

Item no.

Report to: **Audit Scrutiny Committee**

Date: **Monday, 5th December, 2005**

Report of: **Head of Democratic Services and Administration**

Subject: **Audit Committees - Practical Guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA)**

Ward:

1. **Purpose of the Report**

1.1 The purpose of the report is to inform Members of the content of the practical guidance document issued by CIPFA on Audit Committees. The guidance seeks to consider the key issues of governance, financial reporting and performance of the authority and to look at the Audit Committee's role.

2. **Consultation**

2.1 This report has been prepared in consultation with the Chief Executive, Director of Finance and Corporate Services, the Monitoring Officer and the Audit Manager.

3. **Background**

3.1 The role of those responsible for corporate governance and the financial reporting process continues to be open to scrutiny by regulators, legislators and the general public. Audit Committees are increasingly viewed as a critical component in the overall corporate governance process.

3.2 CIPFA, recognising this growing importance, has developed a set of principles for Audit Committees in local government. Good corporate governance requires independent, effective assurance about the adequacy of financial management and reporting. CIPFA feel these functions are best delivered by an Audit Committee, independent from the Executive and Scrutiny functions.

3.3 The guidance has been written to help those authorities that do not already have an Audit Committee to implement one effectively and to help those authorities that have Audit Committee arrangements in place to assess whether they are as effective as they need to be to contribute to good governance.

3.4 The guidance, therefore seeks to consider the key issues for all authorities to help them address the principles.

4. **Position Statement**

4.1 CIPFA recognise that the way in which an Audit Committee is organised will vary depending upon the specific political and management arrangements in place in any local authority. The guidance therefore explores how Audit Committees relate to local authorities' different arrangements for managing and governing themselves.

- 4.2 Although legislation does not require local authorities to establish Audit Committees, a Council is required "to ensure that its financial management is adequate and effective in that it has a sound system of internal control which facilitate the effective exercise of its functions". Further, section 151 of the Local Government Act 1972 requires the Council to "make arrangements for the proper administration of its financial affairs."
- 4.3 CIPFA acknowledge that a local authority's Chief Finance Office is key to discharging these requirements. However, to be truly effective they feel that the Chief Finance Officer requires an effective Audit Committee to provide support and challenge, as well, of course, as adequate and effective internal audit.
- 4.4 CIPFA does not wish to prescribe any particular model, but it believes that there are features that should be common to all. These key features form the framework of their guidance:
1. A Statement of Purpose
 2. Core functions
 3. Features
 4. Structure and administration

4.4.1 *Statement of Purpose*

CIPFA suggest that the local authority should formally approve a Statement of Purpose, along the following lines:

The purpose of an Audit Committee is to provide independent assurance of the adequacy of the risk management framework and the associated controlled 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.

CIPFA feel that the scope of an Audit Committee should be sufficient to provide challenge across all committees of the Council, as well as the Executive.

4.4.2 *Core Functions*

Audit Committees will:

- Consider the effectiveness of the authority's risk management arrangements, the control environment and associated anti-fraud and anti-corruption arrangements.
- Seek assurances that action is being taken on risk-related issues identified by auditors and inspectors.
- 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.
- Approve (but not direct) internal audit's strategy, plan and monitor performance.

- Review summary internal audit reports and main issues arising, and seek assurance that action has been taken where necessary.
- Receive the annual report of the head of internal audit.
- Consider the reports of external audit and inspection agencies.
- Ensure that there are effective relationships between external and internal audit, inspection agencies and other relevant bodies, and that the value of the audit process is actively promoted.
- 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.

An Audit Committee should be able to improve corporate focus on the issues arising from risk management, internal control and reporting. It may be difficult for officers and Members to identify what needs to be done to improve, or to act on significant issues arising from audit work or the review of the Statement on Internal Control, unless there is a forum for reviewing such issues and tracking action on what needs to be done.

Internal Audit

The Audit Committee will have a clear role in relation to the authority's internal audit function

External Audit and Inspections

The Audit Committee's role will include receiving and considering the work of the District Auditor.

Scrutiny

The committee should also ensure that it is aware of the work of scrutiny and other committees so that it can take account of issues relevant to its areas of interest.

Control Strategies

The Council will have a number of strategies in place to regulate its activities and control the actions of its employees, elected Members and contractors. The Audit Committee should take a view on whether these strategies have been properly formulated, and remain effective.

Financial Statements

The Audit Committee should review the financial statements, for example, before they are approved under regulation 10 of the Accounts and Audit Regulations 2003, and again, in conjunction with the external auditor's SAS 610 (ISA 260) report to those charged with governance, following completion of the audit.

4.4.3 *Features*

The Audit Committee needs to be recognised as an important body in the Council's structure to allow it to provide the essential challenge to the Executive when needed.

Best practice would be for an Audit Committee to report directly to the Council, therefore making it independent from the Executive and Scrutiny functions. This provides status, independence and clarity to the role.

Good Audit Committees will be characterised by:

- A strong Chair - displaying a depth of skills and interest
- Unbiased attitudes - treating auditors, the Executive and management equally
- The ability to challenge the Executive when required
- A membership that is balanced, objective, independent of mind and knowledgeable

4.4.4 Structure and Administration

Independence

CIPFA suggests that to be effective, the Audit Committee needs to be independent from Executive and Scrutiny. The link with the Scrutiny function can be beneficial but the ultimate power of the Audit Committee could be compromised by too much cross-membership. The Audit Committee needs to retain the ability to challenge the Executive on issues and report to it on major issues and contraventions. Therefore cross-membership should not be the norm and if it is seen as necessary, should be restricted to one Member from each.

The Audit Committee chair should not be, expressly, a Member of the Executive. A non-executive chair is important in order to promote the objectivity of the audit committee and to enhance its standing in the eyes of the public.

Meetings

The frequency and timing of meetings is a matter for each authority to determine based on its own committee timetable and needs. However, from general practice, CIPFA recommend that at least four meetings per year appear to be appropriate. One meeting annually will be taken up with setting the programme, agreeing audit plans and generally preparing for the year ahead, leaving three meetings which are available for monitoring purposes and to fit in with the cycle of assurance statements and financial reporting.

Composition

The size of the Audit Committee is relevant although not crucial. Too small a number of Members and political balance may be difficult to achieve; too large and meetings may become unwieldy. HM Treasury guidance recommends between three and five Members for an Audit Committee.

Any Audit Committee, which is a properly constituted committee of the Council, will need to abide by the rules concerning political balance.

Many authorities have made provision to co-opt a Member but have not bestowed voting rights on that Member. This allows flexibility in co-option and retains the decision-making function for the permanent Members of the Audit Committee.

Skills and Experience

To be effective, the Members of the Audit Committee will require certain skills and will benefit from having gained experience in some of the key areas to be considered by the committee. Whilst financial awareness is essential, particularly for the chair, an accounting background or qualification is less important than a broad understanding of the financial, risk and control, and corporate governance issues facing local authorities generally and the Council specifically.

An ability to question, probe and seek clarification about complex issues is also essential.

Training

CIPFA recognise that identifying sufficient Members with appropriate skills or experience could be difficult, especially as many such Members could also be serving on other committees and thus may not be eligible for membership.

Appropriate and timely training for Members will help them overcome this problem and build upon the key attributes of independence, a risk focused attitude and balanced approach that preferred Members will already possess.

Induction training should be provided for all new committee Members and cover:

- the roll of the committee
- the terms of reference
- the time input required of Members
- an overview of Council activities
- the financial and risk environment

Further, regular and specific Audit Committee training should also be provided in:

- financial reporting
- governance
- understanding financial statements
- the regularity framework
- the role of internal and external audit
- the importance of risk management

Administration

Effective administrative support for the Audit Committee will clearly be important, as for any committee of the Council.

If the committee is to take an active part in Council business, it should be administered as effectively as any other should.

The regular attendance of key senior management officers is important both to maintain the credibility of the committee and to ensure that Members are adequately supported by appropriate professionals. CIPFA acknowledge that local authority Chief Finance Officers will have an important relationship with the committee. This officer should therefore be the key point of contact for Audit Committee Members.

4.4.5 *Some Key Questions*

The briefing guidance sets out some key questions and answers to help local authorities appreciate why the guidance is important and how it can be used to best effect.

These questions and answers have been included at Appendix (1).

5. **Implications**

5.1 *Financial Implications*

5.1.1 This report has no financial implications.

5.2 *Legal Implications*

5.2.1 This report has no legal implications.

5.3 *Policy Implications*

5.3.1 Whilst the report has no direct policy implications, there may be some impact upon the Council's Constitution in respect of the potential future role of an Audit Committee within the Council's decision making structures.

5.4 *Risk Implications*

5.4.1 A risk assessment has been carried out and controls are in place to manage those risks.

5.5 *Communication Implications*

5.5.1 This report has no communication implications.

6. **Corporate Implications**

6.1 *Corporate Plan and Priorities*

6.1.1 Corporate Plan and Priorities

The issues identified within the report will contribute to Council Priority 2, Striving for Excellence in the Workplace, specifically Objective SRE3, ensuring the corporate health of the Council through sound and prudent financial management.

6.2 *Service Plan*

6.2.1 The report will have no implications for existing Service Plans.

6.3 *Equality and Diversity*

6.3.1 The report has no adverse impact upon Equality and Diversity issues.

6.4 *E-Government*

6.4.1 The report has no E-Government Implications.

6.5 *Procurement*

6.5.1 The report has no procurement implications

6.6 *Performance Management and Scrutiny*

6.6.1 Whilst there are no direct implications for Performance Management and Scrutiny arising from this report, the potential establishment of an Audit Committee, independent of Executive and Scrutiny will have implications for the future of the Council's Audit Scrutiny Committee.

6.6.2 There may also be performance implications for the Council of establishing an Audit Committee in respect of the Council's CPA result in respect of the Use of Resources Key Lines of Enquiry.

7. **Conclusion**

7.1 Whilst this report has been produced for Members' information, it can be seen from the content that there are potential implications for the Council's existing Political Management and Corporate Governance arrangements which will need to be addressed.

8. **Recommendations**

8.1 Members are requested to:

- a) receive the report and note the information detailed therein;
- b) refer the report to the Council's Political Management Working Group to discuss the potential management and corporate governance arrangements.

Background Papers:

1. CIPFA: Audit Committees - Practical Guidance for Local Authorities
2. CIPFA: Audit Committees - Practical Guidance for Local Authorities - Briefing Note for Users of the Guide
3. The Council's Constitution
4. District of Easington Corporate and Performance Plan 2005-2006.

BG/PH adm/gen/051101
21st November, 2005