, management and operation of the schemes as outlined in the relevant Operations Agreement and the Scheme Rules. This includes assistance and advice to LGASA with the management and operation of the schemes.

As defined in the Management Agreements, self-insurance services include, but are not limited to: risk management; claims management; fund operations; investment of scheme assets; accounting and auditing of the scheme and fund; actuarial services; legal services; and rehabilitation services (relevant to WCS). The remuneration for these services comprises:

- a management/service fee for providing management and operational services
- a claims management fee for each admitted claim managed
- a risk management fee for risk management services.

On 27 June 2008, a variation to the MLS Management Agreement was made to include an additional annual remuneration to JLT and LGASA.

The examination revealed that JLT's services as scheme manager have increased over time and remunerated accordingly. Except for the above variation, additional remuneration is being paid without variations to the Management Agreements.

4.4.1 Local Government Association Mutual Liability Scheme – management fee formula is unclear

The scheme manager's annual remuneration is calculated in accordance with the formulas provided under clause 3 of the MLS Management Agreement. The annual remuneration includes a fee for the management and operational services (the management fee).

Based on our interpretation of the wording in clause 3, we recalculated the 2014-15 management fee. Our calculation resulted in an amount approximately \$150 000 lower than that calculated by LGRS and paid by the MLS.

Our calculation was discussed with the Acting CEO and the GM during the examination. The details of the calculation have not been included in this Report to preserve the commercial confidentiality of the scheme manager's remuneration.

Discussions with the GM and review of the 1989 and current management agreements indicated that the wording in clause 3 has been in place since 1989 (from the commencement of the MLS). Further, LGRS's calculation of the 2014-15 management fee has been consistently applied throughout the life of the 1989 and current management agreements.

The GM indicated that the wording in clause 3 does not accurately reflect the intent of how the management fee was to be calculated. The fact that our independent calculation produced a different result suggests that the wording in clause 3 is unclear and open to interpretation.

Risk exposure

There is a risk that the scheme manager's remuneration is being incorrectly calculated, leading to an increased risk of value-for-money not being achieved and non-compliance with the terms of contractual arrangements.

Audit recommendations

We recommended that the LGASA Board reviews the calculation and confirms the appropriate interpretation as intended at the commencement of the contractual arrangement.

We also recommended that LGASA management review the MLS Management Agreement to ensure the wording is clear and revises it to remove any misinterpretation or uncertainty. This may require including an example of the calculation in an agreement schedule.

Prior to payment, the LGASA delegate should ensure the remuneration fees are calculated in accordance with the relevant agreements and any supporting documentation. The responsibilities of a contract manager may include certifying the payment as checked and correctly calculated prior to approval for payment.

Local Government Association of South Australia response

The LGASA agreed with the recommendations and, by 31 December 2015, will:

- review the calculation of the management fee
- review the MLS Management Agreement as recommended
- consider capability requirements for contract management with a view to recruiting a contract manager. The roles and responsibilities of this contract management role will include appropriate checking and validation of invoice amounts against relevant agreements and coordination of approvals.

4.4.2 Overpayment in remuneration fees – goods and services tax

Our review of the 2014-15 remuneration paid to JLT revealed that it is not being calculated in accordance with the contract provisions where the goods and services tax (GST) is being added to the remuneration fees.

For the MLS, clause 3.4 of the MLS Management Agreement provides that the fees in clause 3 (ie scheme manager's annual remuneration) are inclusive of GST at the rate of 10%. Further, if the GST rate is varied then the amounts referred to in clause 3 will continue to be inclusive of the GST but the agreement shall be varied to reflect the change in GST rate.

Our review of the 2014-15 annual remuneration for the MLS revealed that GST has been added to the management fee and risk management fee.

For the WCS, clause 3 of the WCS Management Agreement provides the basis of calculating the annual remuneration. The WCS Management Agreement was signed on 30 June 1997, prior to the introduction of GST. This agreement has not been varied.

Our review of the 2014-15 annual remuneration for the WCS revealed that GST has been added to the service fee, claims fee and risk management fee. In applying the GST this has changed the fee calculation as provided in the agreement. At the time that GST was introduced, the agreement should have been amended to provide clear agreement on the application of GST and the new fee calculation.

Risk exposure

There is increased risk that scheme manager remuneration is being incorrectly calculated and overpayments being made, leading to an increased risk of value-for-money not being achieved and non-compliance with the terms of the contractual arrangements.

Audit recommendations

Prior to payment, an LGASA delegate should ensure the remuneration fees are calculated in accordance with the relevant agreements and any supporting documentation.

LGASA management should review the WCS Management Agreement to determine whether a variation is required to the annual remuneration fee to take into account GST.

LGASA management should determine any action needed to address any confirmed overpayment in fees in 2014-15 and prior years.

LGASA management should maintain, separate to the scheme manager's records, an adequate record of variations made to the agreements together with all approvals to support the variation. Such documentation should be easily accessible when required.

Local Government Association of South Australia response

LGASA confirmed that an appropriate delegate will ensure that remuneration fees are calculated in accordance with relevant agreements and any supporting documentation.

The relevant WCS agreement will be reviewed, particularly in the context of the calculation of GST, and LGASA will consider any follow-up actions required.

LGASA will maintain separate records, including a record of the variations made to the scheme agreements and supporting information. This will be completed as part of the new role LGASA is currently considering.

These actions will be implemented by 31 December 2015.

4.4.3 Unauthorised variations to contractual arrangements

In addition to the risk management fee provided in the management agreements, JLT receives an annual regional risk management fee (total of approximately \$2.1 million (GST inclusive) for 2014-15). This fee is funded equally by the two schemes. The GM advised that risk management services are part of the delivery services outlined in the management agreements.

In 1995, the Scheme Boards agreed to expand the services to include a more focussed service to regional councils by introducing the role of regional risk coordinators. Despite this expansion of the scope of services and remuneration, no variations were made to the WCS Management Agreement.

The current MLS Management Agreement was signed in 2001, sometime after the increase in risk services. The risk management fee provided in the current MLS Management Agreement was increased by 112% from the 1989 agreement and the new risk management fee is also indexed annually. While the MLS Management Agreement was signed after the extension of risk services, the GM advised this increase in remuneration does not reflect the increased services introduced in 1995.

The annual regional risk management fee constitutes a variation to the management agreements. All variations should be made in accordance with the provisions of the management agreement which requires variations to be in writing. Such variations should be evidenced formally by a deed of variation. Further all variations should be approved by an officer with the delegated authority.

Risk exposure

There is an increased risk of unauthorised variations being made to contracts, leading to unauthorised payments being made from the scheme fund and/or payments made are not based on agreed terms.

Audit recommendation

We recommended that LGASA management ensures all remuneration paid to the scheme manager is consistent with the contractual arrangements. Where necessary, variations to the agreement should be made to reflect additional fees for service. Variations should be appropriately authorised in accordance with delegated authority and the provisions of the agreement.

Local Government Association of South Australia response

In addition to the actions provided under section 4.4.2 of this Report, LGASA will, by 31 March 2016, ensure:

- all previous variations in the scheme manager's remuneration are reviewed and documented. The scheme documents will be amended to reflect the agreed variations
- all future variations to the scheme manager's remuneration are appropriately documented, approved and scheme documents updated accordingly.

The modernisation program will include consideration of existing scheme agreements and associated documentation. This will include updating and amending agreements to reflect contemporaneous fee arrangements.

4.4.4 Lack of key definitions

The scheme manager's MLS management fee is based on gross contributions. Neither the MLS Management Agreement nor the MLS Scheme Board policies provide a definition of gross contributions.

In reviewing the management fee calculation, gross contributions represent the member's contribution plus the reduction in contribution provided to the member as a result of a bonus payment awarded to the member. We questioned whether it was appropriate for the scheme manager's remuneration calculation to include the bonus payment, when the amount was deducted from the contribution and not effectively paid into the scheme.

On 1 July 2015 the GM provided us with a copy of a letter dated 3 December 2001 addressed to the then CEO, LGASA. The letter indicated that the MLS Management Agreement (dated 1 July 2001) was amended to clarify that all remuneration is inclusive of GST. Further, the letter also described the gross contribution calculation. At the time of the examination, LGASA management could not provide a copy of LGASA's written agreement/response to the gross contribution calculation.

Risk exposure

The absence of clear and documented definitions of key terms increases the risk of misinterpretation of the terms and conditions of the agreements and the expectations of contracting parties not being met.

Audit recommendation

We recommended that the LGASA Board provides advice on the meaning of gross contributions and its calculation as provided in the MLS Management Agreement and the rationale for the manager's remuneration fee being based on gross contributions.

Local Government Association of South Australia response

LGASA will develop definitions for gross contributions and its calculation as provided in the MLS Management Agreement and the rationale for the manager's remuneration fee being based on gross contributions. This will be completed by 31 March 2016.

4.5 Reporting – non-compliance with the Scheme Rules

The Scheme Rules require certain information to be submitted to LGASA, including:

- an annual report on all aspects of the scheme
- a budget and financial report for each year
- an annual actuarial report.

A review of the LGASA Board meeting minutes revealed that the former CEO provided a report to the LGASA Board on these matters. However, the above reports have not been submitted and tabled at the LGASA Board meetings.

The GM advised that copies of these reports have not been provided to the LGASA Board as the Scheme Boards consider them commercially sensitive documents and consequently not to be made publicly available. Notwithstanding this, the LGASA Constitution requires the affairs of LGASA to be undertaken in an open and transparent manner. In doing so, the LGASA Board has regard to its duty of confidence.

With regard to the budget and financial report, the Scheme Rules require the Scheme Boards to prepare these documents and submit them to the LGASA. This implies that the LGASA Board is required to adopt the budget and financial report. Given the wording of the Scheme Rules, it is reasonable to conclude that the schemes' budget and financial reports are required to be adopted by the LGASA Board.

Risk exposure

Non-compliance with the Scheme Rules increases the risk of the budget and subsequent variations not being authorised by the appropriate governing body.

Audit recommendations

We recommended that the Scheme Boards provide the LGASA Board with the information required by the Scheme Rules.

The Scheme Boards' should submit the schemes' budget and financial report to the LGASA Board for adoption. Information to support the budget should also be provided to the LGASA Board, such as the annual actuarial report.

The LGASA Board and Scheme Boards' should establish and endorse a protocol to preserve the confidentiality of commercial-in-confidence documents.

Local Government Association of South Australia response

LGASA agreed with the audit recommendations and will, by 31 December 2015, ensure that:

- the Scheme Boards provide the LGASA Board with the information required by the Scheme Rules

- budgets and financial reports are submitted to the LGASA Board for adoption, as well as relevant supporting information, following adoption by the Scheme Boards
- the LGASA Board and Scheme Boards establish and endorse a protocol to preserve confidentiality of the commercial-in-confidence documents. The form of this will be a paper that describes what constitutes commercial-in-confidence information and how such information will be handled including reporting, stakeholders, availability, security and disposal.

4.6 Administrative arrangements – management of perceived conflict of interest/role

The Scheme Rules for both schemes allow two members to be nominated by the scheme manager. Consequently, the Chief Executive Officer, JLT Trading Board and the GM are board members of both schemes. We consider it inappropriate for the GM to be appointed a scheme board member as it may be perceived as a direct conflict with his senior role as GM.

The GM is significantly involved in managing and operating the schemes and the LGRS scheme managers directly report to the GM. For example, the GM and scheme managers provide assistance and advice in the management and operations of the schemes and then as a board member the GM is involved in making decisions on that same advice. This includes policy advice on contributions, which has a direct link to the remuneration of JLT.

In late 2014 the Scheme Boards endorsed a governance manual which provides conflict of interest protocols. While the governance manual requires only actual conflicts of interest to be disclosed, the potential/perception of a conflict of interest can be as damaging if not disclosed and managed in an adequate and timely manner.

Risk exposure

Conflicts of interest can occur at any time and across all activities of the scheme and it is important that disclosures are made and managed in a timely manner. Failure to do so can reduce the effectiveness of governance arrangements, increase reputational risk and undermine the decision making process and scheme members' confidence in the integrity of the scheme board.

Audit recommendations

We recommended that the LGASA Board reconsiders the appointment of the GM as a scheme board member.

In addition to the protocols provided in the governance manual, the Scheme Boards should consider requiring board members to declare interests on appointment and establish a register of board members' interests. The register should be updated for declarations made on appointment, future changes in interests and maintain documentary evidence of any conflicts that arise and how they have been managed.

Where the LGASA Board considers the appointment of the GM to be appropriate, the governance manual and schemes' risk management plan should provide the appropriate action taken to reduce the perceived/potential conflict of interest/role.

LGASA management should also consider reviewing the Management Agreements to include a requirement for JLT and its employees to declare any conflict of interests as they are identified.

Local Government Association of South Australia response

The LGASA Board will review the current arrangement where the scheme manager has full voting membership as part of the Scheme Boards. Currently, the Scheme Rules stipulate that the scheme manager will also be a board member. This will be completed by 30 June 2016.

LGASA will implement a register of all conflicts of interest which will be maintained and current at all times, including how the conflicts of interest will be managed. A register will be implemented by 31 December 2015.

4.7 Administrative arrangements – unclear roles and responsibilities of committees

The Schemes' governance manual requires that committees, working parties or advisory panels (committees) established by the Scheme Boards must be supported by relevant terms of reference. The terms of reference are to clearly outline the role and responsibilities, membership and any other matters that the Scheme Board may consider appropriate. This represents good governance practice.

Certain committees and working parties were established prior to endorsing the governance manual, specifically the Overview Committee and Combined Schemes Working Party.

The examination revealed that documented terms of reference have not been endorsed for these committees.

An Overview Committee was required under clause 3 of the MLS Operations Agreement, comprising the LGASA Executive Director and Jardine State Director (SA). Clause 3 provides the functions of the Overview Committee which are advisory and include:

- assisting JLT in the promotion of the MLS
- assisting with strategic initiatives which can enhance the scheme
- monitoring the performance of JLT pursuant to the MLS Operations Agreement.

Further, the Overview Committee is required to engage an independent consultant to assess and review the performance of JLT. Any recommendations arising from the independent review are considered by both parties and they have opportunities to comment upon and make recommendations to the Overview Committee. The MLS Operations Agreement does not provide any further information regarding the reporting requirements of the Overview Committee on its activities, including the outcome of the independent review and regular monitoring of JLT's performance (ie between independent reviews).

As previously mentioned, discussions with the former CEO and GM indicated that the activities of the Overview Committee are not formalised as intended by the MLS Operations Agreement. In particular, the Overview Committee discussions are not formally documented.

Risk exposure

The lack of clear and documented roles and responsibilities increases the risk that:

- the intended purpose/objective of the Committee is not met
- reporting responsibilities to the Scheme Board are not carried out as intended, leading to increased risk that Scheme Board's objectives are not met
- the activities of the Committee are inconsistent with the Scheme Board's requirements, leading to inefficient use of resources
- there is uncertainty for members of the Committee identifying and responding appropriately to any actual/potential conflict of interests.

Audit recommendations

In reviewing the contractual documentation, LGASA management should review the purpose and future requirements of the Overview Committee. Where it is considered that the Overview Committee is to continue, terms of reference should be established in line with the guidance provided in the Scheme Boards' governance manual.

Further, the Scheme Boards' governance manual should include a section on the role of the Overview Committee, recognising that while this is not a committee of the Scheme Board, it forms part of the governance structure.

For all existing committees/working parties, the Scheme Boards should approve terms of reference, specifically when additional funding has been allocated to support the activities of the working party.

Both Scheme Boards should review the governance manual to extend the declaration and management of conflict of interests to members of committees and working parties.

Local Government Association of South Australia response

LGASA will review the purpose and role of the Overview Committee as part of the modernisation program to be completed by 30 June 2016.

LGASA will ensure that terms of reference are prepared for existing committees and working parties by 31 December 2015.

The governance manual will be updated for the conflict of interest declaration and management requirements to members of committees and working parties by 31 December 2015.

4.8 Administrative arrangements – lack of documented delegations of authority

In accordance with the Scheme Rules of both schemes, the LGASA Board has delegated specific powers and functions to the individual Scheme Boards. These delegations do not provide further delegation of the LGASA Board's powers. The current delegations were approved in July 2004 and July 2006 for MLS and WCS respectively.

A specific function that has not been delegated to the Scheme Boards is the requirement to determine the administration fee payable for the performance of LGASA's functions and duties under the Scheme Rules.

The WCS and MLS Management Agreements provide for LGASA to claim payment or reimbursement from the scheme funds for the provision of advisory services requested by the Scheme Manager. The MLS and WCS Management Agreements provide a formula to determine the annual remuneration fee of LGASA. Other costs, such as out-of-pocket expenses, are separately determined and claimed by LGASA.

As provided in the schemes' Operations Agreement, the scheme manager shall on behalf of LGASA pay and discharge all proper liabilities from the fund. We found no evidence of the delegated authority for determining the administration fee prior to payment.

In line with LGASA's Constitution, the LGASA Board may delegate a power or function of the Board. Further a record of all delegations is required to be kept and reviewed at least once in every financial year.

We requested a copy of the LGASA Board's instrument of delegation to ascertain the CEO's delegated authority, including whether the CEO had authority to make variations to contracts on behalf of LGASA.

The Acting CEO advised that, after an extensive search, no formal documented delegation of authority could be located.

Risk exposure

The lack of documented delegations of authority increases the risk that scheme activities and transactions are unauthorised.

Audit recommendation

In line with LGASA's Constitution, the LGASA Board should formalise the delegations by signing an instrument of delegation outlining the nature and level of authority for each delegate. The instrument should include authority delegated to LGASA officers regarding scheme activities. The instrument of delegation be reviewed annually and made readily available.

Local Government Association of South Australia response

LGASA will develop an instrument of delegation that covers the schemes' activities by 31 December 2015.

4.9 Administrative arrangements – policy framework

The Scheme Boards' governance manual provides the policies and guidelines relevant to the schemes. An examination of the policies indicated areas for improvement in the Scheme Boards' policy framework which are outlined in the following sections of this Report:

- 4.9.1 Untimely review of investment policies
- 4.9.2 Untimely review of accumulated surplus policy

- 4.9.3 Lack of documented risk management policy and assessment
- 4.9.4 Improvements in policy documentation.

4.9.1 Untimely review of investment policy

The MLS investment policy was reviewed in March 2010 and the Scheme Board agreed to continue with the longstanding policy of investing scheme funds with the LGFA. The policy provides that the options provided by LGFA were compared to the investment rates provided by the banks. The WCS Scheme Board has adopted the same investment policy.

Given the continuous growth in accumulated surplus amounting to \$26.9 million and \$29.6 million for MLS and WCS, respectively as at 30 June 2014, we consider that the Scheme Boards should review the investment strategy on a more timely basis. The Scheme Rules allow for scheme funds to be invested in any security or investment authorised by the *Trustee Act 1936* or the LG Act.

In reviewing the investment policy, the Scheme Board should consider the various options under the Scheme Rules and the considerations provided in section 139 of the LG Act. For example, in assessing options they have regard to the diversification of investments, the nature of and risk associated with various options and capital/income loss. The Scheme Boards may consider seeking independent and expert advice on the investment of funds.

Risk exposure

There is a potential risk that schemes are not maximising their return on the investment of scheme funds, including adequate consideration of accepted levels of investment risk and available investment options.

Audit recommendation

We recommended that the Scheme Boards consider seeking independent and expert advice on the various investment options applicable to the schemes. Such advice should be sought on a timely basis and considered in reviewing the schemes' investment strategies.

Local Government Association of South Australia response

LGASA will seek independent advice on investment options applicable to the schemes by 30 June 2016.

4.9.2 Untimely review of accumulated surplus policy

The accumulated surplus target of \$20 million (increased annually for LGPI) for the MLS and WCS was determined in 2009 and 2011 respectively. The accumulated surplus is \$1.5 million and \$6.9 million in excess of the target as at 30 June 2014 for the MLS and WCS respectively.

With regard to the MLS, in 2014 the actuary reported that the surplus is seven times its net liabilities and is projected to significantly increase upon closure of a large outstanding claim in 2016-17. Further, the actuary advised that the retention of such a large surplus appears contrary to the concept of a mutual scheme. In addition, the independent reviewer has recommended both Scheme Boards consider the overall strategy for maintaining funds above the target surpluses.

In response the Scheme Boards are continuing to investigate further strategies to reduce the surpluses. The strategy to date has been to provide special distributions and/or bonus/rebate payments to reduce the accumulated surplus amount to its targeted amount.

Risk exposure

While the Scheme Rules allow LGASA to accumulate and retain funds for any purpose consistent with the objectives of the schemes, there is risk that LGASA may be subject to criticism for retaining surplus funds in excess of requirements. This is particularly the case in an environment where scheme members are operating under financial pressures and needing to focus on efficiency savings.

Audit recommendation

Further to the Actuary's report and the independent review recommendations, we recommended that the Scheme Boards review the target amount of \$20 million to ensure it remains reasonable. This review should clearly document the rationale to support the Scheme Board's assessment and decision, including consideration of the actuarial advice and the independent review recommendations.

Local Government Association of South Australia response

LGASA will review the surplus target amount to ensure that it remains reasonable, taking into account considerations and recommendations put forward by previous actuarial and independent reviews, and the requirements of member councils and the long-term nature of the scheme arrangements. This review will be completed by 30 June 2016.

4.9.3 Lack of documented risk management policy and assessment

An examination of the policies provided indicates that the Scheme Boards do not have a risk management policy.

While risk is being considered in the strategic and operational activities of the schemes, the Scheme Boards should consider formalising the risk assessment process and documenting identified risks in a risk management plan. The risk management plan should outline the risk, action taken to mitigate the risk and assign the responsibility to the relevant officer for managing the risk. Such risks, for example, may cover business continuity, disaster recovery, financial, strategic objectives, cost-effectiveness of current scheme management arrangements, procurement and contract management activities.

Applying effective risk management practices may improve the Scheme Boards achieving their strategic objectives by, for example, reducing the risk of fraud, a more efficient use of resources, better service delivery to members and a focus on key matters that have significant impact on the scheme's performance.

Risk exposure

In the absence of a risk management policy and plan, there is potential for risks not being identified and monitored on a timely basis and insufficient risk treatment being applied.

Audit recommendations

We recommended that the Scheme Boards develop and endorse a risk management policy.

The Scheme Boards should formally document their risk assessment of the scheme in a risk management plan. The documented risk management plan be updated as new risks are identified and risk treatments implemented. The effectiveness of the risk treatments should be regularly reviewed and reported according to the requirements of the Scheme Board.

Local Government Association of South Australia response

The Scheme Boards will develop and endorse a risk management policy and undertake a risk assessment exercise to identify and assess scheme risks. The risks will be assessed against an agreed better practice risk framework, and mitigation actions will be developed commensurate with each of the identified risks. Risk management will be included as a formal item for review on the Scheme Board's agenda at least annually. These actions will be implemented by 31 March 2016.

4.9.4 Improvements in policy documentation

Policies aim to provide a clear direction of the activities and how these activities are to be implemented to meet the expectations of the governing body.

A review of the policy documentation indicated areas of improvement for the Scheme Boards to consider to improve the clarity and effective implementation of policy requirements.

Policies should clearly define key terms made in the policy document and reference other relevant policies or guidelines. For example:

- the MLS accumulated surplus policy provides that additional financial reserves shall be returned to council members through special distributions or value added services. The policy does not provide further explanation (or reference to a separate policy) of these terms and how they will be allocated/provided to the council members
- the MLS annual contributions policy makes reference to gross membership contributions which are not defined. In practice, gross is prior to the special distribution being applied. Further, the policy does not provide how membership contributions are to be calculated as determined by the Scheme Board and Scheme Rules
- the acquisition of non-core services policy does not define 'non-core'.

Policies should also include key administrative information such as:

- the next review date and the actual date the policy was endorsed by the Scheme Board
- the timing of when the policy is applied and information required in making informed decisions. For example, the accumulated surplus policy is considered annually and in doing so takes into account the timing of when contributions are determined, actuarial report and the annual budget

- a clear definition of which members the policy applies to. For example, the accumulated surplus policy states that the Scheme Board has adopted the policy to achieve financial stability to ensure ongoing delivery of the services to members. However, the additional financial reserves to be returned are restricted to council members only. The Scheme Rules define members as an eligible body admitted at the discretion of LGASA to membership of the scheme. Eligible body includes councils, subsidiaries and other prescribed bodies. The policy, where relevant, should provide an explanation as to which members are exempt and the rationale for the Scheme Board's decision.

Risk exposure

The absence of clear and sufficient information in the policy document increases the risk of uncertainty in applying policy requirements as expected by the Scheme Board.

Audit recommendation

The Scheme Boards should consider reviewing the policies for the abovementioned improvements. Definitions in policies should be consistent with those provided in the Scheme Rules and other key documentation (eg contractual agreements).

Local Government Association of South Australia response

The Scheme Boards will review their policies in light of the audit recommendations. Further, the Scheme Boards will ensure that there is consistency, driven by the Scheme Rules, across policies and other key documentation. This will be completed by 31 March 2016.

4.10 Positive action to address independent review recommendations

The independent reviewer's December 2013 report was considered by the Scheme Boards at a planning forum held in February 2014.

The Overview Committee and Combined Schemes Working Party (CSWP) was established with a responsibility to consider the recommendations and provide advice to the Scheme Boards. A report was provided to the Scheme Board in March 2014 outlining the issues to be considered by the CSWP. As there are no terms of reference, the responsibility and reporting requirements of the CSWP are unclear. While some papers presented to the Scheme Boards mention CSWP involvement (for example the June 2014 report on the development of strategic plan), the reports to the Scheme Boards do not clearly identify which officer or committee is presenting the report to the Scheme Boards.

Discussions with the former CEO indicated that both Scheme Boards agreed to all of the independent reviewer's recommendations. The Scheme Boards are provided with regular progress reports on addressing the recommendations. A number of significant recommendations were addressed through the development of the schemes' 2014-17 strategic plans.

In February 2015 the MLS Scheme Board was provided with a task list reflecting the current status of recommendations aligned with the 2014-17 strategic plan. A review of the task list revealed that all recommendations except two will be implemented by June 2015. The remaining two are expected to be implemented by early 2016.

A review of the activities undertaken or planned to be undertaken indicated it is unclear whether the independent reviewer's recommendations are being addressed in their entirety. For example, the recommendations that the:

- services provided by the scheme manager to be more formalised performance based arrangements
- Scheme Boards undertake a review of structures and operations, including the consideration of the requirements to maintain separate Scheme Boards and establish subcommittees. The task list provides the action taken to address this recommendation is complete. It is unclear from the activity undertaken (as provided on the task list) and the 2014-16 strategic plan as to whether the structure of the Scheme Boards has been considered and the outcome. Discussions with the GM indicated that this element of the recommendation is being deferred and requires further analysis as to its efficiency and effectiveness.

Risk exposure

The absence of documented roles and responsibilities of the CSWP increases the risk that:

- the intended purpose/objective of the working party is not met
- reporting responsibilities to the Scheme Board are not carried out as intended, leading to increased risk that Scheme Boards' objectives are not met
- the activities of the working party are inconsistent with the Scheme Boards' requirements, leading to inefficient use of resources.

Audit recommendations

We recommended that the Scheme Boards approve terms of reference for all existing working parties.

The CSWP should amend the task list to include the considerations provided in each recommendation and the action taken/planned. Where it is decided that the specific consideration will not be addressed, the rationale for not taking any further action should be documented. This is to provide an adequate management trail of the Scheme Boards' response to the recommendations of the independent review.

Local Government Association of South Australia response

LGASA will consider the current task list against the recommendations and actions completed/planned arising from the independent review. Where recommendations will not be implemented, LGASA will ensure that all decisions are appropriately considered and documented. Where recommendations will be undertaken but are not yet completed, LGASA will provide an updated timeframe for completion and reporting purposes. This will be completed by 31 December 2015.

Appendix: Contract management policy framework

Effective contract management provides a number of benefits which are often underestimated by organisations. To realise these expected benefits it is essential that sound contract management and monitoring practices are applied throughout the term of a contract. Such benefits include:

- ensuring significant contract terms and conditions are met
- better quality outcomes are achieved through continuous improvement in service delivery, especially for longstanding arrangements
- performance is monitored and issues are identified timely and appropriately managed
- contract risks are identified timely and appropriately managed
- achieving and maintaining value-for-money
- the ability to identify potential savings to be negotiated during the contract renewal process.

Key contract management practices to consider in developing a policy framework include the following elements.

- assigning responsibility
- contract management plan
- managing the relationship with the service provider
- monitoring and evaluating performance
- contract risk management
- record management

Assigning responsibility

Responsibilities for contract management should be assigned to an officer (ie a contract manager) with the appropriate skills and knowledge to manage contracts and a sound understanding of the contracted services being provided and the terms and conditions of the relevant contract(s).

The role and responsibilities of the contract manager should be clearly defined, including the reporting requirements to executive management/governing body on contract status, significant issues/risks and service delivery outcomes. Generally, the contract manager's responsibilities would be based on the contract conditions and the requirements provided in a CMP.

Further, the contract manager would be responsible for ensuring that the contract is managed in line with organisational administrative processes.

Contract management plan

A CMP is an effective instrument for managing a contract and ensuring the abovementioned benefits. Ideally, CMPs are developed at the time of preparing the contract documentation and reviewed regularly throughout the contract term. Further, to maintain its relevance and effectiveness, the CMP should reflect changes in contract management practices and the agreement.

The comprehensiveness of CMPs may depend on factors such as the complexity of the agreement and its significant nature. Comprehensive CMPs enhance the effectiveness of contract management practices, specifically in the event of changes in personnel and when the arrangements are longstanding with no defined expiry date. In essence, the CMP should include all the information necessary for the contract manager to manage the contract effectively. The policy framework should provide guidance to enable a contract manager to determine the nature and extent of information required in the CMP.

Managing the relationship with the service provider

Management should maintain regular communications with the service provider to ensure the delivery and achievement of service outcomes. Communications may be a combination of informal discussions and formal meetings held at specific milestones and attended by executive management/contract representatives of both parties along with the contract manager.

Monitoring and evaluating performance

Monitoring and evaluating the service provider's performance is a critical element to ensuring the benefits and outcomes are achieved. It is important that clear and measurable performance indicators are established, regularly monitored and formally assessed. In addition, necessary and timely action should be taken to address any performance issues.

Performance indicators should be outlined in the contractual arrangements along with the necessary reporting on service delivery. The reporting requirements should reflect the information the contract manager needs to monitor and assess the service provider's performance and contract outcomes. Such a process should be supported by an adequate and relevant performance management system.

Further, this information is essential in identifying and assessing service failures that may be deemed to be an event of default. A default may be considered a significant breach of the agreement and result in a potential termination of the contract.

Contract risk management

Contract risks should be identified and managed from the procurement stage through to the expiry of a contract. All key contract risks should be identified and considered prior to finalising the contract, with risks documented in a contract risk management plan (CRMP).

The CRMP must remain current during the term of the contract. Risks and risk treatments listed in the CRMP should be regularly reviewed and updated in the CRMP when applicable. In addition, when identified, new risks and associated risk treatments should be added to the CRMP.

Common contract management risks include: unauthorised changes to the contract; failure of the service provider to satisfy the contract terms and conditions; and conflicts of interest or unethical behaviour/fraud.

Record management

A policy framework provides guidance on key documentation that should be retained. For example: signed contracts; variations to the contract including approvals; evidence of key documentation required under the contract; an accurate management record of formal meetings; performance assessment outcomes; and a clear documented management trail of any issues raised and actioned.