

Item 3

STANDARDS COMMITTEE

5TH MAY 2006

JOINT REPORT OF THE CHIEF EXECUTIVE AND DIRECTOR OF RESOURCES

Portfolio: RESOURCE MANAGEMENT

THE IMPLICATIONS OF THE ESTABLISHMENT OF AN AUDIT COMMITTEE

1. SUMMARY

- 1.1 The Council is being encouraged by the Audit Commission to consider the establishment of an Audit Committee. The Chartered Institute of Public Finance and Accountancy also considers that an Audit Committee, which would be separate from the Executive and Scrutiny functions, would enhance public trust and confidence in the financial governance of an authority.
- 1.2 The purpose of the report is therefore to identify the issues that need to be taken into account in determining a statement of purpose, core functions, structure and composition and the constitutional impact of creating an Audit Committee.

2. RECOMMENDATIONS

- 2.1 That Standards Committee considers this Report and makes recommendations to the Council.
- 2.2 That the Constitution be amended to incorporate the changes shown in Appendix 2 of this report together with any other consequential changes identified by the Monitoring Officer.

3. BACKGROUND

- 3.1 The Local Government Act 2000 introduced new ways of governing local authorities. Principal Councils were required to have an Executive and one or more Scrutiny Committees.
- 3.2 ***The Current Position***
In May 2002 this Council decided to establish the Cabinet to undertake the role of the Executive and three Overview and Scrutiny Committees to fulfil a scrutiny role. Some local authorities at that time established an Audit Committee, as they considered that from a corporate governance viewpoint that Committee would provide an independent assurance about the adequacy of financial management and reporting.
- 3.3 ***Audit Commission***
More recently the Audit Commission, in a corporate national report on Stewardship and Governance, issued in July 2005, expressed its concern that less than half of local authorities had a formally constituted Audit Committee. It

was the Commission's opinion that the absence of an effective Audit Committee was a fundamental weakness in a local government body's governance arrangements.

- 3.4 To further encourage those local authorities who have not established an Audit Committee, the Audit Commission has included in their 'Use of Resources' Key Lines of Enquiry (KLOE) for future CPA reviews, a requirement that to achieve the highest possible score, local authorities must have an Audit Committee.
- 3.5 The Council has always been commended as having relatively strong financial management arrangements and has scored well in this area as a result. We have always taken the view that we should learn from the best practice of others and been prepared to carefully consider what the Audit Commission and indeed CIPFA have to recommend in terms of improving our arrangements.
- 3.6 One of the reasons for the Audit Commission setting out KLOEs is to encourage local authorities that do not at the moment fully comply, to put arrangements in place to meet the criteria over time. There will be other criteria that the Council will need to achieve to gain the maximum score and these are all being addressed. It is therefore appropriate to give consideration to the issue surrounding the adoption of an Audit Committee as we move forward with this agenda.

Chartered Institute of Public Finance and Accountancy (CIPFA)

- 3.7 CIPFA has recently issued a guidance note, '*Audit Committees – Practical Guidance for Local Authorities*', in an effort to encourage all authorities to put an Audit Committee in place, if they do not already have one, and help make the established Audit Committees become more effective.
- 3.8 CIPFA has listened to a wide spectrum of opinion on the subject of Audit Committees and accepts that in local government there is a diversity of views about the added value, which Audit Committees bring to the governance arrangements within authorities. It agrees that a prescriptive 'one size fits all' statement would therefore be inappropriate and unhelpful but suggests that what is important is that the functions of Audit Committees are discharged effectively and are recognised for their significance in relation to overall governance.
- 3.9 CIPFA suggests that good Corporate Governance requires effective assurance about the adequacy of financial management and reporting. It suggests that effective Audit Committees help raise the profile of internal control, risk management and financial reporting issues, within an organisation as well as providing a forum for the discussion of issues raised by Internal and External Auditors or any other inspection agencies.
- 3.10 CIPFA believes that the functions of an Audit Committee are best delivered by a Committee which is separate and independent from Executive and Scrutiny functions, and chaired independently from both these functions. CIPFA acknowledges that the link with the scrutiny function can be beneficial but suggests that the ultimate power of the Audit Committee could be compromised by too much cross membership. It states that the Audit Committee needs to retain the ability to challenge the Executive on issues and to report to it on major issues and contraventions. CIPFA therefore suggests that a cross membership

should not be the norm and, if it is seen as necessary, should be restricted to one member from the Executive and one from Scrutiny.

3.11 As CIPFA does not wholly endorse any one particular model, it is therefore for this Council to determine the membership of the Committee. A number of options would include:

- *To have a number of members who are all independent of Cabinet or Overview and Scrutiny Committee responsibilities.*
- *To allow no more than one member from Cabinet and one member from Overview and Scrutiny Committee to serve on the Audit Committee.*
- *A combination of the above two options.*

3.12 CIPFA also suggests that the Committee must have a clear right of access to full Council, other Council Groups and Committees.

3.13 Although CIPFA suggests that the case for separating Audit Committees from the Executive is clear and self-evident, it recognises that some authorities have already set up Audit Committees as part of Scrutiny structures. CIPFA suggests that the role of Scrutiny is to review policy and challenge whether the Executive has made the right decisions to deliver policy objectives. It argues that this is different from the role of the Audit Committee, which should provide an independent assurance that there are adequate controls in place to mitigate key risks and to provide an assurance that the Council, including the Scrutiny function, is operating effectively. CIPFA also recommends that an Audit Committee should be separate, organisationally and practically, from both the Executive and Scrutiny functions.

4. STATEMENT OF PURPOSE

4.1 CIPFA suggests that if an Audit Committee is to be established, a Statement of Purpose should be formally approved, 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 control environment, independent scrutiny of the Council’s financial and non-financial performance to the extent that it affects the Council’s exposure to risk and weakens the control environment, and to oversee the financial reporting process.”

Proposal: That the Council formally approves the Statement of Purpose as shown above.

5. CORE FUNCTIONS

5.1 CIPFA suggests a number of core functions that an Audit Committee should be responsible for and these are shown at Appendix 1. A number of other suggested functions are also identified in the Appendix, which might be appropriate for this Council to consider.

Proposal: That the Council agrees the role and functions of the Audit Committee as shown in the attached Appendix 1.

6. FEATURES

6.1 CIPFA suggests that a good Audit Committee 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 (Leader or Chief Executive) when required.
- A membership that is balanced, objective, independent of mind and knowledgeable.

NOTE:

CIPFA suggests that there are many personal qualities needed to be an effective Chair, but key to these are promoting a political open discussion, managing meetings to cover all business and encouraging a candid approach from all participants. It also suggests that an effective Chair should have an interest in and knowledge of financial management.

7. STRUCTURE

7.1 Although CIPFA does not prescribe a single model for an Audit Committee, it suggests that it should:-

- Be independent of the Executive and Scrutiny functions.
- Have clear reporting lines and rights of access to other Committees/functions, for example Scrutiny and Service Committees, any corporate boards or other strategic groups.
- 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.
- Meet with the External Auditor and Head of Internal Audit.
- Include as regular attendees, the Section 151 Officer (the Director of Resources) or Deputy, the Head of Internal Audit and appointed External Auditor and Relationship Manager. Other attendees may include the Monitoring Officer (for any Standards issues) and the Chief Executive. CIPFA suggests that these officials should also be able to have access to the Committee or Chair, as required. CIPFA also suggests that the Committee should have the right to call any other officers or agencies of the Council as required.
- Be properly trained to fulfil their role.

Proposal: The Council endorses the principles outlined by CIPFA in relation to the structure of an Audit Committee as shown in paragraph 7.1 and integrated into Appendix 1 of the report.

8. COMPOSTION

8.1 CIPFA suggests that although the size of an Audit Committee is relevant, it is not crucial. It argues that too small a number of members and political balance may be difficult to achieve; too large a number and meetings may become unwieldy. CIPFA suggests that co-option from outside the authority may well be beneficial as often the injection of an external view, for specific discussions, can be seen as bringing a new approach to Committee discussions. According to CIPFA, many authorities have made provision to co-opt Members but some have not bestowed voting rights on that Member, which would allow flexibility in co-option and retains the decision making function for permanent Members of the Committee.

Proposal: Taking into account CIPFA's comments as shown in paras. 3 and 8 above, it is proposed that an appropriate composition of an Audit Committee of this Council, should be politically balanced and one of the following options be agreed:

- *The Committee should be composed of six members, none of whom are members of Cabinet or Overview and Scrutiny Committees.*
- *The Committee should be composed of six members, with not more than one member from each of Cabinet and Overview and Scrutiny Committees.*
- *A combination of the above options.*

It is also proposed that one member of the Committee should be co-opted. The co-opted member would ideally live within the Borough and have some knowledge, expertise or interest in the work of the Committee. No Councillor or Officer of this Council could serve as a co-opted member on this Committee.

It is proposed that any co-opted member of this Committee would be subject to the Members' Code of Conduct.

These proposals are summarised in Appendix 1 to the report.

9. CONCLUSION

- 9.1 When the Council's Constitution was agreed in 2002, there was not the same level of emphasis being placed on the need to have an Audit Committee and therefore it was not put forward as something that members needed to consider when the functions of the Cabinet, Overview and Scrutiny and other Committees were being agreed.
- 9.2 A present some of the functions of an Audit Committee, as recommended by CIPFA, have been partially split between Cabinet (e.g. Risk Management) and Overview and Scrutiny (e.g. Audit and Internal Control arrangements). The creation of a separate Audit Committee will mean that the existing responsibilities of Cabinet and Overview and Scrutiny Committees will need to be reviewed and proposals to amend the Constitution are shown in Appendix 2.
- 9.3 Similarly the composition of an Audit Committee would have to be agreed and a special responsibility allowance determined for the Chair and Vice-Chair.
- 9.4 It is considered that in principle the Council will benefit from the establishment of an Audit Committee and there are a number of proposals incorporated into the report, which could integrate an Audit Committee into the Council's Constitution.

10. FINANCIAL IMPLICATIONS

- 10.1 It would be necessary to arrange for the Independent Panel to determine an appropriate level of special responsibility allowance for at least the Chair of this new Committee and potentially a Deputy Chair also. It is anticipated that these costs would not be significant.

10.2 Appropriate training for members of the Audit Committee would also be required and an adequate budget would need to be provided.

11. CONSULTATION

11.1 The purpose of this report is to allow Members to consider the implications of the establishment of an Audit Committee and is therefore a consultative document. Cabinet approved this Report on 13th April 2006

12. OTHER MATERIAL CONSIDERATIONS

Links to Corporate Objectives/Values

12.1 The consideration being given to the establishment of an Audit Committee ensures that the Council's corporate values are being taken into account, in particular:-

- That it is being open, accessible, equitable, fair and responsive.
- That consultation is taking place.
- That the Council is being responsible with and accountable for public finances.
- That the Council is seeking to achieve continuous improvement and innovation in service delivery.

Risk Management

12.2 The absence of an Audit Committee may make it more difficult for the Council to demonstrate to the Audit Commission that the Council has a robust arrangement in place to provide independent assurance of the adequacy of the risk management framework and the associated control environment.

Health and Safety

12.2 There are no additional Health and Safety implications as a consequence of this report.

Equality and Diversity

12.3 No Equality and Diversity issues have been identified.

Legal and Constitutional

12.4 There are proposed changes to the Constitution incorporated within the content of this report. This Report therefore is to be placed before Council for its approval under Article 15 of the Constitution

Overview and Scrutiny

12.5 As mentioned above, the functions, responsibilities and membership of the existing Overview and Scrutiny Committees will need to be considered.

12.6 There are no other material considerations to take into account.

Contact Officer: Harold Moses

Telephone No.: 01388-816166 ext. 4385
E-Mail Address: hmoses@sedgefield.gov.uk
Key Decision Validation:

Appendices: Appendix 1 – Key Functions of an Audit Committee.

Background Papers: Audit Commission Report – Stewardship and Governance 2004.
CIPFA – Audit Committees – Practical Guidance for Local Authorities.
Various reports to the Council amending the Constitution.

	Yes	Not Applicable
1. The report has been examined by the Council's Head of the Paid Service or his representative.	<input checked="" type="checkbox"/>	<input type="checkbox"/>
2. The content has been examined by the Council's S.151 Officer or his representative.	<input checked="" type="checkbox"/>	<input type="checkbox"/>
3. The content has been examined by the Council's Monitoring Officer or his representative.	<input checked="" type="checkbox"/>	<input type="checkbox"/>
4. Management Team has approved the report.	<input checked="" type="checkbox"/>	<input type="checkbox"/>

SEDGEFIELD BOROUGH COUNCIL

AUDIT COMMITTEE

PROPOSED AMENDMENTS TO THE CONSTITUTION

Article 10 – The Audit Committee**10.1 Audit Committee**

The Council meeting will establish and Audit Committee.

10.2 Composition**(a) *Membership***

The Audit Committee will be composed of: -

- Six members, all independent of Cabinet and not more than one having Overview and Scrutiny Committee responsibilities; plus
- one co-opted member who is not a Councillor or Officer of the Council or any other body having an Audit Committee.

(b) *Co-opted Members*

The Co-opted Member will not be entitled to vote at meetings.

(c) *Chairing the Committee*

- Chair and Vice-Chair of the Audit Committee will be appointed at the Annual Council meeting.
- The Chair must not be a member of Cabinet or Overview and Scrutiny Committees.
- If the position of Chair or Vice-Chair becomes vacant during the year, the position will be filled at the next appropriate Council meeting.

(d) *Quorum*

A Quorum for a meeting of the Audit Committee will be 3 Members.

10.3 Role and Function

The Audit Committee will have the following role and function:-

- (a) To consider the effectiveness of the Council's Risk Management arrangements, the control environmental and associated anti-fraud and anti-corruption arrangements. To report at least annually to Cabinet on the effectiveness of the Risk Management arrangements.

- (b) To seek assurances that action is being taken on risk related issues, identified by Auditors and Inspectors.
- (c) To be satisfied that the Council's Assurance Statements, including the Statement of Internal Control, properly reflect the risk environment and any actions required to improve it.
- (d) To approve the Council's Internal Audit Strategy Plan, Annual Audit Plan and monitor performance against all associated plans
- (e) To review summary Internal Audit reports and the main issues arising and seek assurance that action has been taken where necessary.
- (f) To receive an Annual Report from the Head of Internal Audit.
- (g) To 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.
- (h) To review financial statements, including the Council's Statement of Accounts, External Auditor's and other inspection agencies opinions and reports to Members and monitor management action in response to the issues raised by External Audit and other inspection agencies.
- (i) For the Chair and Vice-Chair to meet privately and separately at least once a year with the External Auditor and Head of Internal Audit.
- (j) To have the right to call any officers of the Council as required.
- (k) To consider performance and best value issues to the extent that they relate to the audit and control environment and risk management issues of the Council.

Note: For the purpose of these roles and functions 'Audit' relates to corporate issues, complaints, inquiries, financial probity and such other matters as may be decided by the Council.

10.4 Frequency of Meetings

The Committee shall meet on four occasions annually.

SEDGEFIELD BOROUGH COUNCIL

AUDIT COMMITTEE

CONSEQUENTIAL AMENDMENTS TO OTHER PARTS OF THE CONSTITUTION

Part 2 – Articles of the Constitution

Insert –

new Article 10 – The Audit Committee

Re-number –

existing Articles 10 to 16 to Articles 11 to 17

Article 6 – Overview and Scrutiny Committees

6.03 Specific Functions (b) Scrutiny

Remove –

(vii) Review the Statement of Internal Control and consider it separately from the Accounts.

Remove –

(viii) Review and Scrutinise the Council's Audit activities.

Part 4 – Rules of Procedure

F Financial Regulations 4 Risk Management and Control of Resources

Remove -

4.2.1 Cabinet is responsible for approving the Council's Risk Management Policy and Strategy and for reviewing the effectiveness of Risk Management.

Add -

4.2.1 Cabinet is responsible for approving the Council's Risk Management Policy and Strategy. The Audit Committee will review the effectiveness of Risk Management and present a report annually to Cabinet on its effectiveness.

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