



# A Toolkit for Local Authority Audit Committees

AT THE HEART OF  
PUBLIC SERVICES

## ABC

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# Section 1 – Introduction

## Executive Summary

This toolkit has been produced to build on the work already done by CIPFA and the guidance provided in its publication *Audit Committees – Practical Guidance for Local Authorities*. The toolkit is intended to provide a more detailed set of advice, give examples and suggest good practice to assist both officers and members who are involved in the establishment and operation of an audit committee. The toolkit draws on existing best practice from local government, and the wider public sector, and from the advice provided in CIPFA's *Handbook for Audit Committee Members in Further and Higher Education*.

## Objectives

Good corporate governance requires independent, effective assurance about both the adequacy of financial management and reporting, and the management of other processes required to achieve the organisation's corporate and service objectives. Good practice from the wider public sector indicates that these functions are best delivered by an independent audit committee. In this context, "independence" means that an audit committee should be independent from any other executive function.

It is important that local authorities have independent assurance about the mechanisms underpinning these aspects of governance. Specifically:

- **independent assurance** of the adequacy of the control environment within the authority;
- **independent review** 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
- **assurance** that any issues arising from the process of drawing up, auditing and certifying the authority's annual accounts are properly dealt with and that appropriate accounting policies have been applied.

## Corporate Governance in the public sector

The corporate governance arrangements of an organisation are the means by which strategy is set and monitored, managers are held to account, risks are managed, stewardship responsibilities are discharged and viability is ensured. Corporate governance has been widely debated since the late 1980s, when there were a number of high-profile corporate failures. In its early forms corporate governance was often seen as being concerned mainly with minimising risk and avoiding failure. Whilst this is part of its role, it is not the sole purpose. The governors of public service organisations face a difficult task. They are the people responsible for governance – the leadership, direction and control of the organisations they serve.

Their responsibility is to ensure that they address the purpose and objectives of these organisations and that they work in the public interest.

Organisations are increasingly recognising that good governance is the structural basis for achieving fundamental policy goals. As well as being a key element in improving efficiency and effectiveness within an organisation, corporate governance is one of the primary means by which a set of relationships is established between an organisation's management, its governing body and its stakeholders. There is a clear benefit to local authorities in adopting effective frameworks of corporate governance.

In general, good corporate governance provides proper incentives for the local authority and its management to pursue objectives that are in the interests of the authority and its stakeholders and provide a framework that facilitates effective monitoring. The presence of an effective corporate governance system, both within an individual local authority and across the sector as a whole, helps to provide a degree of confidence that is necessary for all stakeholders who interact with that sector.

Corporate governance deals with the rights and responsibilities of an authority's management, its board and stakeholders. Good corporate governance is therefore essential for those authorities that want to maintain a high profile and good reputation with their stakeholders, regulators and funders. On the other hand, poor corporate governance weakens an authority's potential and, at worst, can pave the way for financial difficulties, poor performance, loss of reputation, fraud and corruption.

Local authorities are entrusted with public funds and therefore have a particular duty to observe the highest standards of corporate governance at all times and ensure that they are discharging their duties with due regard to the proper conduct of public business. In summary, the guiding principles are that an authority should:

- observe the highest standards of integrity, objectivity and honesty in the transaction of all its business
- follow a policy of openness and transparency
- be accountable for its stewardship of funds
- maximise value for money by ensuring that services are delivered in the most effective, efficient and economical way.

If corporate governance is effective, the authority can flourish and, in this context, external stakeholders can rely on that authority. Good governance enables self-regulation and minimises the need for external regulation. Opportunities for authorities to demonstrate the effectiveness of their corporate governance arrangements include:

- publishing reports of reviews of corporate governance. This is consistent with *Audit Committees – Combined Code Guidance* (the Smith Report, January 2003), which recommended that a governing body should undertake a rigorous evaluation of its own performance each year
- publishing a statement of internal control that describes an effective system of risk management, control and governance, demonstrating that all key risks have been identified and managed
- publishing with the financial statements a corporate governance controls assurance statement incorporating the statement on internal control.
- arranging for, and paying due heed to, the work of effective internal and external auditors.

Where authorities fulfill their corporate governance responsibilities and demonstrate that they are operating effectively, this provides considerable assurance and is the basis for a sophisticated ongoing accountability relationship with their stakeholders.

## Benefits Of Audit Committees

Effective audit committees can bring many benefits to local authorities and these benefits are described in CIPFA's *Audit Committees - Practical Guidance for Local Authorities* as:

- raising greater awareness of the need for internal control and the implementation of audit recommendations
- increasing public confidence in the objectivity and fairness of financial and other reporting;
- reinforcing the importance and independence of internal and external audit and any other similar review process (for example, providing a view on the Statement on Internal Control); and
- providing additional assurance through a process of independent and objective review.

Effective internal control and the establishment of an audit committee can never eliminate the risks of serious fraud, misconduct or misrepresentation of the financial position. However, an audit committee:

- can give additional assurance through a process of independent and objective review
- can raise awareness of the need for sound control and the implementation of recommendations by internal and external audit

## Requirements and expectations for having an Audit Committee

There is no statutory obligation for a local authority to establish an audit committee. However, the topic of audit committees is not new. Audit committees have been in place in many parts of the public sector for some time, operating in different ways in different organisations. Audit committees are ever more widely recognised across the public and private sectors, and internationally, as a core component of effective governance. Yet local government shows a mixed pattern of adoption and practice. Up to about twelve months ago, less than half of local authorities had a formally constituted audit committee. Rising public and media expectations about transparent governance arrangements and the expectations of CPA have raised the bar and it is now estimated that about 90% of local authorities have an audit committee or a committee which fulfils the functions of an audit committee.

It is accepted that there is a diversity of views about the added value that audit committees bring to the governance arrangements within local authorities. CIPFA's guidance on audit committees is deliberately flexible in a number of areas including the membership and timing of meetings. It also recognises that audit committees may exist under a number of different names. Nevertheless, there are some core principles on which flexibility is less appropriate. For example, the chair of the

committee should be independent of the executive and the remit of the committee should cover the governance of the whole authority.

Good corporate governance requires independent, effective assurance about both the adequacy of corporate, operational and financial management and reporting, and the management of other processes required to achieve the organisation's corporate and service objectives. 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.

CIPFA believes that these functions are best delivered by an audit committee separate from executive functions. The committee must also have a clear right of access to full council, and other council groups and committees as appropriate.

Throughout the wider public sector, experience and best practice indicates that separating audit committees from the executive is the obvious way in which its independence can be guaranteed. However, CIPFA recognizes that some local authorities have already set up audit committees as part of scrutiny structures. The role of scrutiny is to review policy and challenge whether the executive has made the right decisions to deliver policy goals. This is different from the role of the audit committee which exists to provide independent assurance that there are adequate controls in place to mitigate key risks and to provide assurance that the authority, including the scrutiny function, is operating effectively. That said, an audit committee's judgments might well be informed by the results of scrutiny activity within the authority. Both audit committees and the scrutiny function deal with complex matters, sometimes requiring specialist knowledge and advice. CIPFA believes that they are likely to be more effective if they are required to focus on their own defined areas of business rather than a broader remit.

The Audit Commission has supported the introduction of audit committees in local government for a number of years, including the publication of a paper in 1996 entitled 'Called to account – the role of audit committees in local government'.

## Other guidance

Other guidance relevant to audit committees in local authorities is available in the documents listed in Appendix 1.

## Section 2 – Audit Committee self-assessment checklist

| ESTABLISHMENT, OPERATION AND DUTIES |  |     |    |     |                 |
|-------------------------------------|--|-----|----|-----|-----------------|
| Role and remit                      |  |     |    |     |                 |
| Priority                            | Issue  | Yes | No | N/a | Comments/action |
| 1                                   | Does the audit committee have written terms of reference?  |     |    |     |                 |
| 1                                   | Do the terms of reference cover the core functions of an audit committee as identified in the CIPFA guidance?                                |     |    |     |                 |
| 1                                   | Are the terms of reference approved by the council and reviewed periodically?  |     |    |     |                 |
| 1                                   | Has the audit committee been provided with sufficient membership, authority and resources to perform its role effectively and independently? |     |    |     |                 |
| 1                                   | Can the audit committee access other committees and full council as necessary?   |     |    |     |                 |
| 1                                   | Does the authority's statement on internal control include a description of the audit committee's establishment and activities?              |     |    |     |                 |
| 2                                   | Does the audit committee periodically assess its own effectiveness?  |     |    |     |                 |

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|---|---|--|--|--|--|
| 2   | Does the audit committee make a formal annual report on its work and performance during the year to full council?   |  |  |  |  |
| <b>Membership, induction and training</b> |   |  |  |  |  |
| 1   | Has the membership of the audit committee been formally agreed and a quorum set?  |  |  |  |  |
| 1   | Is the chair independent of the executive function?   |  |  |  |  |
| 1   | Has the audit committee chair either previous knowledge of, or received appropriate training on, financial and risk management, accounting concepts and standards, and the regulatory regime? |  |  |  |  |
| 1   | Are new audit committee members provided with an appropriate induction?   |  |  |  |  |
| 1   | Have all members' skills and experiences been assessed and training given for identified gaps?  |  |  |  |  |
| 1   | Has each member declared his or her business interests?   |  |  |  |  |
| 2   | Are members sufficiently independent of the other key committees of the council?  |  |  |  |  |
| <b>Meetings</b>                           |   |  |  |  |  |
| 1   | Does the audit committee meet regularly?  |  |  |  |  |
| 1   | Do the terms of reference set out the frequency of meetings?  |  |  |  |  |

|                         |   |  |  |  |  |
|-------------------------|---|--|--|--|--|
| 1                       | Does the audit committee calendar meet the authority's business needs, governance needs and the financial calendar?   |  |  |  |  |
| 1                       | Are members attending meetings on a regular basis and if not, is appropriate action taken?  |  |  |  |  |
| 1                       | Are meetings free and open without political influences being displayed?  |  |  |  |  |
| 1                       | Does the authority's S151 officer or deputy attend all meetings?  |  |  |  |  |
| 1                       | Does the audit committee have the benefit of attendance of appropriate officers at its meetings?  |  |  |  |  |
| <b>INTERNAL CONTROL</b> |   |  |  |  |  |
| 1                       | Does the audit committee consider the findings of the annual review of the effectiveness of the system of internal control (as required by the Accounts & Audit Regulations) including the review of the effectiveness of the system of internal audit? |  |  |  |  |
| 1                       | Does the audit committee have responsibility for review and approval of the SIC and does it consider it separately from the accounts?   |  |  |  |  |
| 1                       | Does the audit committee consider how meaningful the SIC is?  |  |  |  |  |
| 1                       | Does the audit committee satisfy itself that the system of internal control has operated effectively throughout the reporting period?   |  |  |  |  |

|   |   |  |  |  |  |
|---|---|--|--|--|--|
| 1   | Has the audit committee considered how it integrates with other committees that may have responsibility for risk management?  |  |  |  |  |
| 1   | Has the audit committee (with delegated responsibility) or the full council adopted "Managing the Risk of Fraud – Actions to Counter Fraud and Corruption?"                       |  |  |  |  |
| 1   | Does the audit committee ensure that the "Actions to Counter Fraud and Corruption" are being implemented?   |  |  |  |  |
| 2   | Is the audit committee made aware of the role of risk management in the preparation of the internal audit plan?   |  |  |  |  |
| 2   | Does the audit committee review the authority's strategic risk register at least annually?  |  |  |  |  |
| 2   | Does the audit committee monitor how the authority assesses its risk?   |  |  |  |  |
| 2   | Do the audit committee's terms of reference include oversight of the risk management process?   |  |  |  |  |
| <b>FINANCIAL REPORTING AND REGULATORY MATTERS</b> |   |  |  |  |  |
| 1   | Is the audit committee's role in the consideration and/or approval of the annual accounts clearly defined?  |  |  |  |  |
| 1   | Does the audit committee consider specifically: <ul style="list-style-type: none"> <li>the suitability of accounting policies and treatments</li> <li>major judgements</li> </ul> |  |  |  |  |

|                       |  |  |  |  |  |
|-----------------------|--|--|--|--|--|
|                       | <p>made</p> <ul style="list-style-type: none"> <li>• large write-offs</li> <li>• changes in accounting treatment</li> <li>• the reasonableness of accounting estimates</li> </ul> <p>the narrative aspects of reporting?</p> |  |  |  |  |
| 1                     | Is an audit committee meeting scheduled to receive the external auditor's report to those charged with governance including a discussion of proposed adjustments to the accounts and other issues arising from the audit?    |  |  |  |  |
| 1                     | Does the audit committee review management's letter of representation?   |  |  |  |  |
| 2                     | Does the audit committee annually review the accounting policies of the authority?   |  |  |  |  |
| 2                     | Does the audit committee gain an understanding of management's procedures for preparing the authority's annual accounts?   |  |  |  |  |
| 2                     | Does the audit committee have a mechanism to keep it aware of topical legal and regulatory issues, for example by receiving circulars and through training?  |  |  |  |  |
| <b>INTERNAL AUDIT</b> |  |  |  |  |  |
| 1                     | Does the audit committee approve, annually and in detail, the internal audit strategic and annual plans including consideration of whether the scope of internal audit work  |  |  |  |  |

|   |   |  |  |  |  |
|---|---|--|--|--|--|
|   | addresses the authority's significant risks?  |  |  |  |  |
| 1 | Does internal audit have an appropriate reporting line to the audit committee?  |  |  |  |  |
| 1 | Does the audit committee receive periodic reports from the internal audit service including an annual report from the Head of Internal Audit?                             |  |  |  |  |
| 1 | Are follow-up audits by internal audit monitored by the audit committee and does the committee consider the adequacy of implementation of recommendations?                |  |  |  |  |
| 1 | Does the audit committee hold periodic private discussions with the Head of Internal Audit?   |  |  |  |  |
| 1 | Is there appropriate cooperation between the internal and external auditors?  |  |  |  |  |
| 1 | Does the audit committee review the adequacy of internal audit staffing and other resources?  |  |  |  |  |
| 1 | Has the audit committee evaluated whether its internal audit service complies with CIPFA's Code of Practice for Internal audit in Local Government in the United Kingdom? |  |  |  |  |
| 2 | Are internal audit performance measures monitored by the audit committee?   |  |  |  |  |
| 2 | Has the audit committee considered the information it wishes to receive from internal audit?  |  |  |  |  |

| EXTERNAL AUDIT    |  |  |  |  |  |
|-------------------|--|--|--|--|--|
| 1                 | Do the external auditors present and discuss their audit plans and strategy with the audit committee (recognizing the statutory duties of external audit)?               |  |  |  |  |
| 1                 | Does the audit committee hold periodic private discussions with the external auditor?  |  |  |  |  |
| 1                 | Does the audit committee review the external auditor's annual report to those charged with governance?   |  |  |  |  |
| 1                 | Does the audit committee ensure that officers are monitoring action taken to implement external audit recommendations?   |  |  |  |  |
| 1                 | Are reports on the work of external audit and other inspection agencies presented to the committee, including the Audit Commission's annual audit and inspection letter? |  |  |  |  |
| 1                 | Does the audit committee assess the performance of external audit?   |  |  |  |  |
| 1                 | Does the audit committee consider and approve the external audit fee?  |  |  |  |  |
| ADMINISTRATION    |  |  |  |  |  |
| Agenda management |  |  |  |  |  |
| 1                 | Does the audit committee have a designated secretary from Committee/Member Services?   |  |  |  |  |

|                        |   |  |  |  |  |
|------------------------|---|--|--|--|--|
| 1                      | Are agenda papers circulated in advance of meetings to allow adequate preparation by audit committee members?                           |  |  |  |  |
| 2                      | Are outline agendas planned one year ahead to cover issues on a cyclical basis?   |  |  |  |  |
| 2                      | Are inputs for Any Other Business formally requested in advance from committee members, relevant officers, internal and external audit? |  |  |  |  |
| <b>Papers</b>          |   |  |  |  |  |
| 1                      | Do reports to the audit committee communicate relevant information at the right frequency, time, and in a format that is effective?     |  |  |  |  |
| 2                      | Does the audit committee issue guidelines and/or a proforma concerning the format and content of the papers to be presented?            |  |  |  |  |
| <b>Actions arising</b> |   |  |  |  |  |
| 1                      | Are minutes prepared and circulated promptly to the appropriate people?   |  |  |  |  |
| 1                      | Is a report on matters arising made and minuted at the audit committee's next meeting?  |  |  |  |  |
| 1                      | Do action points indicate who is to perform what and by when?   |  |  |  |  |

# Section 3 – Establishment, operation and duties

## Introduction

A local authority has a duty to ensure that it is fulfilling its responsibility for adequate and effective risk management, control and governance and for the economy, efficiency and effectiveness of its activities. The audit committee has a key role in overseeing and assessing the risk management, control and corporate governance arrangements and advising the governing body on the adequacy and effectiveness of these arrangements.

These responsibilities require an independent and challenging approach. The audit committee should be properly constituted and be given sufficient authority and resources by the authority. It should have the right to obtain all the information it considers necessary and the right to consult directly with senior managers. Best practice from both the public and private sectors indicates that the audit committee should report directly to the governing body of the organization. In the case of a local authority, the full council. This will assist in giving it independence from the executive and scrutiny functions and in addition provides status, and clarity to the role.

Through these mechanisms, audit committee members are able to use their skills and experiences to influence an authority's risk management and internal control processes, independently of senior management.

For the chair to successfully deliver the expectations placed on the audit committee, it needs to be recognised as an important body in the authority's structure and to report directly to the full council. It is also essential that it has the full support of the chief executive and the leader of the council. In some parts of the public sector this support is shown by the chief executive attending audit committee meetings and, even if this is not always possible, attendance at key meetings, for example when the statement on Internal Control is being considered, should be encouraged.

## Roles and remit

### The duties of an audit committee

An audit committee's main responsibilities will include advising the authority on all matters relating to its corporate governance and in doing so 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 the 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 findings of the review of effectiveness of the systems 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.

## Terms of reference

The committee will require formal terms of reference, covering its core functions, which should be formally adopted by the full council and reviewed on an annual basis, taking into account relevant governance developments and how it integrates with other committees within the authority.

An audit committee's terms of reference should cover the following areas:

- constitution
- membership
- attendance at meetings
- frequency of meetings
- authority
- duties
- reporting procedures.

Specimen terms of reference are given in Appendix 2.

## The Annual Report

The audit committee, in line with best practice in other sectors, should prepare an annual report to the full council that sets out the committee's work and performance during the year, including how it has met its terms of reference. The report should include, as a minimum:

- Confirmation that the system of risk management in the authority is adequate in identifying risks and allowing the authority to understand the appropriate management of those risks; and
- Confirmation that there are no areas of significant duplication or omission in the systems of governance in the authority that have come to the committee's attention and not been adequately resolved

In addition, the report should highlight to the full council the main areas that the committee has reviewed and any particular concerns or issues that it has addressed. These could include:

- The financial position and financial reporting systems of the authority
- Any major break-down in internal control that has led to a significant loss in one form or another
- Any major weakness in the governance systems that has exposed, or continues to expose, the authority to an unacceptable risk

From time to time the audit committee should undertake a formal review of its effectiveness and should include the result in the annual report.

## Membership, induction and training

### Chair

CIPFA's guidance in *Audit Committees – Practical Guidance for local authorities* and *Audit committee principles in local authorities in Scotland – A guidance note* makes it clear that a key feature of a successful committee will be a strong chair displaying a depth of skills and interest. Accordingly as part of his/her duties the chair of the audit committee should be prepared to encourage open discussion at meetings and should not seek to restrict debate. Discussion and challenge should be apolitical and the chosen chair should have the personal qualities necessary to achieve this.

CIPFA makes it clear that the committee chair should, expressly, not be a member of the executive. A non-executive and independent chair is essential in order to promote the objectivity of the audit committee, its authority and to enhance its standing in the eyes of the public.

In reality, finding a strong individual with the requisite skills who does not already hold a major role within the authority may be difficult.

### Membership

CIPFA's guidance on audit committees makes the point that to be effective the audit committee needs to be independent from executive and scrutiny and, while links with the scrutiny function will be beneficial, the ultimate authority of the audit committee could be compromised by too much cross membership. The audit committee therefore must have the ability to challenge the authority's executive on relevant issues and to be able to report to it on significant issues without interference. The CIPFA audit committee guidance therefore makes it clear that cross membership should not be the norm and if it is seen as necessary should be restricted to one member from each of executive and scrutiny.

This may create specific challenges for authorities in identifying members with the appropriate degree of independence and skills. While co-option is discussed below, there should still be some independent representation on the audit committee from the elected members. Although still relatively new in local authorities, audit committees will, as in the private and the rest of the public sectors, quickly become seen as a key part of the organization's governance with a significant influence. Again if the experience of those other sectors is mirrored, the audit committee will become seen as an activity in which enthusiastic members will wish to participate. It could also provide an excellent training ground for new members given its all-encompassing remit.

In appointing the audit committee, the council must address the question of how potential conflicts of interest can be resolved. Corporate governance principles advocate a full disclosure as well as an explanation by parties of how they are managing any conflicts of interest. Far from being simply aimed at providing information, disclosure should be aimed at increased transparency. Care should be taken to ensure that audit committee members have declared their business interests.

## Co-option

It is perfectly legitimate, if it so wishes, for a local authority to appoint someone other than an elected member and from outside the authority to either serve on or chair the audit committee.

As for any other role, it is important that the choice of the co-opted member and/or chair is made carefully and after due consideration of the requirements of the role, the skill sets and the qualifications and experience needed. In Appendices 3 and 4 there are sample job descriptions and person specifications for such roles.

## Training & awareness

Audit committee training will need to be undertaken in a number of both individual and overlapping subject areas. Some of this can be achieved using in-house resources and skills, whilst other aspects may be better presented by external facilitators or professional advisors, including for example the authority's external auditors in relation to their specific areas of expertise. Audit committee members' skills and experiences should be assessed and training given for identified gaps. It is recognised that the following training regime will have to compete with other priorities of the individual members and will not be inexpensive to the authority. However, the regime outlined is the ultimate which authorities should strive to achieve but, in practice, a more flexible approach may need to be followed by, for example, ensuring the audit committee chair is fully trained and aware of the following issues, and other audit committee members receive such training and awareness as and when time and budgets permit.

### Induction

At the very least, all members of an audit committee should receive a comprehensive induction from the authority covering the committee's remit, the environment in which it operates and the rights and duties of its members. They should be introduced to the relevant codes of practice, the authority's most recent annual report and accounts, and be given a briefing on the role of internal and external audit.

Such a programme will allow the members to meet and understand the roles of the Head of Finance, Section 151 Officer, Monitoring Officer, Head of Internal Audit, Risk Management Officer and, if available, a representative of the external auditors. Ideally such inductions should be at least introduced by the chief executive to reinforce his or her support for the committee.

### Audit Activity

The committee will need to be briefed on the roles of the auditors both internal and external. This should include providing an understanding of the difference between

the two functions, their responsibilities and duties, terms of reference and what the committee can expect from them.

## Regulatory Framework

Obviously the regulatory framework within which the authority works is an essential area of understanding for all members of the committee and close attention will need to be given to not only the initial training but also briefings to ensure that the members are kept up to date with any changes. This heading should also include sessions on the Comprehensive Performance Assessment and other inspection programmes that the authority faces.

## Accounts

Some of the technically most complex subjects the committee will have to address are those relating to the annual accounts. It is therefore essential that the committee members are all able to understand both the structure and content of the accounts to a level from which they will be able to effectively question their content and understand the responses to those questions. This does not mean that the members will have to be qualified accountants but they will need to understand key concepts such as provisions, reserves, bad debts, cash flow and the structure of the balance sheet.

Similarly the members will need to understand the structure of local government funding and grants and sources of other income especially from third parties e.g. European funding.

## Corporate Governance and the Statement on Internal Control

The audit committee will naturally become one of the keystones of the corporate governance of any authority that establishes it properly. Accordingly the members of the committee must be fully aware of the authority's structure of corporate governance, their place within that structure and any changes to it, either internally or externally generated.

As part of their duties the committee will have a significant role to play in approving the annual Statement of Internal Control and they should be briefed and updated on the authority's processes behind its preparation and how assurances, as to how effective the internal control regime is, can be obtained.

## Value for Money and Efficiency Issues

Again, the committee is likely to be charged with considering the extent and success of the authority's programme and processes for achieving Value for Money, and the members should therefore be made aware of the authority's VFM strategy and how it ensures its delivery. Additionally the members should be briefed on the Gershon expectations and how they might affect the authority.

## Risk Management

Part of the audit committee's remit is likely to involve taking an overview of risk management arrangements across the authority including those relating to the risks it faces with, and because of, its partners. The members should therefore be given training in the basic concepts of risk management, including how the risks are

identified, measured, mitigated and how the acceptable level of residual risk (exposure) is decided. The committee will also need to understand the requirements of the Civil Contingencies Act and how the authority manages its own contingency and business recovery plans; the authority's key partners including major suppliers on whom the authority is reliant, any specific risks attached to those relationships and how those risks are managed; and how the role of insurance and other risk financing is used within the risk management process.

## Fraud Management

The Council's Officers are responsible for establishing and implementing arrangements to counter fraud and corruption. The Audit Committee is responsible for overseeing these management arrangements. The Audit Committee is powerful (e.g. it has delegated responsibility to act on behalf of the full Council, and is "those charged with governance".)

The role of the Audit Committee is crucial to support managers in achieving their anti-fraud objectives. Fundamentally, the Audit Committee makes sure that effective actions to counter fraud and corruption take place. It acts to enforce, enable and encourage successful actions to counter fraud.

## Meetings

### Frequency of meetings

It is for the authority to decide the frequency of audit committee meetings. These might be quarterly, half yearly or on some other basis. However, it is important to ensure that the frequency of audit committee meetings is timed to the authority's business needs, governance needs and financial calendar

### Register of attendance

Some form of register of attendance needs to be maintained and appropriate action taken if members are not attending audit committee meetings on a regular basis.

### Finance Officer

The importance of the relationship with a local authority's chief finance officer (CFO) is stressed in CIPFA's guidance. CIPFA believes, and evidence from the wider public sector shows, that the roles are mutually supportive. An effective audit committee is an additional source of assurance to the CFO that systems of internal control are working effectively and that internal audit is operating in accordance with the CIPFA Code of Practice for internal audit in local government. In turn, the audit committee relies on the CFO to provide advice and guidance. Some CFOs may be concerned that the opportunity for external and internal auditors to meet privately with the audit committee might undermine their position. The guidance says that there should be the opportunity for such meetings to support auditor independence, just as CFOs should also have confidential access to members in appropriate circumstances.

### Other Officers

In terms of corporate governance a number of other senior officers will contribute as appropriate, including the chief executive and the monitoring officer.

# Section 4 – Internal control

## Internal control

The audit committee has responsibility for advising the authority on whether effective internal control systems have been established and are being maintained in accordance with laws and regulations governing local authorities. Such systems should also provide reasonable assurance that assets are safeguarded, that waste or inefficiency is avoided and that reliable financial information is produced. They should also give reasonable assurance of effective and efficient operations. Day-to-day responsibility for reviewing the adequacy of the system of internal control is delegated to an authority's management.

An authority's management is responsible for the whole system of internal control. Management must be able to assure the audit committee, and subsequently the authority, that the systems of internal control are operating effectively.

The box below summarises issues that audit committee members should consider when reviewing their authority's internal control systems.

### **QUESTIONS FOR AUDIT COMMITTEE MEMBERS – REVIEW OF INTERNAL CONTROL**

- Have any major changes been made to the internal control systems in the past year? Were they made in order to improve existing controls or were they new controls established due to changes in operating systems?
- Are appropriate procedures in place to ensure adequate user involvement in the development of new systems and major systems changes, including the design of appropriate controls?
- Are audit committee members fully aware of new initiatives or major system changes or developments?
- What were the most significant internal control weaknesses found by the internal and external auditors during the period?
- What is the auditor's view of the balance between the risk of error in the present internal control systems and the cost of additional controls?
- Have any cases of fraud or illegal, questionable or unethical activities been found which might affect the accounts or which cause concern?

## Statement on Internal Control

Regulation 4 of the Accounts and Audit Regulations (2003) requires audited bodies to conduct a review at least once a year of the effectiveness of its system of internal control and publish a statement on internal control (SIC) each year with the authority's financial statements. The Accounts and Audit Regulations were amended in 2006 and now require that the findings of the review of the effectiveness of internal control must be considered by a committee or members of the organisation meeting as a whole, following which they shall approve the SIC. The new CIPFA/SOLACE good governance framework due to be published in the Spring of 2007 is likely to recommend that that authority should issue a good governance statement and this would incorporate the SIC.

The purpose of the SIC process is to provide a continuous review of the effectiveness of an authority's internal control and risk management systems, so as to give assurance on their effectiveness and/or to produce a management action plan to address identified weaknesses in either process. At its most effective, the process of preparing the SIC will add value to the corporate governance and internal control framework of an authority.

CIPFA's proper practice requires the most senior officer (Chief Executive or equivalent) and the most senior member (Leader or equivalent) to sign the SIC – clearly they must be satisfied that the document is supported by reliable evidence and accurately reflects the internal control environment. This emphasises that the document is about all corporate controls and is not confined to financial issues.

The precise format and detail of the SIC will vary between authorities according to what other statements on governance arrangements are produced. In Scotland and Northern Ireland only, the SIC may include the "Statement on the System of Internal Financial Control" required by the Code of Practice on Local Authority Accounting and be used in the authority's accounts in place of that Statement. The SIC may also be assimilated into a wider governance statement – likely to be cited as best practice in the CIPFA/SOLACE *Good governance in local government: A framework*. In each case, the higher-level document must include all aspects of the statement it absorbs.

It is suggested that the SIC should contain a brief description of the audit committee's establishment and activities.

As already stated, the audit committee must 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.

To enable it to achieve this an authority should have in place a formal model (assurance framework) through which it can evidence the existence of its internal control system and the effectiveness of its operation throughout the period of account. CIPFA's publication *"Statement on internal control - Meeting the requirements of the Accounts and Audit Regulations 2003 - A Rough Guide for Practitioners"* contains an example of an assurance framework.

The audit committee should satisfy itself that the statement that is being recommended has been prepared in accordance with the authority's assurance framework and that this review has been undertaken in a diligent manner. This assurance can be assisted by an independent opinion from the Head of Internal Audit on the review process. In recommending the statement for approval by the full Council, the audit committee should include confirmation that the draft Statement on Internal Control is consistent with the view of the Committee on the authority's system of internal control, subject to any reasonable limitations that the Committee may draw attention to.

See the box below for questions audit committee members could use to challenge officers on the SIC.

**Questions for audit committee members – Statement on Internal Control**

- Does the authority have an approved formalised assurance framework and processes to enable it to arrive at its statement?
- Is the statement prepared as a corporate document rather than the views of an individual officer?
- What does the authority's statement of internal control, included within the financial statements, say? Is it a full compliance statement, or are there any areas where the authority does not comply with relevant guidance? On what basis can the governing body give the statement (for example, has sufficient internal audit work been carried out? Are its conclusions consistent with the statement given?)
- Has the corporate risk register been regularly and recently updated and reviewed?
- Do any of the residual risks remain at a level that causes concern?
- Is there a system whereby senior officers acknowledge that their risk registers are up to date and that their systems of internal control have operated throughout the period under review?
- Have sufficient assurances been received from senior officers? Are there any gaps in assurances?
- Have there been any material breaches of internal control, fraud, losses or other incident?
- Have there been any concerns raised by other inspection agencies?
- Have there been any issues arising through governance failures?
- Are there any concerns raised in the Head of Internal Audit's annual report?
- Has the Head of Internal Audit given an independent opinion on the overall adequacy and effectiveness of the internal control environment?
- Are there any concerns raised by the External Auditors?
- Are there any outstanding Audit Committee issues?
- Is the Chief Executive prepared to sign the statement?

## Risk Management

The authority has ultimate responsibility for risk management. It is likely that in most authorities the audit committee will take on the role of gaining assurance, on their behalf, that risk management is being properly undertaken.

The authority may have already formed a group of officers to advise on risk management. While the officers will carry out the detailed work, overall responsibility for risk management remains with the authority. It is also helpful to identify a risk champion from the authority's senior management, who will be responsible for steering the authority through the risk management process.

Risk management should become an integral part of any decision made by the authority and its managers. Good risk management has the potential to change the whole ethos of an organisation.

The audit committee should review the strategic risk register at least annually.

**QUESTIONS FOR AUDIT COMMITTEE MEMBERS – RISK IDENTIFICATION & MANAGEMENT**

- What are the areas of high risk? Are they verified in the authority's risk management plan?
- Have our strategic objectives changed?
- Are our key risks still relevant to the current strategic objectives?
- Is the authority facing any new risks?
- Have any risks been mitigated to the extent that they are no longer key risks?
- Have changes in the external environment (for example, political) meant that the authority is facing new risks or that existing risks are no longer relevant?
- Are there changed internal factors that might affect risks? For example, has the authority been inspected during the year or is it about to be inspected?
- Is the ranking of risks in the risk register still appropriate?

**QUESTIONS FOR AUDIT COMMITTEE MEMBERS – WHETHER RISK MANAGEMENT IS EMBEDDED IN THE ORGANISATION**

- Are all staff aware of the risk management policy?
- Has it been promoted in newsletters?
- Has it been promoted on the intranet?
- Have training sessions been run on risk management?
- Have they included middle managers and other staff?
- Have all staff been consulted on the risks the authority faces?
- Do all departments have their own risk management plan? Is it linked to their operating plan?
- Do all staff understand their role in risk management?
- Is risk management part of all planning and decision making processes?
- Are risks considered before the authority enters into any new activity?
- Are the authority's risk management processes benchmarked against sector best practice?
- Is a common definition of risk used across the authority?
- Do staff have clearly defined responsibilities and accountabilities for risk management?
- Have key performance indicators (KPIs) been set for key areas of activity?
- Do reporting mechanisms allow for reporting against these KPIs?
- Is innovation encouraged?
- Is there a no blame culture?
- Is support given when things go wrong?

## Risk Management Officer

As with internal audit, the risk management function will give assurance to the committee that best practice is being followed by the authority in its understanding and management of its risks. It is important that the committee is kept up-to-date with how new risks are being identified and how existing risks are changing.

The person responsible for the risk management process (who may or may not have the job title of Risk Manager) should attend every audit committee meeting at which risk management is being discussed. Matters that the responsible officer for risk management should cover in the risk report include:

- The risk management strategy and any changes to it

- The risk register and any significant changes within it to higher level, corporate risks
- Any new or emerging risks at a corporate level
- Any significant incidents or near misses that reflect on the completeness of risk management
- Progress on completing action plans for key risks.
- Progress on embedding risk management into the other business activities of the authority.

In addition the report may include a description of the key risks for major developments or projects (new offices, major purchases, new I.T. systems etc.)

## Counter Fraud & Corruption

The action needed to be effective in countering fraud and corruption is described in the publication, *"Managing the Risk of Fraud – Actions to Counter Fraud and Corruption"*.

This is available from the following web link

<http://www.cipfanetworks.net/fileupload/upload/Counter%20Fraud%20publication1102006321831.pdf>

Countering fraud and corruption is everyone's job. It requires organisational and individual commitment to a culture of zero-tolerance, Nolan principles and ensuring that money is spent on what it was intended for.

*"Taking actions to proactively stop fraud occurring in the first place is a far better remedy than merely managing the risk."*  
Steve Freer, Chief Executive, The CIPFA Group.

It is management's responsibility to establish and implement effective arrangements.

It is the job of the audit committee to oversee, monitor, support, enable, encourage, evaluate and when necessary enforce, effective actions to counter fraud.

A good committee agenda includes regular reports, updates and discussion of fraud issues and cases.

It may be necessary to hold separate special meetings and/or exclude the press and public from main meetings.

Committee members are better able to accomplish their role when they have been provided with training to understand their counter fraud responsibilities, in particular:

- Internal control
- Fraud risk factors: the fraud triangle – incentives, rationalisation, opportunity
- Good governance
- Financial management and reporting
- International Standard on Auditing 240
- Links to achieving organisational objectives
- Final accounts.

# Section 5 – Financial reporting and regulatory matters

## Compliance with the law and regulations governing local authorities

Changes in legislation occur regularly within the sector and it is imperative that the authority establishes a mechanism to ensure that its audit committee members are aware of relevant topical legal issues.

To keep the audit committee up to date, it is worth considering including the following on the audit committee's agenda:

- an update of relevant circulars and correspondence from government departments etc
- relevant minutes and papers from council meetings (these are especially helpful for co-opted members)
- relevant reports from the Audit Commission, National Audit Office and other relevant regulators

## Financial Statements

The Audit Committee should review the Financial Statements before submission to the full Council, focusing particularly on:

- the outcome of reviews of the effectiveness of the internal control arrangements including internal audit
- the wording in the Statement on Internal Control and other disclosures relevant to the Terms of Reference of the Committee
- changes in, and compliance with, accounting policies and practices
- unadjusted mis-statements in the financial statements
- major judgemental areas
- significant adjustments resulting from the audit
- any relevant issues raised in the external auditor's report to those charged with governance

The Committee should also ensure that the systems for financial reporting to the full Council, including those of budgetary control, are subject to review as to completeness and accuracy of the information provided to the full Council and its committees.

The timetable for preparing the financial statements is normally tight. If the audit committee is to play an effective role in the process, it needs to hold a meeting before the financial statements are formally approved. The role of the audit

committee in the approval, and the purpose of the meeting should be made absolutely clear. If there are any delays in preparing and auditing the financial statements the audit committee should find out why, as they may be due to underlying problems within the finance department or audit process.

However, the audit committee needs to ensure it does not become involved in any details that should be dealt with more properly by the director of finance, designated office holder or other relevant committee.

**QUESTIONS FOR AUDIT COMMITTEE MEMBERS – REVIEW OF THE FINANCIAL STATEMENTS**

- Which significant items in the accounts are based on accounting estimates? Which accounting policies followed by the authority required an element of judgment in their application? How does the approach taken this year to these items and policies compare with the previous year?
- Have there been any developments in accounting standards or generally accepted accounting practice of relevance to the authority since the audit committee last reviewed the authority's accounting policies and practices?
- Do the financial statements satisfy all statutory and other regulatory disclosure requirements to which the authority is subject?

## Section 6 – Internal Audit

Internal audit is one of the principal ways in which the authority (members and managers) gains assurance on the effectiveness of the control environment, which comprises risk management, control and governance.

The head of internal audit (HIA) should generally be invited to attend every audit committee meeting. The CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom sets out matters which the HIA should bring to the attention of the audit committee and these are as follows:

- The terms of reference for internal audit;
- The internal audit strategy;
- The resourcing of internal audit;
- The periodic plans of internal audit, progress against and material changes made to these plans, and any implications arising from their findings and opinion;
- The adequacy of management response to internal audit advice and recommendations;
- The HIA's annual report;
- The arrangements for and the results of quality assurance and performance management processes; and
- The arrangements made for co-operation between internal audit, external audit and other review bodies.

Internal audit should have a right of access to the chair of the audit committee at all times. This is essential to maintain the integrity and independence of the internal audit function.

The committee will need to have a clear role in relation to the authority's internal audit function. This should involve:

- formally approving (but not directing) the overall strategy to ensure that it meets the authority's overall strategic direction
- approving the annual programme of audits (paying particular attention to whether there is sufficient and appropriate coverage), and
- monitoring progress against the plan and assessing whether adequate skills and resources are available to provide an effective audit function.

## Internal Audit Activities

### Strategy and Planning

Internal auditors will adopt a risk-based systematic approach to planning their work. Accordingly, internal audit should consider the whole of the authority's risk management, control and governance arrangements, including all its operations, resources, staff, services and relationships with partner bodies. It should cover all activities associated with the authority, including those controls that protect the authority in its dealings with any partnership.

Considering the whole system of risk management, control and governance does not imply that the whole system should be audited. This is the essence of the risk-

based approach. If internal auditors are confident about risk management, and if the risk management arrangements effectively mitigate a risk, then that risk should not merit additional audit attention. If, however, internal auditors have a good reason for believing that a risk is insufficiently prioritised or mitigated by management, then management of that risk may well be included in the audit plan.

## Reporting Arrangements

There should be a clear reporting line from the head of internal audit to the authority's audit committee. The authority should determine day-to-day internal reporting arrangements, usually after consultation with the audit committee. A senior officer should be designated as professionally responsible for the internal audit service. Often this responsibility falls to the Section 151 officer but internal audit should have the right of direct access to the chief executive, or equivalent, and the chair of the audit committee.

Auditees and senior management should be asked for a view on internal audit reports before they are presented to the audit committee. Depending on the content of the report, the committee may wish the senior manager whose area has been reported upon to attend the meeting for that item.

The audit committee must ensure that actions already agreed with auditees and senior management are implemented in accordance with a pre-determined timescale. The committee should satisfy itself that appropriate action has been taken within this timescale. The role of internal audit in this area is to review the effectiveness of such action.

As well as receiving reports from internal audit arising from the ongoing audit plan, the committee should also expect to receive an annual report from the HIA giving an opinion on the adequacy and effectiveness of the authority's internal control environment.

The following box summarises the key issues the audit committee should take into account when determining its reporting procedures in relation to internal audit.

**ADVICE FOR AUDIT COMMITTEE MEMBERS – INTERNAL AUDIT REPORTING ARRANGEMENTS**

**Type of report**

The audit committee needs to decide what type of information it wants to see from internal audit. For example, does it want to see every report, an executive summary or just a periodic summary? Practice will vary between authorities, but the key is to ensure that the committee receives sufficient information to fulfill its role. Audit committee members should be aware that their role includes ensuring that recommendations agreed between management and the authority's auditors are implemented.

**Progress reports**

Audit committees should receive regular progress reports from the internal audit service summarising internal audit activity. They should describe the major audit issues and compare activity to date against the audit plan.

**Follow-up**

The audit committee should ensure that important recommendations have been actioned by management. Authorities should consider establishing a register of audit recommendations and progress made in implementing those recommendations. Situations where the recommendations are not accepted by management or where management has failed to implement agreed recommendations should be reported to the committee.

**Prioritising findings**

The audit committee may wish the internal audit function to prioritise its findings against defined standards, to indicate the importance of each finding and the urgency of action required. An implementation plan detailing the recommendations made, officer responsible, priority, action taken and action date is an effective way of achieving this objective.

## Private discussions between auditors and the audit committee

In both the private and the rest of the public sector it is considered good practice for audit committees to hold periodic private discussions with the internal audit service, without the authority's senior management being present and this is recommended in the CIPFA's Practical Guidance publication. This enables audit committee members to listen to the views of the internal auditors independently of senior management, with whom the internal auditors must retain a working relationship.

The following table details issues for audit committee members to consider in private discussions with their internal auditors.

**QUESTIONS FOR AUDIT COMMITTEE MEMBERS – PRIVATE DISCUSSIONS**

- Do the internal auditors receive the necessary degree of co-operation?
- Do the authority's statements on corporate governance reflect reality?
- Has there been any attempt to restrict the scope of the internal auditors' work in any way?
- Was the original audit plan modified due to deficiencies in internal control or accounting records?
- Did the auditors have any significant disagreements with management? How were these resolved?
- Do the internal auditors have any concerns about management's control awareness or operating style?
- What is the internal auditors' view of their relationship with management?
- Do the internal auditors believe they are under any undue pressure?
- Are there any other matters that, in the opinion of the internal auditors, should be considered by the audit committee?

## Provision of internal audit services

It is recognised that some authorities will have their internal audit services provided by a third party and obtain their internal audit service on a contract basis either individually or as a group of authorities. Such contracts may be with audit firms or with a consortium established on a regional basis to provide an internal audit service to a range of geographically close authorities. The same auditor is not permitted to provide both external and internal audit services.

Where authorities are considering buying in their internal audit service from a firm, audit committee members may find the following additional questions useful.

**QUESTIONS FOR AUDIT COMMITTEE MEMBERS – SELECTION OF INTERNAL AUDIT SUPPLIED BY A FIRM**

- Is the firm active in the sector?
- Can it provide examples of past successes in the sector?
- What is included in the quotation for services – preparation of a risk assessment and plan may be extra.
- How will future fee increases be calculated?
- Can other authorities supply references?
- What will be the mix of qualified to unqualified staff?
- What assurance can the firm provide concerning continuity of staffing?

## Ensuring standards are met

The audit committee should evaluate the extent to which the internal audit service complies with the CIPFA Code of Practice for Internal Audit in Local Government. It should do this by:

- considering the work performed by external audit in its assessment of the internal audit service
- seeking the opinion of senior management
- considering the outcome of a review of the effectiveness of internal audit, which should be undertaken annually in support of the Statement on Internal Control (in accordance with the Accounts and Audit Regulations 2003 (as amended)).

The audit committee should also exercise its own judgment. This may include considering whether internal audit has:

- an effective quality assurance programme
- sufficient resources
- appropriately skilled, experienced and qualified staff
- appropriate independence.

The following box raises a number of issues of which audit committee members should be aware when reviewing their internal audit function.

### **QUESTIONS FOR AUDIT COMMITTEE MEMBERS – REVIEW OF INTERNAL AUDIT PERFORMANCE**

- Are there formal terms of reference that define internal audit's objectives, responsibilities, authority and reporting lines?
- Has the scope of internal audit work been determined using a risk-based systematic approach and in accordance with CIPFA's Code of practice for Internal Audit in Local Government in the United Kingdom?
- What are the relative emphases given to internal control reviews, VFM (economy/efficiency/effectiveness) audits and special projects?
- Are any restrictions placed on the scope of internal audit work and, if so, who establishes them?
- If internal audit is asked to undertake a special project, how is its independence safeguarded?
- Does internal audit report directly to an appropriate level of management that will ensure audit recommendations are given due weight and attention? Are the internal auditors free from any other responsibilities that could impair their objectivity?
- Do internal audit staff have sufficient technical knowledge and experience to ensure that duties are performed to an appropriate standard? Is there sufficient information systems expertise to deal with the level of technology used by the authority?
- Is the work of the internal auditors properly planned, completed, supervised and reviewed? Are there any quality assurance procedures?
- Are internal audit reports issued on a timely basis?
- Are reports followed up on a timely basis? Is there evidence that internal audit has a systematic approach to following up recommendations, and reporting on those where little or no action has been taken by management?

## Performance indicators

In order to monitor the effectiveness of the internal audit service, the audit committee, in conjunction with the internal audit service and the authority's management, should establish and maintain appropriate performance indicators to measure the work of the internal audit service. Some possible performance indicators for internal audit are shown in Appendix 5.

## Section 7 – External Audit

### The role of external audit in the public sector

External audit is an essential part of the process of accountability for public money. It makes an important contribution to the stewardship of public resources and the corporate governance of public services. External auditors in the public sector give an independent opinion on public bodies' financial statements and review, and report on, aspects of the arrangements put in place by public bodies to ensure the proper conduct of their financial affairs and to manage their performance and use of resources. Because of the special accountabilities attached to public money and the conduct of public business, external audit in local government is characterised by three distinct features:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements, but also aspects of corporate governance and arrangements to secure the economic, efficient and effective use of resources; and
- auditors report all aspects of their work to the authority however, in certain circumstances, the authority may be required to make these reports public.

These features are consistent with the 'principles of public audit' as defined by the Public Audit Forum, which comprises all the national audit agencies in the UK.

### Role of the audit committee

The role of the audit committee in relation to the work of the external auditor will typically involve:

- advising the authority on any questions arising from a proposed change of external auditor by the Audit Commission
- discussing the nature and scope of the audit with the auditor, before the audit begins
- discussing problems and reservations arising from the interim and final audits with the auditor, reviewing the auditor's report to those charged with governance and the Audit Commission's annual audit and inspection letter including management responses, and any other matters the auditor may wish to discuss (without management being present, where necessary).

Various elements of this role are considered below.

### Reviewing the external audit strategy

CIPFA's *Audit Committees – Practical Guidance for Local Authorities* states that the programme of audits will follow a nationally agreed path to some extent but, where local flavour from the auditor's risk assessment can be added, the committee should be given the chance to comment on the inclusion of any audit work and

should receive reports following the completion of such work in order to monitor action to be taken.

In the wider public sector and in the private sector it is considered good practice for external audit to present its audit strategy/plan to the audit committee for discussion and approval before the start of each audit year.

The Audit Commission's Code of Audit Practice requires auditors to provide an opinion on a local authority's annual statement of accounts and a conclusion on whether the authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The external auditor's report to those charged with governance, which supports the audit opinion and conclusion, should be presented to the audit committee so that progress against recommendations and other items can be monitored.

External auditors should generally be invited to attend all meetings of the audit committee.

The table below sets out questions that audit committee members should consider when reviewing the external audit plan.

**QUESTIONS FOR AUDIT COMMITTEE MEMBERS – REVIEW OF THE EXTERNAL AUDIT PLAN**

- Which aspects of the authority's operations do the auditors consider to be of high risk? Why? And how will they be covering them?
- What is the overall audit approach? How much does it rely on, and test compliance with, internal controls and how much does it use direct tests of details of transactions?
- How will the auditors satisfy themselves about the accuracy and completeness of computer processed data?
- How are the external auditors co-ordinating their work with the authority's internal auditors?
- To what extent will the external auditors consider the process of risk management in place at the authority?
- What regulatory changes will affect the audit of the financial statements in the current year?
- Are there any circumstances that will generate extra fees?
- Does the audit team have the requisite experience and expertise? Have there been any significant changes in the team since last year?

## Co-operation between internal and external audit

The audit committee should ensure that a professional relationship is maintained between internal and external audit so that lines of reporting can be used effectively and duplication of effort is avoided.

## Appointing the external auditor

The appointment of the external auditor is the responsibility of the Audit Commission who also determines the terms of appointment and prepares the Code of Audit Practice.

The Audit Commission operates a rotation of auditor policy to maintain auditor independence. Under this policy, the engagement lead as a minimum will be rotated off of the audit after a maximum of five years. The appointed auditor and the authority are consulted over any changes but the final decision lies with the Audit Commission.

## Fees

Details of the planned external audit fees for the year are included in the planning document which is presented to the audit committee. The final audit fee will be reported in the report to those charged with governance.

## Use of resources assessment

English local authorities are currently subject to Comprehensive Performance Assessment (CPA) by the Audit Commission. As part of CPA, external auditors undertake an annual use of resources assessment. This involves scoring the authority's performance against a set of pre-determined criteria (key lines of enquiry) set by the Audit Commission. The areas assessed are financial reporting, financial management, financial standing, internal control and value for money. Further details of the current key lines of enquiry for use of resources can be found on the Audit Commission's website.

## Reporting arrangements

As stated in CIPFA's *Audit Committees – Practical Guidance for Local Authorities*, the committee should contribute to the authority's response to any relevant external audit reports and the Audit Commission's annual audit and inspection letter.

As for internal audit, it is considered good practice for the committee to meet privately and separately with the external auditor at least once a year, independent of the presence of those officers with whom the auditor must retain a working relationship.

# Section 8 – Administration

## Agenda management

### Committee/Member Services

As with any committee, really effective work is best achieved if there is strong administrative support that allows the members of the Committee to concentrate on their role in preparing for, and contributing to, the meeting. For an audit committee to make effective use of its limited time it needs to have a secretary who, ideally, should be a senior officer of the organisation so that the audit committee's influence continues between meetings. The secretary should not be the chief finance officer or head of internal audit.

The timing of meetings needs to be discussed with all the parties involved, including internal audit, external audit and the chief finance officer to ensure that key tasks, such as the approval of accounts, are accommodated. The planning of meetings is likely to be the responsibility of the secretary to the audit committee.

### Papers

Given the likely complexity of many of the issues being discussed it is essential that committee members are provided with the agenda and papers in sufficient time for them to be able to give full consideration to them and, where necessary, obtain further assistance on the detail before the meeting. In fact, the Local Government Act requires that agendas and reports are sent out 5 clear days prior to any meeting.

Some organisations, in both the public and private sector, find it useful to have a pre-meeting briefing with the chair of the committee to clarify any outstanding issues. In fact, it is normal practice in local government to have a chairman's briefing for every committee meeting.

For co-opted members it will be important that they are kept up to date with what is happening in other decision-making fora that would be naturally available to the elected members on the committee and some form of briefing arrangements should be put into place along with the inclusion of the co-opted members on circulation lists for committee minutes etc where relevant.

It is considered good practice for outline agendas to be planned one year ahead to cover cyclical issues such as the audit committee's consideration of the SIC.

It is also good practice to formally request inputs for any other business in advance from audit committee members, relevant officers, internal and external auditors.

# Appendix 1

## Other guidance relevant to local authority audit committees

- *Audit Committees – Practical Guidance for local authorities* – CIPFA 2005
- *Audit committee principles in local authorities in Scotland – A guidance note* – CIPFA – 2004
- *The statement on internal control in local government – Meeting the requirements of the Accounts and Audit Regulations 2003* – CIPFA - 2004
- *The Statement on internal control – meeting the requirements of the Accounts and Audit Regulations 2003 – Rough Guide for practitioners* – CIPFA Finance Advisory Network - 2005
- *Code of practice for internal audit in local government* – CIPFA 2003\*
- *Risk management guidance notes - Number Ten—Risk Management Guidance for Elected/Board members* – CIPFA Better Governance Forum - 2006
- *Good governance in local government: A framework* – CIPFA/SOLACE – 2001

\* CIPFA intend to issue a revised Code of Practice imminently. This will, of course, supercede any guidance in the 2003 Code of Practice

## Other useful background material

- *Handbook for audit committee members in further and higher education* – CIPFA – 2005
- *NHS audit committee handbook* – Department of Health/HFMA - 2005
- *The audit committee handbook* – HM Treasury – 2003

## Other sources of guidance

On counter fraud and audit committees:

Greg Marks  
Senior Governance Manager  
(Counter Fraud)  
CIPFA Better Governance Forum  
E-mail: [Greg.Marks@cipfa.org](mailto:Greg.Marks@cipfa.org)  
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On risk management:

Ian Horwood  
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CIPFA Better Governance Forum  
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# Appendix 2

## Audit Committee – Terms of Reference

Source: *Audit Committees – Practical Guidance for Local Authorities*, CIPFA, 2005

### **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 timescale.
- To consider the External Auditor's Annual 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.
- The Council's arrangements for corporate governance and agreeing necessary actions to ensure compliance with best practice.
- 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.

# Appendix 3

## Job Description

### Example 1 – District Council

#### **AUDIT COMMITTEE – INDEPENDENT PERSON**

##### **PERSON SPECIFICATION**

##### **Experience**

You will be a person who has experience working in a medium/large organisation at a senior level or other experience which would give similar benefits.

Financial management experience (accountancy, audit or management of a large budget) would be advantageous.

##### **Skills**

- Able to understand complex issues and the importance of accountability and probity in public life.
- Able to analyse and assess evidence and come to a rational conclusion.
- Able to reconcile the ideal with reality and practicality
- Able to demonstrate objectivity.
- Able to demonstrate integrity and discretion.
- Able to make decisions.
- Must possess effective interpersonal skills.

##### **Knowledge**

Some knowledge of local government would be useful.

Knowledge of corporate governance arrangements in either public or private sectors would be beneficial.

Knowledge of risk management.

##### **Commitment**

This post will take up about four half days per annum for meetings plus preparation time.

##### **Other**

- You must not be a councillor or officer of the council or have been so in the preceding five years prior to appointment.
- You must have no criminal convictions.
- You must not be an undischarged bankrupt.
- You should have no significant business dealings with the council.
- You should have no connection with any political group.

## **Payment**

This public office does not command a salary, however a modest allowance will be paid together with reimbursement for travelling and subsistence expenses.

The independent person may be asked to chair the Audit Committee, if so an additional allowance will be payable.

# Appendix 4

## Job Description

### Example 2 – County Council

|                        |   |
|------------------------|---|
| <b>Post Title</b>      | Chairman of the Audit Committee   |
| <b>Salary Grade</b>    | Up to £15,000   |
| <b>Hours</b>           | Approximately 20 days per year  |
| <b>Location</b>        | County Hall   |
| <b>Reports To</b>      | Council   |
| <b>Service Area</b>    | Democratic Support Service  |
| <b>Purpose Of Post</b> | Chairing the Committee of the Council charged with overseeing the financial reporting, risk management, audit and internal control arrangements of the Council to assure the Council and its tax payers that resources are properly managed and high standards of financial probity are maintained. |

### JOB DESCRIPTION

#### **PRINCIPAL RESPONSIBILITIES**

1. Chairing the Audit Committee to review
  - financial statements,
  - internal audit reports,
  - external audit reports
  - other evidence of the Council's risk management and internal control systems.
2. Working with the Executive Director (Finance) and the Head of Internal Audit and Risk Management to plan an effective work programme for the Committee.
3. Report to Council when necessary to give assurances about the Council's financial statements, risk management and internal control mechanisms or to raise concerns of any significant weakness
4. Receive briefings from Directors or other senior staff in order to understand the context and import of forthcoming issues.

This job description reflects the major tasks to be carried out by the post holder and identifies a level of responsibility at which they will be required to work. In the interests of effective working, the major tasks may be reviewed from time to time to reflect changing needs and circumstances. Such reviews and any consequential changes will be carried out in consultation with the post holder.

## PERSON SPECIFICATION

| Requirement   | Essential   | Desirable   |
|---|---|---|
| <b>1. Educational</b>                                     | Appropriate financial training and experience<br><br>Knowledge of internal control and audit standards  | Demonstrate continued updating of professional skills |
| <b>2. Work Experience</b>                                 | Able to demonstrate the ability to work closely with politicians<br><br>Experience of chairing high level meetings to achieve effective outcomes<br><br>Experience of the internal control function in a large, multi-disciplinary organisation.<br><br>Operated within a formal risk management framework<br><br>Worked for 10 years at a senior level | Previously chaired an audit committee or similar      |
| <b>3. Abilities, Intelligence &amp; Special Aptitudes</b> | Chairing skills<br><br>Influencing and consensus building<br><br>Listening skills   | Knowledge of local government finance                 |

| Requirement                              | Essential  | Desirable   |
|--|--|---|
| <b>4. Adjustment &amp; Social Skills</b> | Ability to establish good working relationships with Councillors and managers<br><br>Ability to manage and present information orally to groups in politically sensitive environments<br><br>Able to demonstrate strong leadership<br><br>Assertive in pursuing the correct course of action<br><br>Able to work effectively with colleagues who may have different levels of experience and understanding | Diplomacy and tact<br><br>Live in or have connections with County |
| <b>5. Motivation</b>                     | Enthusiastic, not easily deterred & able to convey enthusiasm to others<br><br>Committed to excellent public services  |   |
| <b>6. Equal Opportunities</b>            | Understanding & commitment to promoting equality of opportunity in service delivery with an understanding of the issues underpinning these values  |   |

# Appendix 5

## A selection of possible performance indicators for internal audit

Source: CIPFA - Performance Management for Audit Guide 2000\* & actual performance indicators in use in a district council

### **Monetary Value**

- Overall cost of the service\*
- Average cost per day\*
- Budget v outturn\*
- Cost per day/year compared with alternative provision
- Cost per day/year compared with budget
- Cost is comparable to that for similar councils

### **Staff quality**

- Turnover rates\*
- Provision of training/continued professional development for internal audit staff

### **Technical quality**

- Compliance with relevant standards\*
- Compliance with local audit standards\*
- Relationship between internal audit and external audit\*
- Technical training per staff member\*
- Reliance placed by external audit on internal audit work\*

### **Plans**

- Progress against annual plan
- Progress against long-term plan
- Audits completed on time and as planned as percentage of total audit work

### **Reports**

- Timeliness and accuracy of report
- Layout of report is helpful to readers
- Conclusions are clear, unambiguous and well supported
- Reports on complex systems (eg IT) show evidence of use of specialist skills

### **Coverage**

- Extent of risk areas covered\*

### **Time**

- Chargeable time planned/actual (%)\*
- Non chargeable time planned/actual (%)\*

### **Added Value**

- Percentage of clients who regarded audit as worthwhile\*
- Practicality of recommendations\*
- Improvement in control environment\*

### **Recommendations**

- Recommendations flow from conclusions and are concerned with substantive measures to remedy control weaknesses and/or enhance VFM
- Recommendations agreed by senior management against those made (%)
- Recommendations implemented within agreed timescales against those accepted %)

# Appendix 6

## Specimen good governance statement

### **ANNUAL GOVERNANCE STATEMENT**

#### **Scope of responsibility**

[The authority] is responsible for ensuring that its business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively. [The authority] also has a duty under the Local Government Act 1999 to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

In discharging this overall responsibility, [the authority] is responsible for putting in place proper arrangements for the governance of its affairs and for ensuring that there is a sound system of internal control which facilitates the effective exercise of its functions and which includes arrangements for the management of risk.

[The authority] has approved and adopted a code of corporate governance, which is consistent with the principles of the CIPFA/SOLACE Framework *Good Governance in Local Government*. A copy of the code is on our website at [...] or can be obtained from [...].

This statement explains how [the authority] has complied with the code and also meets the requirements of regulation 4 of the Accounts and Audit Regulations 2003 in relation to the publication of a statement on internal control.

#### **The purpose of the governance framework**

The governance framework comprises the systems and processes for the direction and control of the authority and its activities through which it accounts to, engages with and leads the community.

The system of internal control is a significant part of that framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of [the authority's] policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically.

The governance framework has been in place at [the authority] for the year ended 31 March 200x and up to the date of approval of the [annual report] and statement of accounts.

#### **The governance environment**

Describe the key elements of the systems and process that comprise the authority's governance arrangements including arrangements for:

- establishing and monitoring the achievement of the authority's objectives
- the conduct of behaviour
- the facilitation of policy and decision-making
- ensuring compliance with established policies, procedures, laws and regulations
- embedding risk management in the activity of the authority, including how leadership is given to the risk management process, and how staff are trained or equipped to manage risk in a way appropriate to their authority and duties;
- ensuring the economical, effective and efficient use of resources, and for securing continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness as required by the Best Value duty;
- the financial management of the authority and its financial reporting; and
- the performance management of the authority and the reporting of performance management.

### Review of effectiveness

[The authority] has responsibility for conducting, at least annually, a review of the effectiveness of its governance framework including the system of internal control. The review of effectiveness is informed by the work of the executive managers within the authority who have responsibility for the development and maintenance of the governance environment, the Head of Internal Audit's annual report, and also by comments made by the external auditors and other review agencies and inspectorates.

Describe the process that has been applied in maintaining and reviewing the effectiveness of the system of internal control, including some comment on the role of:

- the authority
- the executive
- the audit committee/overview and scrutiny committees/risk management committee
- the standards committee
- internal audit
- other explicit review/assurance mechanisms.

I/we have been advised on the implications of the result of the review of the effectiveness of the governance framework and system of internal control by the Authority, the executive/audit committee/overview and scrutiny committee/risk management committee (*amend list as appropriate*), and a plan to address weaknesses and ensure continuous improvement of the system is in place.

**Significant governance issues**

[Include an outline of the actions taken, or proposed, to deal with significant governance and internal control issues.]

We propose over the coming year to take steps to address the above matters to further enhance our governance arrangements. We are satisfied that these steps will address the need for improvements that were identified in our review of effectiveness and will monitor their implementation and operation as part of our next annual review.

**Signed:** .....

Leading Member & Chief Executive on behalf of [the authority]

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