

Report of	Meeting	Date
Director of Finance	Management Team	21/03/06
	Audit Committee	27/03/06
	Executive Cabinet	30/03/06

## THE ROLE & MEMBERSHIP OF THE AUDIT COMMITTEE

### PURPOSES OF REPORT

1. To evaluate the Council's compliance with new CIPFA guidance on the composition and remit of Audit Committees.
2. To put forward proposals to address recommendations made by the Audit Commission in the Use of Resources assessment, regarding the Audit Committee's remit and relationship with the Executive and Scrutiny functions.
3. To recommend the Council's adoption of the new CIPFA model Terms of Reference for Audit Committees.

### CORPORATE PRIORITIES

4. The latest guidance on audit committees and the Audit Commission's corresponding recommendations have "raised the bar" in terms of the expected role and jurisdiction of the Council's Audit Committee. The Committee now has a key role to play in monitoring the organisation's overall governance arrangements, including risk management and performance and holding the Executive to account on these matters.
5. The role of the Audit Committee is therefore of central importance to ensuring that the Council is a performing organisation.

### RISK ISSUES

6. The issues raised and recommendations made in this report involve risk considerations in the following categories:

Strategy	3	Information	3
Reputation	3	Regulatory/Legal	3
Financial	3	Operational	
People		Other	

7. The establishment of effective monitoring arrangements for governance, performance, risk and internal control matters is key to the effective management of the Council as a whole and is now of central importance in CPA terms.

### BACKGROUND



8. The Council's Audit Committee has been in place since 2002 and has operated in accordance with the terms of reference shown at **Appendix 1**. These terms of reference were formally approved and were aimed to ensure compliance with the Audit Commission guidance "Called to Account" – The Role of Audit Committees in Local Government". The Committee's remit has largely covered the monitoring of audit workload and quality (both internal and external).
9. Although the Committee has operated very effectively in this regard, the latest CIPFA guidance now directs Audit Committees to monitor councils' arrangements for governance, risk management and performance. The Audit Commission has made it a condition of CPA that authorities are unlikely to be rated good or excellent unless they have an effective audit committee in place.

## CORPORATE GOVERNANCE

10. Corporate Governance is the product of the interlocking systems and processes through which an organisation manages and directs itself to determine and deliver its objectives. Whilst as the phrase implies this includes issues of probity and ethics the impact is much wider and CIPFA and SOLACE in their joint publication "Corporate Governance in Local Government – A Framework for Community Governance" point to the following five dimensions:
  - Community Focus
  - Service Delivery Arrangements
  - Structures and Processes
  - Risk Management and Internal Control
  - Standards of Conduct
11. This therefore requires the Audit Committee to provide oversight of the effectiveness of all the Council's fundamental business processes, including community and corporate planning, performance management, financial management, risk management, constitutional compliance and its arrangements for ensuring the economic, efficient and effective use of resources.
12. Of critical importance is the Audit Committee's role in receiving key external and internal audit reports in these areas, and tracking the implementation of recommendations to secure improvement.

## NEW CIPFA GUIDANCE

13. In recognition of the wider role now expected of Audit Committees, CIPFA have issued new guidance: "Practical Guidance for Local Authorities" including a new model terms of reference (**Appendix 2**). This is far more prescriptive and wide ranging than the Audit Committee's original / current terms of reference and as such the Council automatically finds itself in a largely non-compliant position.
14. The key elements of the new CIPFA guidance are re-produced below, together with an assessment of the extent to which the Council's Audit Committee arrangements currently comply:

MAIN	CURRENT	ISSUES	ACTION
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PRINCIPLES	STATUS		REQUIRED
<b>PURPOSE</b>			
<p>Authorities should formally approve a Statement of Purpose along these lines:</p> <p>“The purpose of the Audit Committee is to provide independent assurance of the adequacy of the risk management framework and the associated control environment, independent scrutiny of the authority’s financial and non-financial performance to the extent that it affects the authority’s exposure to risk and weakens the control environment, and to oversee the financial reporting process”.</p>	Non-compliant.	No Statement of Purpose is currently in situ.	A Statement of Purpose should be formulated along the lines suggested.
<b>CORE FUNCTIONS</b>			
<ul style="list-style-type: none"> <li>▪ Consider the effectiveness of the authority’s risk management arrangements, the control environment and associated anti-fraud and anti-corruption arrangements.</li> </ul>	Partly compliant.	Reports on these issues have been considered, including a recent report on the Statement on Internal Control (SIC). The focus has however been on audit and assurance rather than wider governance and risk matters.	The Committee’s remit should be widened to oversee the effectiveness of the Council’s Governance, Risk & Control Framework. Specific ways in which this could be executed are noted below.
<ul style="list-style-type: none"> <li>▪ Seek assurances that action is being taken on all risk-related issues identified by auditors and inspectors.</li> </ul>	Non-compliant.	<p>Until recently the Corporate Improvement Plan has been the Council’s vehicle for addressing key risks. Progress against Plan has been reported to Executive Cabinet &amp; O&amp;S.</p> <p>A separate Strategic Risk Register is now being compiled to identify the key risks to the achievement of the new strategic objectives and priorities.</p>	<p>The Committee should receive regular monitoring reports showing that action has been taken to:</p> <ul style="list-style-type: none"> <li>▪ Address all agreed external audit recommendations, including those relating to governance.</li> <li>▪ Address the risk issues identified in the new Strategic Risk Register.</li> </ul>
<ul style="list-style-type: none"> <li>▪ Be satisfied that the authority’s assurance statements, including the Statement on Internal Control, properly reflect the risk environment and any actions required to improve it.</li> </ul>	Partly Compliant.	Prior to formally approving the SIC, the Committee received a report explaining the basis on which it had been produced, following a detailed review of the Council’s internal control environment.	The Committee should also receive regular reports on progress to address weaknesses in the internal control environment, identified through the SIC process.
<ul style="list-style-type: none"> <li>▪ Approve (but not direct) internal audit’s strategy,</li> </ul>	Compliant.		

plan and monitor performance.			
<ul style="list-style-type: none"> <li>Review summary internal audit reports and the main issues arising, and seek assurance that action has been taken where necessary.</li> </ul>	Compliant.		
<ul style="list-style-type: none"> <li>Receive the annual report of the head of internal audit.</li> </ul>	Compliant.		
<ul style="list-style-type: none"> <li>Consider the reports of external audit and inspection agencies.</li> </ul>	Partly compliant.	Significant pieces of work have tended to be individually reported, but the Committee has not policed the implementation of associated recommendations.	As stated above, the Committee should receive regular monitoring reports showing that action has been taken to address all agreed external audit recommendations.
<ul style="list-style-type: none"> <li>Ensure that there are effective relationships between external &amp; internal audit, inspection agencies and other relevant bodies, and that the value of the audit process is actively promoted.</li> </ul>	Compliant	The Committee have received a report on external / internal audit liaison and joint working arrangements and frequently questions their operation.	
<ul style="list-style-type: none"> <li>Review the financial statements, external auditor's opinion and reports to members, and monitor management action in response to the issues raised by external audit.</li> </ul>	Partly compliant.	Relevant reports have been received but the Committee has not policed the implementation of associated recommendations.	As stated above, the Committee should receive regular monitoring reports showing that action has been taken to address all agreed external audit recommendations.
<b>FEATURES</b>			
<ul style="list-style-type: none"> <li>Unbiased attitudes - treating auditors, the executive &amp; management equally.</li> </ul>	Partly compliant	The Committee has operated effectively and with integrity since its creation in 2002. However the new guidelines require it to be completely separate from the executive and have the ability to question it on matters of governance, risk and control.	In addition to adopting wider Terms of Reference, the Committee's membership, composition and overall mode of operation also need to be reviewed.
<ul style="list-style-type: none"> <li>The ability to question the executive (leader or chief executive) when required.</li> </ul>	See above.	See above.	See above.
<ul style="list-style-type: none"> <li>A membership that is balanced, objective, independent of mind and knowledgeable.</li> </ul>	See above.	See above.	See above.
<ul style="list-style-type: none"> <li>A strong chair – displaying a depth of skills and interest.</li> </ul>	See above.	See above.	See above.

<b>STRUCTURE &amp; ADMINISTRATION</b>			
<ul style="list-style-type: none"> <li>▪ Be independent of the executive &amp; scrutiny functions.</li> </ul>	See above.	See above.	See above.
<ul style="list-style-type: none"> <li>▪ Have clear reporting lines and rights of access to other committees / functions, for example scrutiny and service committees, corporate risk management boards and other strategic groups.</li> </ul>	Non-compliant.	The Committee's reporting lines and inter-relationships with other committees and boards have not been formalised and are unclear.	The Committee's reporting lines and inter-relationships with other committees and boards need to be clarified, particularly with regard to the Overview & Scrutiny Committee, Risk Management Board and Corporate Governance Group.
<ul style="list-style-type: none"> <li>▪ Meet regularly – about four times a year, and have a clear policy on those items to be considered in private and those to be considered in public.</li> </ul>	Partly compliant.	Regular meetings take place but there is no clear policy on private / public business.	A clear policy on the consideration of private / public business is required.
<ul style="list-style-type: none"> <li>▪ Meet privately and separately with the external auditor and head of internal audit.</li> </ul>	Non-compliant.	This facility is currently not in place.	A facility needs to be established, to enable the Committee to meet separately with the external auditor or head of internal audit, if required.
<ul style="list-style-type: none"> <li>▪ Include, as regular attendees, the chief finance officer or deputy, head of internal audit and appointed external auditor and relationship manager. Other attendees may include the monitoring officer (for standards issues), chief executive and the head of resources (where such a post exists). These officers should also be able to have access to the committee, or the chair, as required. The committee should have the right to call any other officers or agencies of the council as required.</li> </ul>	Partly compliant.	<p>Although the required regular attendees do attend, the other suggested attendees have tended not to.</p> <p>The Committee has tended not to call any other officers or agencies, for example to discuss key agenda items.</p>	<p>Agreement is sought as to which officers should regularly attend the Audit Committee.</p> <p>The Committee should be advised of its right to ask other officers to attend meetings as and when required.</p>
<ul style="list-style-type: none"> <li>▪ Be properly trained to fulfil their role.</li> </ul>	Partly compliant.	General training was provided when the Committee was established in 2002 but this has not been repeated for new members and does not cover the roles and responsibilities now expected.	The newly constituted Audit Committee should be appraised of the new terms of reference and training provided on the Committee's wider governance, risk and control remit.

## CONCLUSIONS

15. The Audit Committee has operated very effectively under its original terms of reference. However the new CIPFA Guidance stresses that the Committee now has a key role to play in monitoring the organisation's overall **governance arrangements, including risk management and performance** and holding the Executive to account on these matters. It has a particularly important role in **tracking** the implementation of recommendations made by external and internal audit in these areas.
16. This was recently endorsed by the Audit Commission in their Use of Resources report, whereby the Commission recommended the Council to "extend the Audit Committee's terms of reference to more clearly specify its risk and governance remit and to support this with more awareness training". The Commission also recommended that the Audit Committee should be "**independent of both the Executive and Scrutiny functions**"
17. There are therefore important issues to be resolved regarding the Audit Committee's **remit, composition, membership, training and reporting lines.**

## RECOMMENDATIONS

18. That the Audit Committee remit, composition, membership, training and reporting issues identified above be addressed, by:
  - (a) Adopting the new CIPFA model Terms of Reference for Audit Committees;
  - (b) Aligning the respective Terms of Reference of the Audit and O&S Committees to provide greater clarity of remit and avoidance of overlap;
  - (c) Implementing the actions necessary to ensure compliance with the new CIPFA Guidance on Audit Committees;
  - (d) Consulting the Audit Commission to determine what flexibilities may exist in terms of Audit Committee composition and membership.

GARY HALL  
DIRECTOR OF FINANCE

Background Papers			
Document	Date	File	Place of Inspection
"Called to Account" – The Role of Audit Committees in Local Government".	1996	Finance Unit	Gillibrand St.Offices
"Audit Committees – Practical Guidance for Local Authorities".	2005	Finance Unit	Gillibrand St.Offices

  

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Garry Barclay	5468	13/03/06	ToIRRepJan06

## **ORIGINAL / EXISTING AUDIT COMMITTEE TERMS OF REFERENCE**

- i) to oversee all arrangements for both the internal and external audit of the Council's accounts and financial records;
- ii) to consider and make recommendations on:
  - (a) the annual audit report and management letter of the external Auditor;
  - (b) any other statutory report of the external Auditor;
  - (c) any internal audit report that may be referred by the Chief Executive, the Director of Finance, the Director of Legal and Personnel Services (as Monitoring Officer), the Executive Leader or the Chair of the Overview and Scrutiny Committee;
  - (d) the effectiveness and adequacy of the response by the Council, the Executive, any Committee or Sub-Committee of the Council or the Executive or of any officer to any internal or external audit report or management letter;
  - (e) the systems of control and arrangements for the prevention of fraud and corruption within the Council's organisation; and
  - (f) of any other matter relevant to the audit of the Council's accounts and financial records or its systems for the control and safeguarding of all the Council's assets, both financial and otherwise.
- iii) If necessary for the purpose of its functions, to consider and examine specific matters that have been the subject of an audit report, with the right to call for production of relevant documents in the possession or control of the Council, the Executive or an officer.

## **NEW MODEL TERMS OF REFERENCE FOR AUDIT COMMITTEES**

### **AUDIT ACTIVITY**

- To consider the head of internal audit's annual report and opinion, and a summary of internal audit activity (actual and proposed) and the level of assurance it can give over the council's corporate governance arrangements.
- To consider summaries of specific internal audit reports as requested.
- To consider reports dealing with the management and performance of the providers of internal audit services.
- To consider a report from internal audit on agreed recommendations not implemented within a reasonable time scale
- To consider the external auditor's annual audit letter, relevant reports, and the report to those charged with governance.
- To consider specific reports as agreed with the external auditor.
- To comment on the scope and depth of external audit work and to ensure it gives value for money
- To liaise with the Audit Commission over the appointment of the council's external auditor.
- To commission work from internal and external audit.

### **REGULATORY FRAMEWORK**

- To maintain an overview of the council's constitution in respect of contract procedure rules, financial regulations and codes of conduct and behaviour.
- To review any issue referred to it by the chief executive or a director, or any council body.
- To monitor the effective development and operation of risk management and corporate governance in the council.
- To monitor council policies on "raising concerns at work" and the anti-fraud and corruption strategy and the council's complaints process.
- To oversee the production of the authority's Statement on Internal Control and to recommend its adoption.
- To consider the council's arrangements for corporate governance and agreeing necessary actions to ensure compliance with best practice.
- To consider the council's compliance with its own and other published standards and controls.

### **ACCOUNTS**

- To review the annual statement of accounts. Specifically, to consider whether appropriate accounting policies have been followed and whether there are concerns arising from the financial statements or from the audit that need to be brought to the attention of the council.
- To consider the external auditor's report to those charged with governance on issues arising from the audit of the accounts.