

SUBMISSION IN RESPONSE TO:
LOCAL GOVERNMENT ACT 1995 REVIEW
AGILE • SMART • INCLUSIVE
- LOCAL GOVERNMENTS FOR THE FUTURE -

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Overview

It is timely and appropriate for a comprehensive review of the Local Government Act 1995 (“LGA”) and related legislative and regulatory framework to be undertaken. Regrettably, despite the best efforts of the 1995 legislators, the current legislative and regulatory framework has failed in practice to assure the delivery of an appropriate standard of governance of local authorities (“LAs”) that the communities served by those LAs are entitled to expect.

The opportunity afforded to the community to respond to the consultation paper published by the Department of Local Government and Communities is very much appreciated.

The art and the science of governance of organisations has evolved and matured significantly over recent years since 1995.

The same, or substantially similar in most material respects, principles of “governance” that apply to corporations and organisations generally in society, whether public companies, community based organisations or public sector authorities, should also apply to LAs established under the LGA.

In this context when reviewing the existing legislative governance framework for LAs considerable insights might be gained by considering the accepted principles for “good governance” that apply to corporations and organisations generally in society.

This submission to the consultation paper responds in terms of the following 3 parts:

1. Applying general accepted “good governance” principles in the context of LAs. This part seeks to raise philosophical issues concerning the governance of LAs and their effective regulation which may assist policy formulation in framing proposed changes to the LGA.

2. Broad level reform initiatives (whether or not specifically raised in the consultation paper) to address improved LA governance and performance outcomes.
3. Specific response to Section 2 of the Consultation Paper – Training.

Cole Corporate welcomes the opportunity to engage further concerning the issues raised in this submission. The important role played by LAs in the community must be respected as well as the desire to ensure that the legislative and regulatory framework for LAs, and those who govern, direct and manage LAs, is appropriate and fit-for-purpose. This will assist in optimising the prospect of delivering enhanced performance outcomes and better managing risks for the districts and communities served by the LAs.

1. **Part 1 - Applying general accepted “good governance” principles in the context of LAs**

1.1 **Fundamental Governance Theory**

LAs are formed to better serve the needs and circumstances of their districts and constituents in accordance with their statutory mandate and adopted strategic objectives. The governance, direction and management of LAs is entrusted to and shared by elected Councillors and an appointed CEO. That entrustment is on the basis that those people can better achieve the intended or desired strategic outcomes for the LA than can either the State government itself through a designated Minister and Department, or the LA's district constituents themselves on mass.

Governance is an organisational construct designed to facilitate:

- Performance – by better assuring delivery of outcomes consistent with the LA's statutory mandate and strategic objectives, including appropriately managing organisational risk;
- Conformance – by better assuring the control and accountability of LAs including, importantly, by helping to manage “agency risk”. This refers to the behaviours, actions and conduct (or lack thereof) of those entrusted with the governance, direction and management of the LA proving to be otherwise than in the best interests of the LA and its constituents.

In relation to Councillors and officers of the LA, agency risk includes:

- (i) malfeasance – the risk of illegal and wrongful behaviour by the LA's Councillors or officers potentially giving rise to criminality e.g. dishonest dealing;
- (ii) misfeasance – the risk of culpable behaviour by the LA's Councillors or officers falling short of accepted standards potentially giving rise to civil claims e.g. negligence;
- (iii) underperformance – mere ineptness or failure by the LA's Councillors or officers to govern, direct and manage in a manner that realises the LA's performance potential, but without malfeasance or misfeasance.

“Effective governance” commonly includes a third element of *assurance*. This is represented by policies, systems, standards and protocols designed to assist in the more reliable delivery of both the *performance* and the *conformance* objectives of governance.

These components of effective governance (performance, conformance and assurance) work symbiotically to deliver outcomes which are consistent with the LA's statutory

mandate and strategic objectives, and where agency risk is effectively managed. Although theoretically capable of separate categorisation, they work indivisibly and inter-dependently with one another to support a holistic “effective governance” framework.

Governance is the domain of the LA’s Council. It is the LA’s Councillors who should hold themselves accountable for the LA’s governance and the delivery of outcomes consistent with the LA’s statutory mandate and strategic objectives. It is they who must deliberate and make decisions having regard to the best interests of the LA and its constituents as a whole. It is also they who must appoint and, through ongoing oversight, hold accountable the CEO of the LA to execute and implement Council decisions and to administer and manage the day-to-day operations of the LA.

1.2 Analysing the components of effective governance

(a) Performance

For a LA to sustainably deliver outcomes consistent with its statutory mandate and strategic objectives there must be at least appropriate:

- decision making by the LA’s Council;
- execution and implementation of those decisions by the LA’s CEO and management team;
- oversight, monitoring and review of the decisions taken as well as their execution and implementation.

Performance related decisions by LA Councils typically relate to: strategic planning and direction; risk appetite and oversight; resourcing allocation and prioritisation – financial, human and asset (tangible and intangible) through business planning and budgetary approval.

(b) Conformance

An LA’s governance must also protect against the downside of adverse outcomes. This includes behaviour, actions or conduct (or lack thereof) by appointed Councillors, the CEO and management team which is contrary to the achievement of the LA’s statutory mandate and strategic objectives, its policies and/or the law.

Accountability to the LA’s community constituents and regulators is a key element of effective governance. This includes concepts of transparency (subject to legal and commercial constraints), access to relevant LA personnel and reporting of relevant information. In this manner, those to whom accountability is owed (i.e. the regulators and the LA’s district constituents) can be reasonably informed and make proper assessments of the LA’s progress towards performance outcomes. They may also assess the performance of those entrusted to govern, direct and manage the LA.

Importantly, a LA’s governance must also align with a strong ethical framework which is principles-based and rooted in values and integrity. This goes well beyond legal and regulatory compliance, although that too is absolutely vital. It must be designed to underpin an ethos that whatever is done by the LA and its people in the name of the LA, not only must lawfully be able to be done, but is also “right” to be done.

(c) Assurance

Assurance is akin to the glue that holds a LA's governance intact and holistically coalesces the "yin and yang" of the performance and conformance functions of governance.

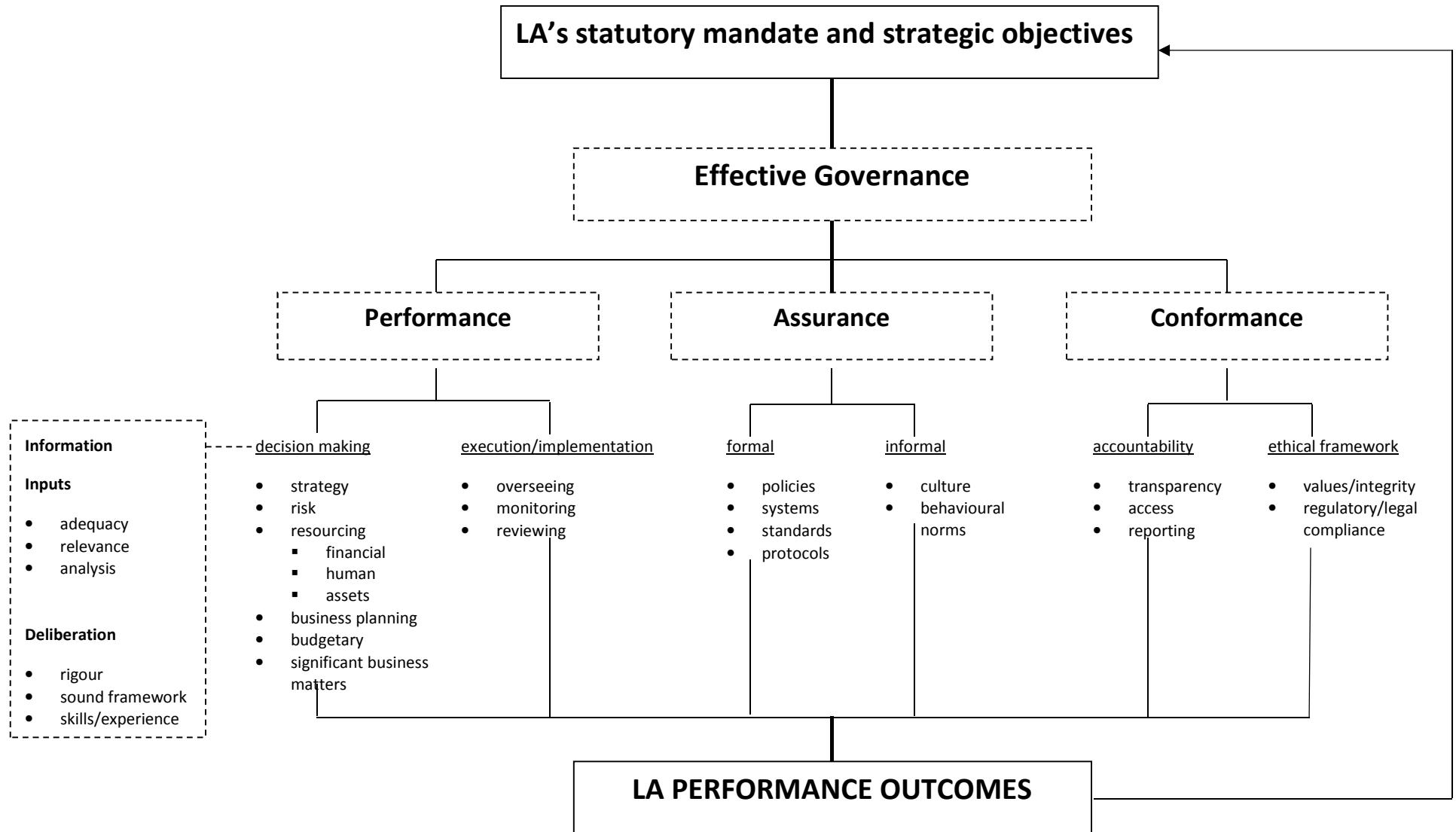
It is a function that embraces both formal and informal elements.

On the formal side are the written policies, systems, standards and protocols that proscribe, prescribe or describe how operations and processes within the LA, or by the LA with the external world, are to be conducted.

On the informal side is the organisational culture of the LA and its people. Having a sound culture is vital for a LA in developing normative behaviour based on principles which can be interpreted and applied by the LA and its people. It facilitates appropriate decision making and action even if a prescribed process as to what should be done has not been formally documented, or cannot readily be accessed.

Table "A" seeks to present these concepts in diagrammatic form.

Table “A” – COMPONENTS OF EFFECTIVE GOVERNANCE



1.3 Governance focus and agency risk

(a) Conformance by managing agency risk

The evolution of organisational governance, both philosophically and in practice, has been significant over recent decades. Applied governance is generally recognised as being both an art and a science.

Importantly, much of its evolution has focused on the conformance aspect of governance. Laws and regulations are passed prescribing and proscribing the behaviour of organisations and their directors and officers. Courts also pass judgment on compliance with these laws and regulations, and the observance (or not) of fiduciary duties by directors and officers. In turn, the media is keen to report on such matters.

Similar comments apply with respect to the prescriptive regulation of the behaviours of LAs and their Councillors and officers.

In the context of agency risk, this legislative, regulatory and judicial focus primarily has been on “malfeasance” and “misfeasance”. This is where fault or culpability, criminal or civil, is sought to be ascribed, and penalties imposed, including as a deterrent to others as to how not to behave in the future.

Stakeholders of LAs whose Councillors or officers have breached legal and regulatory rules have been keen to attribute blame for the breach. At times the blame may be fairly ascribed to the LA’s Councillors or officers, depending on the circumstances. But, at all times, it must be remembered that LA performance is invariably concerned with the prudential management of risk to deliver enhanced performance and strategic outcomes for the LA. By its very nature, risk is steeped in uncertainty.

Our regulators and our judiciary may prosecute and pass judgment on malfeasance or misfeasance of Councillors and officers. It is their job to do just that. It is an important job, and nothing in this submission suggests otherwise.

In support of society’s legislative, regulatory and judicial system, the government and its agencies spend millions of dollars each year in passing legislation and resourcing regulators, prosecutors and the judiciary to monitor and enforce compliance, and to bring miscreant LAs and their Councillors and officers to account.

Governance academics and practitioners then seek to respond to the ever changing legislative, regulatory and judicial landscape. In doing so they may create increasingly detailed and prescriptive governance guidelines, rules and standards which seek to define policies, systems and processes. These are designed to ensure that these legislative, regulatory and judicial requirements are not offended.

(b) Questions to be considered in managing agency risk

It is not disputed that there are important moral issues, having both governance and social relevance that need to be controlled and managed to effectively address agency risk. After all, our system of LA governance is founded on principles of integrity, transparency and the rule of law.

But the question that needs to be asked is whether society is gaining optimal return for its overall investment in resources that seek to mitigate governance risks concerning LAs? This is especially so given that the primary focus to date has been on *conformance* and *compliance* to address the “agency risks” of malfeasance and misfeasance, rather than addressing the cost and expense to society of LA *underperformance*.

Questions that need to be asked in this context include:

- Could there be a risk of *unintended consequences* arising from the current increasingly detailed and prescriptive focus on legislative, regulatory and judicial compliance?
- Could there be a greater *moral hazard* to society – that is, the cost to society of LA underperformance – which is either being masked or not appropriately managed and resourced relative to the considerable focus being applied to *conformance* related risks?

(i) Unintended Consequences

The concept of “unintended consequences” has particular application where regulation, designed to manage or control particular behaviour or circumstances, in fact also has impacts and effects (often negative or unduly intrusive or burdensome) well beyond the intended scope of influence of the regulation.

At times, the “unintended consequences” have proven to be more costly or have greater adverse impacts than the original egregious behaviour or circumstance sought to be managed or controlled by the regulatory intervention, especially where the egregious behaviour may be by a small minority yet the impact of the regulatory intervention is a burden shared by all.

In a governance context, the question to be asked is whether the current attention given to regulating the behaviour of Councillors and officers of LAs is creating an environment where:

- too many aspects of such behaviour are being prescriptively regulated;
- the amount of regulation has become burdensome and virtually impossible for most to fully understand, have full knowledge of and therefore comply with;
- too much valuable time and effort of the LA’s resources (people and financial) are being consumed on legal and regulatory compliance functions;
- LA performance outcomes are being suppressed or, at least, not fostered and optimised.

(ii) Moral Hazard

Could the costs to society of the agency risk of underperformance of LAs exceed the risk of regulatory non-compliance?

Moral hazard, in economic theory, is where a party (for example, a Councillor or officer of an LA) is more likely to behave (or not behave) in a manner where the resultant cost or consequences of the behaviour (or lack of behaviour) will be borne by another (for example, the LA itself or a stakeholder of the LA), or at least not by the Councillor or officer him or herself.

In essence, if the primary focus on the behaviour and performance of a Councillor or officer is through a legal or regulatory compliance lens with only a secondary focus on the contribution of the Councillor or officer in adding value to the *performance* of the LA, and achievement of the LA’s strategic and operational objectives (where formal sanctions against the Councillor or officer for failure to

perform are minimal, especially in relative terms compared with malfeasance and misfeasance), then the *moral hazard* needs to be considered.

If the propensity and/or the prospective cost and expense to society of this outcome is high, then steps need to be taken to mitigate and address the moral hazard arising.

(c) Further consequential questions for consideration

As part of the process of undertaking this current review of the LGA, it is submitted that the following questions also should be addressed:

- What are the areas of LA governance where attention and public resources should best be applied in order to deliver enhanced LA performance outcomes?
- To what extent should public resources and attention be prioritised and applied to each of these areas of LA governance?
- How should the application of public resources and attention be applied to each of these areas of governance to optimise the prospect of enhanced LA performance towards delivery of the LA's statutory mandate and strategic objectives?
- Is the current cost to society of seeking to address the risk of malfeasance and misfeasance of Councillors and officers of LAs disproportionate to the benefit currently being derived?
- Might greater social dividend be gained if some of the public resources and attention currently deployed towards governance for compliance and conformance were redeployed to governance initiatives designed to enhance the performance of the LA and its Councillors and officers?

1.4 Conclusion

Governance is an organisational construct designed to better enable organisations to achieve their objectives. An important element of governance is the management of "agency risk".

In addition to performance and conformance, effective governance includes a third element of assurance, embracing formal policies, systems, standards and processes, as well as informal cultural practices. Assurance is seen as an enabler of enhanced performance outcomes and reduced conformance failure.

Considerable legislative, regulatory and judicial resources are being deployed seeking to ensure legal and regulatory compliance by LA Councillors and officers. The resources expended or deployed on the agency risks of malfeasance and misfeasance by LA Councillors and officers appears to be relatively disproportionate to that expended or deployed to address the agency risk of underperformance of those people.

The burden of the regulatory focus on LA Councillor and officer malfeasance and misfeasance risks the unintended consequence of exacerbating the prospect of LA underperformance against the LA's statutory mandate and strategic objectives. A rebalancing of resource application and attention to address the risk of underperformance may have significant economic upside potential, with associated social benefit.

2. Part 2 – Broad level reform initiatives

For the sake of expediency, this part will attach 2 separate papers which the author has recently prepared on the topic.

2.1 Local Government Reform – Less Government More Governance (refer to Annexure “A” to this submission)

This paper is contemporary and is anticipated to feature in a forthcoming edition of “Company Director”, the monthly journal of the Australian Institute of Company Directors.

The introduction to that paper is instructive in positioning the current status of LA governance, the dynamic environment in which LAs operate, and the opportunity for reform initiatives.

The paper goes on to propose 6 initiatives towards better governance and performance outcomes for LAs as follows:

- [Initiative 1] A Third Tier of Government? – The State Government must demand greater accountability and take ultimate responsibility for LA performance outcomes with appropriate intervention powers to support that responsibility.
- [Initiative 2] Improved governance framework and governance accountability.
 - (a) Remove prescriptively legislated division of responsibility between LA Councillors and management.
 - (b) Fiduciary responsibilities for Councillors and officers.
 - (c) Skills based Councils.
 - (d) Remove LA ward structures for electoral representation.
 - (e) Remove the institution of popularly elected Mayors/Presidents.
 - (f) Council meeting formalities and functional workings.
- [Initiative 3] Improved financial awareness and oversight by Councillors of LA affairs.
- [Initiative 4] Red tape reduction.
- [Initiative 5] Greater functional co-operation, strategic alignment and integration of operations between adjoining LAs.
- [Initiative 6] Councillor integrity issues – conflicts, corruption, hospitality/gifts, electoral funding.

The paper and its proposed initiatives are commended for consideration in response to the consultation paper and LGA reform generally.

2.2 Good Governance Principles for Local Government Authorities – Ten Principles that Promote Good Governance (refer to Annexure “B” to this submission)

Good governance can offer a number of important benefits to LAs including:

- better organisational strategies, policies and plans;
- improved operational effectiveness;
- more prudent regulatory compliance, financial and risk management;
- improved community engagement and communication flow;

- increased likelihood and degree to which the LA performs for the benefit of the community it serves and delivers on its legislative mandate.

While they may not be exhaustive, the ten principles referred to below provide a useful starting point for a LA to promote good governance practice having regard to the particular circumstances and needs of the LA's district and community.

Ten Principles

1. Clarity of purpose, strategy and performance objectives.
2. Build and manage organisational capacity and capability to deliver on purpose and strategy.
3. Lay solid, organisational and cultural foundations to assure the sound governance and management of the LGA.
4. Structure, populate and manage the Council to effectively govern the LGA.
5. Promote ethical and responsible decision making, and integrity in fulfilling the responsibilities of office.
6. Respect the rights of electors, residents and ratepayers and engage and communicate effectively with stakeholders.
7. Meet statutory and regulatory compliance and reporting requirements.
8. Assure the financial standing and integrity of the LGA.
9. Prudentially recognise and manage risk.
10. Benchmark and report against these "Good Governance Principles for Local Government Authorities".

The Principles and their structure, are reflective of the well accepted approach taken in the ASX Corporate Governance Council Principles and Recommendations (3rd Edition) which listed entities are required to report against on an "if not why not" basis.

Each of these Principles is discussed in the paper. Each Principle is accompanied by a number of ancillary Recommendations, or practical governance arrangements, to support the LA's attainment of the relevant Principle. In addition, each Principle is also accompanied by some Commentary to further assist understanding the relevance of the Principle and to help put the Recommendations in context.

LAs should be mandated to address these Good Governance Principles and to hold themselves accountable to their communities and to the responsible government department by benchmarking and reporting against them, on an if-not-why-not basis, on the LA's web-site and/or annual report.

By benchmarking the LA's governance framework and practices against these Principles, and by publicly holding themselves accountable to their constituents and the regulators against such benchmarking, the LA and its Council will demonstrate their commitment to advancing the integrity and appropriateness of the LA's governance framework as a basis for delivering improved performance outcomes for the LA's district and community.

3. **Part 3 – Specific Response to Section 2 of the Consultation Paper - Training**

3.1 **Overview**

General commentary on this aspect has already been partially addressed at a high level in the papers referred to in Parts 2.1 and 2.2 above:

- (a) Annexure “A” – Initiative 2(c) – Skills based Councils;
- (b) Annexure “B” – Principle 4 – Structure, populate and manage the Council to effectively govern the LA (including Recommendations 4.4 and 4.5).

Lessons may be learnt from the ASX Corporate Governance Council Principles and Recommendations (3rd edition) concerning the education and training of directors and officers of listed entities as well as initiatives to evaluate and improve the performance of boards, their committees and their people.

Relevant extracts from the 3rd Edition appear below

Recommendation 1.6

A listed entity should:

- (a) have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors; and
- (b) disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.

Commentary

The board performs a pivotal role in the governance framework of a listed entity. It is essential that the board has in place a formal and rigorous process for regularly reviewing the performance of the boards, its committees and individuals and addressing any issues that may emerge from that review.

The board should consider periodically using external facilitators to conduct its performance reviews.

A suitable non-executive director (such as the deputy chair or the senior independent director, if the entity has one), should be responsible for the performance evaluation of the chair, after having canvassed the views of the other directors.

When disclosing whether a performance evaluation has been undertaken the entity should, where appropriate, also disclose any insights it has gained from the evaluation and any governance changes it has made as a result.

Recommendation 2.2

A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.

Commentary

Having a board “skills matrix” is a useful tool that can help identify any gaps in the collective skills of the board that should be addressed as part of a listed entity’s professional development initiatives for directors (see recommendation 2.6) and in its board succession planning.

Disclosing the mix of skills and diversity that a board currently has or is looking to achieve in its membership is useful information for investors and increases the accountability of the board on such matters. The disclosure need only be made collectively across the board as a whole, without identifying the presence or absence of particular skills by a particular director. Commercially sensitive information can be excluded.

Recommendation 2.6

A listed entity should have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop and maintain the skills and knowledge needed to perform their role as directors effectively.

Commentary

The board or the nomination committee of a listed entity should regularly review whether the directors as a group have the skills, knowledge and familiarity with the entity and its operating environment required to fulfil their role on the board and on board committees effectively, and where any gaps are identified, consider what training or development could be undertaken to fill those gaps.

Where necessary, the entity should provide resources to help develop and maintain its directors’ skills and knowledge. This includes, in the case of a director who does not have specialist accounting skills or knowledge, ensuring that he or she has a sufficient understanding of accounting matters to fulfil his or her responsibilities in relation to the entity’s financial statements. It also includes, for all directors, ensuring that they receive ongoing briefings on developments in accounting standards.

The following comments seek to apply those principles in the context of local government reform.

3.2 Principles Espoused for Application to LAs

- (a) Councillors and relevant LA officers individually should possess relevant skills, experience, knowledge and attributes to allow them to add value to the LA towards better LA performance outcomes and better management of relevant risks.

- (b) As a whole the Council should possess the skills, experience, knowledge and attributes to be able to effectively discharge the role and responsibilities of Council including strategic direction and oversight of management.
- (c) There may be a core generic base set of skills, experience, knowledge and attributes all Councillors should desirably have (e.g. knowledge of regulatory environment as well as basic Councillor roles and responsibilities).
- (d) Diversity of skills, experience, knowledge and attributes amongst Councillors should:
- allow the LA, and the Council, to benefit from specialist skills, experience, knowledge and attributes of some Council members (e.g. financial, accounting, governance, town planning, strategy, social services);
 - relieve the need for all Council members to have high level skills, experience and knowledge in all aspects of the LA's operations and affairs;
- (e) To the extent to which there are skills, experience, knowledge and attribute "gaps", these should be filled either by:
- more effective succession planning for Council members (but noting the challenges of succession planning in a democratic LA election);
 - education and training.
- (f) It is a shared responsibility, personally by Councillors and organisationally by the LA, to achieve a combined skill set amongst Council members which is "fit for purpose" for the LA, having regard to the LA's unique needs and circumstances.
- (g) It is legitimate for the LA to apply financial and human resources to better equip the LA's Council and its members with the desired skills, experience and knowledge. LA budgets should allocate resources appropriately for such purposes and have policies to encourage and promote the professional development of its Councillors.
- (h) It is legitimate to expect Council members to be responsible for being suitably skilled, experienced and knowledgeable for the role and responsibilities they are to take on, especially given the remuneration they now receive, and to continue their professional development commitment, on an ongoing basis.
- (i) Each Councillor will bring to the table their own set of skills, experience, knowledge and attributes whether they be base/generic (refer (c) above) or more advanced and specialist.
- (j) It would be inefficient and wrong to assume that a standardised curriculum of education and training should apply generically to all LAs and all Council members. Programs should be tailored to the unique needs of the Councillors and the LA.
- (k) Although it is trite to say that professional development improvements of Councillors should deliver demonstrable benefits to the LA and the performance of Councils, prescriptively mandated education and training programs are not the answer (subject to (l) below).
- (l) Base/generic training for new Councillors may be appropriate with the desirability of structured induction programs to get "new" Councillors "up to speed" as soon as possible.

- (m) To mirror the ASX CGC Principles and Recommendations (3rd Edition) approach, a process by which ongoing appropriate professional development is expected of ALL Councillors, and against which the LA and its Council should report to its stakeholders annually on an “if not why not” basis, is the most appropriate approach.
- (n) Such an approach should also allow flexibility in the tailoring or customisation of education and training programs to best suit the unique needs of the LA and its individual Councillors.
- (o) Of note there are a number of appropriate third party providers, along with relevant officers of the LA itself concerning the LA’s internal processes and the specific operations and affairs of the LA, that can be called upon to assist (e.g. WALGA, AICD, AIM, GI etc).

3.3 Specific Responses to guidance questions posed in consultation paper

- (a) Q6 - refer 3.2(c) and (d) above.
- (b) Q7 - yes depending on the size, nature and needs of the LA and the skills of its Council and management team.
- (c) Q8 - refer 3.2(f), (g) and (h) above.
- (d) Q9 - yes. The cost of ongoing professional development is an issue especially for remote and regional smaller LAs. Regional co-delivery of programs can assist in alleviating the cost burden for such LAs and assist in customising programs more relevant to the common needs of such LAs.
- (e) Q10 - definitely no, but refer to 3.2(m) above.
- (f) Q11 - yes, refer to 3.2(l) above.
- (g) Q12 - yes, programs need to be flexible and be tailored to Councillor needs – refer 3.2(j) above.
- (h) Q13 - no prescribed period although base/generic training should be undertaken by new Councillors as soon as practicable – refer 3.2(l) above.
- (i) Q14 - yes, refer 3.2(h) above.
- (j) Q15 - flexibility and customisation of ongoing professional development to meet the Councillors unique needs (refer 3.2(k) above).
- (k) Q16 - a more structured multi-dimensional curriculum guideline could be deployed whereby within the 3 year term of a Councillor, a certain number of CPD (continuing professional development) “points” might be suggested as a benchmark to be reposted against and which might need to satisfy several different “streams” of learning endeavour e.g:
 - Stream 1 - LGA/regulatory compliance and Councillor role and responsibility.
 - Stream 2 - strategy, risk and financial understanding and accountability.
 - Stream 3 - governance practice and ethical conduct.
 - Stream 4 - business operations and affairs of the LA.

(compare the CPD program of the Law Society of WA by way of example).