

CITY OF PLYMOUTH

Subject: Developing the Audit Committee

Committee: Audit Committee

Date: 27th March 2006

Cabinet Member: The Deputy Leader, Cllr Pattison

CMT Member: Director of Corporate Resources

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Part: I

Executive Summary:

Good corporate governance requires independent, effective assurance about the adequacy of financial management and reporting in an organisation. Corporate governance also covers other elements of good business practice such as internal control and risk management, and its counter-fraud arrangements. In both the private sector, and the majority of the public sector, these functions are considered best delivered by an Audit Committee. An effective Audit Committee will enhance public trust and confidence in the overall governance arrangements of an Authority.

The Comprehensive Performance Assessment currently includes specific review of an Authority's corporate governance arrangements, including the effectiveness of its Audit Committee, as part of its 'Use of Resources' assessment. The Council received a scoring of 2 (out of a possible 4) in December 2005 for this element, and recognises there is a need to further develop its Audit Committee as part of improving its CPA rating.

The Council should now seek to develop and implement more effective Corporate Governance arrangements within its Audit Committee and this report explains the background and proposed plan on how this will be achieved.

Corporate Plan 2006-2009:

An effective Audit Committee will impact upon all our corporate priorities by providing an effective challenge to the Council's arrangements for Internal Control, Risk Management and financial reporting. Good Governance arrangements will add value to the Council and contribute towards achieving an excellent CPA rating.

Implications for Medium Term Financial Plan and Resource Implications: Including finance, human, IT and land

None, except that training resources may need to be identified.

Other Implications: e.g. Section 17 Community Safety, Health and Safety, Risk Management, etc.

The Audit Committee has the responsibility for overseeing the internal control arrangements for the Authority, which include risk management.

Recommendations & Reasons for recommended action:

To assist in formulating proposals to improve the effectiveness of the Council's Audit Committee, Members are asked to:

1. Note the contents of this report
 2. Note the CIPFA Publication on Audit Committees – Practical Guidance for Local Authorities
 3. Discuss and provide comments which could inform Officers when formulating proposals on how to develop a more effective Audit Committee
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Alternative options considered and reasons for recommended action:

It is essential to improve the Corporate Governance arrangements within the Authority. Officers could, independently, formulate proposals for the development of the Audit Committee; but it is considered important to obtain Independent, and Council Members' input into the process.

Background papers:

Audit Commission Report on the Use of Resources.
CPA 2005 Audit Commission Report
Audit Committees – Practical Guidance for Local Authorities (CIPFA)

Sign off:

Head of Fin		Head of Leg		Head of HR		Head of AM		Head of IT		Head of Strat Proc	
Originating CMF Member											

1. Introduction

- 1.1 Good corporate governance requires independent, effective assurance about the adequacy of financial management and reporting in an organisation. Corporate governance also covers other elements of good business practice such as internal control and risk management, and its counter-fraud arrangements. In both the private sector, and the majority of the public sector, these functions are considered best delivered by an Audit Committee. An effective Audit Committee will enhance public trust and confidence in the overall governance arrangements of an Authority.
- 1.2 The new Comprehensive Performance Assessment now includes specific review of an Authority's corporate governance arrangements, including the effectiveness of its Audit Committee, as part of its 'Use of Resources' assessment. The Council received a scoring of 2 (out of a possible 4) in December 2005 for this element, and recognises there is a need to further develop its Audit Committee to improve its CPA rating.
- 1.3 An extract from the Audit Commission's 'Use of Resources Assessment 2005', relevant to the Council's Audit Committee is attached at Appendix 1.

2. Background

- 2.1 The Council formally approved the creation of an Audit Committee in January 2002, following the publication of a number of high profile reports¹ in the late 1990's. These reports recommended the establishment of Audit Committees, which should form an essential element of an organisation's corporate governance arrangements, and have responsibility for the independent review of the systems of internal control and of the external audit process.
- 2.2 One of the objectives of an audit committee should be to contribute independently to the corporate governance arrangements of the authority and to provide assurance to the Cabinet that there is an effective framework of internal control. This includes monitoring the integrity of financial statements, reviewing the internal financial control systems and considering the planned activity and outputs of both internal and external audit.
- 2.3 The above objectives are achieved most effectively by selecting committee members who have an appropriate mix of skills, including

¹ Cadbury Committee – The report of the committee on the Financial Aspects of Corporate Governance.
CIPFA – Corporate Governance A framework for public service bodies
Nolan Committee - Report into the standard in public life
Audit Commission – Called to account

recent and relevant financial experience, knowledge of risk management, audit, accountancy and an understanding of corporate governance issues.

- 2.4 In order to supplement elected Members' skills, and to bring professional experience and expertise to the Audit Committee, Plymouth decided to recruit Independent Members to the Committee at its inception.

3. CIPFA Best Practice Guidance

- 3.1 Despite Audit Committees being commonplace in both the private sector and many other areas of the public sector, this is not currently replicated in local government.
- 3.2 However, guidance on developing effective Audit Committees in Local Government has now been received from CIPFA and this is attached at Appendix 4. It recognises the growing relevance and importance of an effective Audit Committee in an Authority's overall Corporate Governance arrangements and incorporates a set of principles which should be adopted:

3.2.1 A Statement of Purpose

The Local Authority should formally approve a Statement of Purpose.

3.2.2 Core Functions

Audit Committees should:

- 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 of 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 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.

3.2.3 *Features of an Audit Committee*

Good audit committees will be characterised by:

- A strong chair – displaying a depth of skills and interest.
- Unbiased attitudes – treating auditors, the executive and management equally.
- The ability to challenge the executive (leader/chief executive/mayor) when required.
- A membership that is balanced, objective, independent of mind, and knowledgeable.

3.2.4 *Structure and Administration*

Although no single model of audit committee is prescribed, all should:

- Be independent from the executive and scrutiny functions.
- Have clear reporting lines and rights of access to other committees/functions, for example scrutiny and service committees, corporate risk management boards and other strategic groups.
- Meet regularly – about four times a year, and have a clear policy on those items to be considered in private and those to be considered in public.
- Meet privately and separately with the external auditor and head of internal audit.
- Include as regular attendees, the relevant portfolio holder, the chief finance officer or deputy, head of internal audit and appointed external auditor and relationship manager. Other attendees may include the monitoring officer (for standards issues), chief executive and other directors. These officers should also be able to have access to the committee, or the chair, as required. The committee should have the right to call any other officers or agencies of the council as required.
- Be properly trained to fulfil their role.

4. The Current Terms of Reference for Plymouth's Audit Committee

4.1 The current membership of Plymouth's Audit Committee, as adopted in January 2002, comprises:

- Five elected Members of Council
- Three Independent Members

- 4.2 Council Members are nominated by their political party and appointed to Audit Committee at the Council's annual meeting. Independent Members are currently appointed through a process of advertisement, interview and selection.
- 4.3 The responsibilities of Audit Committee are defined in its Terms of Reference, attached at Appendix 2.

The Terms of Reference, which form part of the Constitution, were last updated in May 2005.

5. Training

- 5.1 Induction training was provided to appointed Audit Committee Members in July 2003, which covered:

- Corporate Governance – an overview
- External Audit
- Internal Audit
- Risk Management
- Audit Committees in the Public Sector
- Audit Committees in the Private Sector

- 5.2 Additional training, specifically on risk management, was provided when the Council's Risk Management arrangements were being introduced and the Strategic Risk Register being drafted.

6. Consultation / Benchmarking with other Local Authorities

- 6.1 Chief Internal Auditors of Councils across the West of England have established a regional networking group. In order to compare Plymouth's Audit Committee with those of other Local Authorities, Chief Internal Auditors within the West of England Group have been asked how their audit committees are structured and their activity. Feedback has been received from ten Authorities, and a summary of responses is detailed in Appendix 3.
- 6.2 Feedback was also sought and received from our Audit Committee's Independent Members, which will be explored further during Audit Committee discussion

7. Recommendations

- 7.1 To assist in formulating proposals to improve the effectiveness of the Council's Audit Committee, Members are asked to:

- a) Note the contents of this report
- b) Note the CIPFA Publication on Audit Committees – Practical Guidance for Local Authorities
- c) Discuss and provide comments which could inform Officers when formulating proposals on how to develop a more effective Audit Committee