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**Confidential**

2 October 2020

Our ref: CENT20013

Your ref: LEX747

The Chief Executive Officer  
Central Coast Council  
PO Box 21  
GOSFORD NSW 2250

Attention: Emma Roberts

**Email**

Dear Sir,

## **Unauthorised Use of Internally and Externally Restricted Funds**

### **Introduction**

- 1 Council seeks urgent advice in relation to what it suspects is the unauthorised use of internally and externally restricted funds.
- 2 We understand that internally restricted funds are moneys received by Council for which delegation has not been given for the money to be spent. Externally restricted funds are developer contributions under the *Environmental Planning and Assessment Act 1979 (EPA Act)* and water and sewer contributions levied either under the *Local Government Act 1993 (LG Act)* as special rates or charges or as headworks contributions under the *Water Management Act 2000 (WM Act)*.
- 3 Council is awaiting a final report from an independent accountant. We have been provided with a draft of that report (**Draft Report**). The Draft Report concludes that \$218 million was missing from Council's internal and externally restricted funds as at 30 June 2020.
- 4 We understand that Council holds all of the relevant money in its consolidated fund in a single bank account and that the \$218 million has most likely been used to make operational payments.
- 5 As a consequence of the shortfall, the Draft Report concludes that Council appears to be in a severe liquidity crisis. A significant cash injection will be required to ensure that Council can pay future debts without resorting to further use of restricted funds.
- 6 Council is concerned about the potential legal consequences arising from the shortfall in funds, and its obligations to notify third parties.

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## Advice requested

- 7 Council seeks advice on:
- 7.1 the anticipated legal ramifications for Council of the unauthorised use of restricted funds due to financial maladministration;
  - 7.2 whether Council is required to report or notify the OLG, Planning Minister, NSW Ombudsman, and any other relevant agency.
  - 7.3 the timeline and process for such reports or notifications to occur, including whether the Draft Report provides the trigger for those reports or notifications to be made;
  - 7.4 what, if any, information is it recommended can be disclosed publicly at this stage;
  - 7.5 the relevance of the *Local Government Code of Accounting Practice and Financial Reporting (2019-20)* (**Accounting Code**);
  - 7.6 what information is required to be provided to Councillors at this stage regarding non-disclosure;
  - 7.7 the appropriateness of the recommendations set out in the Draft Report.

## Summary of Advice

- 8 This letter of advice has been provided as required on an extremely urgent basis and should be considered provisional and subject to review as further information becomes available.

*What are the consequences for Council of the unauthorised use of restricted funds due to financial maladministration?*

- 9 In our view, the expenditure of any externally restricted funds for purposes other than that for which they were required to be held was in breach of both the EPA Act and the LG Act.
- 10 In terms of the internally restricted funds, those funds have been spent without appropriate delegation. In this regard, the spending was also beyond power, and in breach of the LG Act.
- 11 These breaches expose Council to the potential for civil enforcement proceedings under both the LG Act and the EPA Act. More significantly, and given the extent of the shortfall, they will most likely result in the Office of Local Government (**OLG**) or the Minister exercising their investigation and enforcement powers under the LG Act.

*What are Council's obligations to notify other bodies?*

- 12 Council only has a legal duty to notify another body in the case of corrupt conduct. On the information available to us at present, there is no evidence of corrupt conduct.
- 13 Nevertheless, it is our view that Council should notify the OLG. This is for three reasons:
- 13.1 the OLG likely has the expertise to assist Council to investigate the source of the problem, and address its liquidity problem;
  - 13.2 approaching the OLG now would also demonstrate that Council and its officers are aware of the significance of the non-compliance with the principles of sound financial management in s 8B of the LG Act; and

- 13.3 tied to this, if Council is seen to be proactively and transparently taking action to resolve the problem, this is likely to hold Council in better stead when the OLG and ultimately the Minister consider the exercise of their powers of investigation and enforcement.

*What information can be disclosed publicly?*

- 14 We think that Council should be reluctant to reveal information about the shortfall to the public without first consulting with the OLG. The OLG should be consulted to ensure that any public disclosure will not undermine the effectiveness of any investigation by the OLG.
- 15 This assumes that there has not already been any public disclosure. If Council is approached for comment in circumstances where the shortfall is already known, then it is our view that Council should indicate that it is taking steps in conjunction with the OLG to address the matter, and will not comment on specific details without first consulting with the OLG.

*What is the relevance of the Local Government Code of Accounting Practice and Financial Reporting?*

- 16 Council's accounting practices must comply with the Accounting Code.
- 17 There is not enough information available to us and we are not qualified to determine whether Council's practices accord with the Accounting Code. An accountant would need to review Council's records and advise in what respects there has been and has not been compliance.

*What information can be provided to the Councillors at this stage regarding non-disclosure?*

- 18 The Draft Report is plainly confidential. Council should inform the Councillors that they are obliged by the *Model Code of Conduct for Local Councils in NSW (2020)* (**Model Code**) and the LG Act not to disclose the details contained within the Draft Report.
- 19 For the same reasons, as the shortfall is not known publicly, we think that Councillors cannot publicly disclose (absent reference to the Draft Report) that there is a shortfall in funds otherwise than in accordance with the Council's relevant policies.

*Recommendations in the Draft Report*

- 20 In our view, Council's approach should be twofold:
- 20.1 Council needs to take steps to protect its future financial position to ensure that there is enough liquidity that Council can continue to function and serve the community; and
- 20.2 Council needs to actively facilitate the investigation of the shortfall to ensure that the reasons for the shortfall are addressed and do not recur in future.
- 21 Both points necessitate Council notifying the OLG as soon as possible.

*Other matters*

- 22 We strongly recommend that advice be obtained on whether certain Council officers, including the Chief Executive Officer (**CEO**) and the Chief Financial Officer (**CFO**),

have a conflict of interest which precludes them from providing instructions, or being involved, in Council's response to the shortfall in funds.

## Advice

*What are the consequences for Council of the unauthorised use of restricted funds due to financial maladministration?*

- 23 At present, Council is not aware of how the unauthorised expenditure occurred, nor of how it was authorised. It appears to be because of financial maladministration. In those circumstances, we cannot advise fully on the potential consequences for Council and staff.
- 24 In our view, the expenditure of externally restricted funds was in breach of both the EPA Act and the LG Act.
- 25 Section 7.3 of the EPA Act provides in respect of development contributions that:
- (1) *A consent authority or planning authority is to hold any monetary contribution or levy that is paid under this Division (other than Subdivision 4) in accordance with the conditions of a development consent or with a planning agreement for the purpose for which the payment was required, and apply the money towards that purpose within a reasonable time.*
- 26 This requires Council to apply the funds towards the relevant public amenities and services identified in the Council's contributions plan: *Frevcourt Pty Limited & Anor v Wingecarribee Shire Council* [2005] NSWCA 107, at [112]. That has clearly not been done when the funds have been applied towards operational expenses.
- 27 Water and sewer contributions on the other hand may be levied under the LG Act and WM Act. Section 409 of the LG Act provides relevantly that:
- (2) *Money and property held in the council's consolidated fund may be applied towards any purpose allowed by this or any other Act.*
- (3) *However—*
- (a) *money that has been received as a result of the levying of a special rate or charge may not be used otherwise than for the purpose for which the rate or charge was levied, and*
- (b) *money that is subject to the provisions of this or any other Act (being provisions that state that the money may be used only for a specific purpose) may be used only for that purpose, and*
- (c) *...*
- 28 The WM Act and the LG Act do not contain an express provision requiring water and sewer contributions to be expended towards water and sewer infrastructure.
- 29 There is an argument, however, that the fact that any notice requiring payment of a contribution under s 306 of the WM Act must specify the works for which the payment is required, and that the payment is expressed to be a payment '*towards the cost of* such works, means that the money can only be used for that purpose.
- 30 In this regard, the funds are arguably impressed with a statutory trust by which they can only be spent for the purpose for which they were required: see for example *Bathurst City Council v PWC Properties Pty Limited* (1998) 195 CLR 566; [1998] HCA 59. Any expenditure for another purpose, such as what occurred here, would be in breach of that restriction and by extension s 409(3)(b) of the LG Act.

31 Section 409(3)(b) also captures Council's expenditure of developer contributions paid under the EPA Act. So far as the internally restricted funds also include money obtained by special rates or charges, the expenditure would also be in breach of s 409(3)(a) of the LG Act.

32 The Draft Report suggests that at best the expenditure may be regarded as internal loans. Even if that were the case, this would still breach the LG Act. Any loan of moneys received from special rates or charges requires the approval of the Minister: s 410(3). We do not understand that any approval was granted.

33 There is also no express exception that permits the internal loan of funds falling within s 409(3)(b) of the LG Act. In this regard, the absence of a provision permitting a loan even with Ministerial approval, such as s 410, suggests that an internal loan is not otherwise permissible.

34 In terms of the internally restricted funds, those funds have apparently been spent without an appropriate delegation. In this regard, the spending was beyond power, and in breach of the LG Act.

35 These breaches expose Council to the potential for civil enforcement proceedings under both the LG Act and the EPA Act. They do not expose Council to a criminal prosecution.

36 More significantly, and given the extent of the shortfall, the breaches will most likely result in the Office of Local Government or the Minister exercising their investigation and enforcement powers under the LG Act.

37 Section 430 of the LG Act provides the Chief Executive of the OLG with broad powers to carry out an investigation. It states that:

*The Departmental Chief Executive may, at the request of the Minister or on the Departmental Chief Executive's own initiative, conduct an investigation into any aspect of a council or of its work and activities.*

38 The Minister may order the Council to comply with the recommendations in any investigation report: s 434(2).

39 Alternatively, the sheer amount of money involved could cause the Minister for Local Government to exercise any of her powers under the Act, including:

- 39.1 suspension of the Council: s 438I;
- 39.2 the issue of a performance improvement order: s 438A;
- 39.3 commencing a public inquiry: s 438U; and
- 39.4 after any such inquiry, recommending that the Governor dismiss the Council and appoint an administrator: s 255 and 256.

40 Separately to the potential ramifications for Council, are the consequences for individual Council officers.

41 Relevantly, both the CEO and CFO have responsibility to ensure that measures are adopted to ensure Council's financial obligations are complied with.

42 In terms of the CEO, cl 209 of the *Local Government (General) Regulation 2005* provides that the General Manager 'must ensure that—

- (a) *the provisions of the Act, this Regulation and any other written law relating to councils' financial obligations or the keeping of accounts by councils are complied with, and*
- (b) *effective measures are taken to secure the effective, efficient and economical management of financial operations within each division of the council's administration, and*

- (c) *authorising and recording procedures are established to provide effective control over the council's assets, liabilities, revenue and expenditure and secure the accuracy of the accounting records, including a proper division of accounting responsibilities among the council's staff, and*
- (d) *lines of authority and the responsibilities of members of the council's staff for related tasks are clearly defined.*
- 43 Council's CFO also has responsibilities under cl 207 of the Regulation as Council's 'responsible accounting officer'. Those are:
- (1) *The responsible accounting officer of a council is responsible for keeping the council's accounting records.*
- (2) *The responsible accounting officer must ensure that the accounting records are kept up-to-date and in an accessible form.*
- (3) *The responsible accounting officer must take all reasonable measures to ensure that—*
- (a) *all money payable to the council is collected or recovered promptly, and*
- (b) *appropriate arrangements are implemented for the security and banking of money received by the council, and*
- (c) *the assets of or under the control of the council are properly accounted for, and*
- (d) *liabilities are incurred by the council only with the authority of the council and the council's funds are properly spent in meeting those liabilities, and*
- (e) *appropriate budgeting and accounting systems (including internal control systems) are established and maintained for the purposes of the council, and*
- (f) *adequate measures are taken to protect the council's valuable securities and accounting records from loss, destruction, damage and theft.*
- 44 We cannot say at present whether either of these officers breached these provisions. If there was a breach, or the OLG concludes that these or other officers acted negligently, there is a potential for a surcharge to be imposed pursuant to s 435 of the LG Act..
- 45 Given the seriousness of this, we strongly recommend that the General Manager, the CFO, and any other officers involved, obtain independent legal advice as to their potential liability.
- 46 Furthermore, we strongly recommend that advice be obtained on whether those officers have a conflict of interest which precludes them from providing instructions, or being involved, in Council's response to the shortfall in funds.

*What are Council's obligations to notify other bodies?*

- 47 In our view, Council only has a legal duty to notify another body in the case of corrupt conduct.
- 48 In this regard, s 11 of the *Independent Commission Against Corruption Act 1988 (ICAC Act)* provides that the General Manager is under a duty to report to ICAC any matter which the General Manager suspects on reasonable grounds concerns or may concern corrupt conduct.



- 49 Corrupt conduct is defined extensively in s 8 of the ICAC Act. On the information presently available to us, we cannot see conduct on the part of any individual which would amount to corrupt conduct within the meaning of that section.
- 50 This is not to say definitively that there has been no conduct on the part of any council official that could amount to corrupt conduct. If such conduct is uncovered as a part of further investigation, the General Manager would be required to refer it to ICAC.
- 51 Beyond this, we are not aware of any obligation to refer this matter to any particular body.
- 52 Neither the LG Act or the EPA Act require the referral of any matter about the misuse of funds.
- 53 Where there is an allegation made against a particular person, however, that allegation would likely need to be dealt with under the *Procedures for the Administration of the Model Code of Conduct for Local Councils in NSW (2020)*.
- 54 Part 9 of the Procedures provides relevantly that:
- 9.9 *All allegations of breaches of this code must be dealt with under and in accordance with the Procedures.*
- 9.10 *You must not allege breaches of this code other than by way of a complaint made or initiated under the Procedures.'*
- 55 The Code and the Procedures apply to Council officials. A Code of Conduct complaint is a complaint that *'that shows or tends to show conduct on the part of a council official in connection with their role as a council official or the exercise of their functions as a council official that would constitute a breach of the standards of conduct prescribed under the council's code of conduct if proven'* (see cl.4.1).
- 56 Where an allegation is made by a Council official, and that allegation tends to show a breach of the Code of Conduct, then Council is obliged to deal with that allegation under the Procedures.
- 57 Certain complaints against Councillors and the General Manager must be referred to the OLG: see cl 5.20 and 5.27. A referral is generally only required where the complaint alleges a breach of the pecuniary and conflict of interest provisions, or a breach of the provisions regarding the maintenance of the integrity of the Code. Subject to what we have seen, none of those provisions would presently apply.
- 58 Although there is no legal duty on the Council, or its officers, to notify any other body, it is our view that Council should notify the OLG.
- 59 As the entity responsible for Local Government, the OLG may have expertise to assist Council to investigate and address the matter, including the liquidity problem.
- 60 More significantly, however, the shortfall will ultimately become public knowledge whether that be in the short or long term, at which point the OLG will inevitably take action. If Council is seen to be proactively and transparently taking action to involve the OLG and resolve the problem, this is likely to hold Council in better stead when the OLG and ultimately the Minister are considering the exercise of their powers of investigation and enforcement under the LG Act.
- 61 Approaching the OLG now would also demonstrate that Council and its officers are aware of the significance or non-compliance with the principles of sound financial management in s 8B of the LG Act.
- 62 In these circumstances, we think that it is in Council's best interests to inform the OLG as soon as possible.
- 63 That notification could be made by an officer under s 12B of the *Public Interest Disclosures Act 1994*. Whilst a disclosure made in such a manner would provide

certain protections to the notifying officer, it would provide no additional protection to Council.

*What information can be disclosed publicly?*

- 64 The *Government Information (Public Access) Act 2009* gives Council authority to voluntarily release government information unless there is an overriding public interest against disclosure of the information.
- 65 Arguably, release of detail of the shortfall, and how Council is investigating it, could prejudice an investigation by either Council or the OLG. It may provide any individuals with information that would enable them to destroy evidence or otherwise take action to circumvent an investigation.
- 66 This could give rise to an overriding public interest against disclosure having regard to the considerations at Table 1(f) and (h) of s 14 of the GIPA Act.
- 67 The details of which we are aware at present would unlikely have that effect. Nevertheless, Council should be reluctant to reveal that information to the public without first consulting with the OLG. If the OLG is to take action, it should be consulted to ensure that any public disclosure will not undermine the effectiveness of any investigation by the OLG.
- 68 This assumes that there has not already been any public disclosure. If Council is approached for comment in circumstances where the shortfall is already known, then it is our view that Council should indicate that Council is taking steps in conjunction with the OLG to correct the matter, and will not comment on specific details without first consulting the OLG.

*What is the relevance of the Local Government Code of Accounting Practice and Financial Reporting?*

- 69 Council's accounting practices must comply with the Accounting Code.
- 70 There is not enough information available to us nor have we the expertise to determine whether Council's practices accord with the Accounting Code. An accountant would need to review Council's books and advise in what respects there has been and has not been compliance.

*What information can be provided to the Councillors at this stage regarding non-disclosure?*

- 71 In our view, the Draft Report is confidential information. It is clearly marked '*private and confidential*' and we understand would be provided to Council in circumstances where there is an expectation of confidentiality.
- 72 Both the LG Act and the Model Code are clear that confidential information generally cannot be disclosed.
- 73 Clauses 8.10 and 8.11 of the Model Code provides relevantly that Councillors and Council officers relevantly must:
  - 73.1 maintain the integrity and security of confidential information in a person's possession;
  - 73.2 protect confidential information; and
  - 73.3 only release confidential information if you have authority to do so.
- 74 In addition to this, s 664 of the LG Act provides that:



- (1) *A person must not disclose any information obtained in connection with the administration or execution of this Act unless that disclosure is made—*
- (a) *with the consent of the person from whom the information was obtained, or*
  - (b) *in connection with the administration or execution of this Act, or*
  - (c) *for the purposes of any legal proceedings arising out of this Act or of any report of any such proceedings, or*
  - (d) *in accordance with a requirement imposed under the Ombudsman Act 1974 or the Government Information (Public Access) Act 2009, or*
  - (e) *with other lawful excuse.*

75 None of these exceptions appear to apply in the current case to a public disclosure of the information contained within the Draft Report.

76 In those circumstances, we think that Council should inform the Councillors that they are obliged by the Model Code and the LG Act not to disclose details of the shortfall contained within the Draft Report.

77 This assumes that the details are not already known. As stated by Latham CJ sitting in the High Court in *Foster v Federal Commissioner of Taxation* (1951) 82 CLR 606 at [614]-[615]:

*...it is not possible, according to the ordinary use of language, to 'disclose' to a person a fact of which he is, to the knowledge of the person making a statement as to the fact, already aware.*

78 At present, if the shortfall is not known publicly, we think that Councillors cannot publicly disclose that there is a shortfall in funds or the amount of that shortfall except in accordance with Council's relevant policies.

#### *Recommendations in the Draft Report*

79 In our view, Council's approach to the shortfall should be twofold:

- 79.1 Council needs to take steps to protect its future financial position to ensure that there is enough liquidity that Council can continue to function and serve the community; and
- 79.2 Council needs to actively facilitate the investigation of the shortfall to ensure that the reasons for the shortfall are addressed and do not recur in future.

80 Both points necessitate Council notifying the OLG as soon as possible. In this regard, we are in complete agreement with the recommendation in the Draft Report to do so.

81 We are not accountants and so cannot advise on whether the other recommendations are all that Council must do to address the issue. However, the recommendations set out in the Draft Report appear to be appropriate.

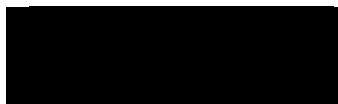
82 In particular, we think that Council should strongly consider establishing separate bank accounts for its restricted funds.

83 Whilst this is not strictly required under cl 204 of the LG Reg, it appears to us that appropriate restrictions were not in place for restricted money held within Council's consolidated fund. That issue could conceivably be addressed in part by creating a separate bank account for the restricted funds.

84 This, however, should not detract from the need for Council to inform the OLG as soon as possible of the shortfall, and to work constructively with the OLG during any enquiries or investigation that it may carry out.

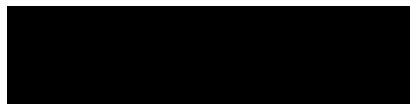
- 85 Please let us know if you would like our assistance in reviewing the notification to the OLG.
- 86 Otherwise, if you would like to discuss any aspect of this advice or require any further assistance, please do not hesitate to contact Stuart Simington on 02 8235 9704 or Matt Harker on 02 8235 9714.

Yours Sincerely,



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