

Report to the Finance and Performance Management Cabinet Committee



**Epping Forest
District Council**

Date of meeting: 25 September 2006

Subject: Audit and Governance Committee – Proposed Establishment

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Committee Secretary: Graham Lunnun (Ext: 4244)

Recommendations/Decisions Required:

- (1) That consideration be given to the option open to the Council to establish an Audit and Governance Committee on the basis set out in this report; and**
- (2) That consultation be undertaken with the Overview and Scrutiny Committee and their views be considered before any recommendations are made to full Council.**

Summary

1. The purpose of the report is to consider the option open to the Council to establish a new Audit and Governance Committee. The proposal has regard to current best practice in governance arrangements, and the improvement areas identified by the Audit Commission in its 'Use of Resources' Key Lines of Enquiry relating to internal control and the management of significant business risks, as appended to this report.
2. It is appropriate to consult with the Overview and Scrutiny Committee and consider any comments from that Committee before making recommendations to Council.
3. As well as considering the options relating to the establishment of the new Committee or the retention of the status quo, there are other issues to address in the event that the new Committee is established. These include the membership of the Committee, the option to invite co-opted members, the frequency of meetings and the Committee's reporting arrangements.

Background

4. The Chartered Institute of Public Finance and Accountancy (CIPFA) provides advice and guidance on financial management, risk management and governance for public services, and also sets the professional standards in these areas. Where appropriate the Council operates in accordance with the formal CIPFA Codes of Practice and seeks to comply with CIPFA guidance on best practice.
5. CIPFA has, in recent years, emphasised the importance of audit committees as a key source of assurance regarding an authority's arrangements for managing risk, maintaining an effective control environment and reporting on financial and other

performance. These issues are key components of corporate governance. Members will also be aware that financial management is a strong theme for inspections under the Comprehensive Performance Assessment (CPA) regime. It is essential for authorities to have in place robust and independent mechanisms for managing their own finances.

6. In summary, some of the benefits to be gained from operating an effective audit committee include:
 - 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 non-financial reporting;
 - reinforcing the importance and independence of internal and external audit and any other similar review processes (for example, providing a view on the Statement of Accounts and Statement on Internal Control); and
 - providing assurance through a process of independent and objective review.

7. The Audit Commission has updated its Use of Resources assessment model, to assist in their evaluation of how well authorities manage and use their financial resources. It is a more stringent test than the scored judgements that formed part of the CPA framework up to 2004. The 4-point scale has been modified so that 'adequate performance' (at minimum requirements) will score 2. The Council has been assessed at this level for the Internal Control category, and is targeting the next level. One of the improvements needed to move to level 3, as part of the 2005 review, related to the establishment of a "specific member group (such as an audit sub-committee or member panel), which has audit and governance issues as the principal responsibility in its terms of reference". The updated 2006 assessment model indicates, that to achieve level 3, the Council.."can demonstrate that it is effectively delivering the core functions of an audit committee....that it provides challenge to the Executive when required, and provides for effective leadership on governance , financial reporting and audit issues". In order to perform this role the audit committee would need to operate independently from the Executive.

8. CIPFA also advised that members of the committee should be given specific training relevant to their responsibilities and that the committee's terms of reference should be reviewed on an annual basis taking into account relevant governance developments and how it integrates with other committees within the Council.

9. CIPFA has published a guidance document that seeks to help those authorities that do not already have an audit committee to implement one effectively, and to help those authorities that have an audit committee to assess whether they are as effective as they need to be to contribute to good governance. The guidance is not prescriptive and seeks to help authorities to develop audit committees that suit their needs whilst adhering to the fundamental principles. The guidance recognises the diversity of local government arrangements, which means that there can be no single model for all audit committees.

10. At this Council, the functions of an audit committee are presently performed by the Finance and Performance Management Cabinet Committee. However this arrangement does not accord with good practice as the Committee is clearly not independent from the Executive Cabinet function.

11. CIPFA has produced guidance that states that councils should formally approve a Statement of Purpose along the following lines –

“The purpose of an audit committee is to provide independent assurance of the adequacy of the risk management framework and the associated control environment, independent scrutiny of the authority’s financial and non-financial performance to the extent that it affects the authority’s exposure to risk and weakens the control environment, and to oversee the financial reporting process.”
12. The Council has a number of strategies in place to regulate its activities and demonstrate the robustness of its governance arrangements. One of the functions of an audit committee would be to take a view on whether these strategies have been properly formulated and remain effective, in order to provide independent assurance to the Council on the adequacy of the internal control and risk management frameworks. The areas covered will include:
 - the assurance framework including the production of the annual Statement on Internal Control (SIC)
 - the local Code of Corporate Governance (adopted in 2002/03), incorporating risk management, internal control, standards of conduct and accountability.
 - arrangements for delivering value for money
 - anti-fraud arrangements
13. The audit committee would also review and comment on the statutory Statement of Accounts and recommend their adoption by the Council under the Accounts and Audit Regulations. This would require the committee to meet towards the end of June 2007, in order to meet the statutory deadline for the submission of the accounts. The audit committee’s remit would focus on:
 - the suitability of accounting policies and treatments;
 - any changes in accounting treatments and policies;
 - major judgemental areas and significant adjustments, e.g. provisions; and
 - any material weakness in internal control reported by the internal or external auditor
14. The Finance and Performance Management Cabinet Committee would also review the Statement of Accounts, but that Committee’s focus would be on the financial management aspects, including issues such as levels of income and expenditure, analysis of significant variations from budget, and levels of revenue balances.
15. To reflect the close links between the work of the audit committee and the Finance and Performance Management Cabinet Committee, consideration could be given to requiring the Finance and Performance Management Portfolio Holder to attend the meetings of the audit committee in a non-voting capacity, to deal with the statutory Statement of Accounts and other financial reporting issues throughout the year. It would also be necessary for other Portfolio Holders, and Heads of Service to attend the Committee on occasions. The Chief Internal Auditor would attend each meeting.

Terms of Reference

16. A new audit committee could be established with effect from the start of the next municipal year 2007/08. Having regard to the latest CIPFA advice, the committee membership would need to be independent of both the Cabinet and the Overview and Scrutiny Committee. This would also exclude members of O&S Panels whose main functions are finance related, but would not preclude members of other O&S Panels from being members of an audit committee.

The following terms of reference for the audit committee could be applied:

- (i) approving Internal Audit's strategy, plan and performance;
 - (ii) monitoring Internal Audit's work and the implementation of their recommendations;
 - (iii) considering the effectiveness of the Council's internal control environment and associated risk management and anti-fraud and anti-corruption arrangements, and seeking assurances that action is being taken on risk related issues identified by auditors and inspectors;
 - (iv) reviewing the local Code of Corporate Governance and issuing guidance as appropriate;
 - (v) reviewing and commenting on the Council's annual Statement of Accounts and Statement on Internal Control, and recommending their approval to Council;
 - (vi) approving the annual External Audit Plan;
 - (vi) ensuring 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;
 - (vii) reviewing the external auditor's opinion and reports to members, and monitoring management action in response to the issues raised by external audit; and
 - (viii) reviewing the reports of inspection agencies, including the External Auditor's Annual Governance Report to the Council
17. As indicated in paragraph 10, responsibility for some of the above matters is currently within the terms of reference of the Finance and Performance Management Cabinet Committee. Appropriate adjustments would have to be made within the Constitution to reflect this. It should be noted, however, that the other key responsibilities of the Finance and Performance Management Cabinet Committee, in relation to the Council's financial strategy, annual budget, Council Tax setting, capital programme, risk management strategy and corporate performance management, would remain unaffected.
18. Some models in use in other authorities also include within the terms of reference for the audit committee, responsibility for the monitoring of the Council's revenue budgets and capital programme. However, it is considered that this function falls more appropriately within the existing remit of the Finance and Performance Management Scrutiny Panel, and that no changes to the current arrangements for these areas of financial management would be necessary.

Committee Name

19. According to the latest Audit Commission guidance on audit committees, and in the view of the officer Corporate Governance Group, the name 'Audit and Governance Committee' would be considered more appropriate than just 'Audit'.

Programme of Meetings

20. The committee would be required to meet five or six times per annum, in order to accommodate Internal Audit plans, the Internal Audit annual report, and quarterly audit monitoring. This is in line with the approach adopted in those authorities which have established an audit committee.

Size of Committee and proportionality requirements

21. An Audit and Governance Committee would be deemed an "ordinary" Committee in that it will be taking decisions on behalf of the Council (eg approval of Annual Audit Plan). There is a duty under the Local Government and Housing Act 1989 is to allocate the number of seats between the political groups on the Council based on their total number of seats. Because this would be an "ordinary" Committee, the pro rata calculation will be subject to the aggregate calculation for all such bodies.
22. In regard to co-option, the Council has powers under the Local Government Act 1972 to co-opt persons who are not councillors onto any committee. This is subject to the proviso that the committee concerned is not responsible for controlling the Council's finances etc. If the seat or seats are designated as seats for co-opted persons, these may be disregarded for pro rata purposes. The calculation would therefore be on the number of seats available to elected members. Normally, the co-optees would not have voting rights. (In a recent survey the majority of those authorities which had established an audit committee did not have co-opted members, those that had included between one and three co-opted members on the committee).
23. Co-opted persons can be eligible for a co-optee's allowance but only as part of its remuneration scheme and after a report has been made by the Independent Remuneration Panel to the Council. Co-optees' allowance is currently available to, and in some cases claimed by, members of the Standards Committee. They are also available to any co-opted members on Overview & Scrutiny.
24. The Committee need to ask the Constitutional Affairs Panel to consider a number of specific points about the terms of reference of the proposed Committee:
 - a) the number of members
 - b) the number of co-optees, if any
 - c) co-optee's allowance
 - d) quorum;
 - e) how any co-optees will be selected to ensure transparency and independence;
 - f) to review the terms of reference of the Overview and Scrutiny Committee, the Standards Committee and this Committee to avoid overlaps with the role of the new Audit and Governance Committee.

25. There will be many other consequential amendments to the Constitution arising from the establishment of this new Committee.

Executive powers

26. It is regarded as essential that the Audit and Governance Committee would be independent of both Cabinet and the Overview and Scrutiny Committee. It would not have any specific executive powers other than to consider and comment on the annual Statement of Accounts prior to their approval by the Council. When considering the audit and governance issues within its terms of reference it would be necessary, in any particular case, for a judgement to be made as to what action was necessary and by which Committee or body. This may, of course, be via a direct report to Council but it might equally be by reference to Cabinet (as for example with risk management matters) or elsewhere.

Conclusion

27. The Council is seeking continuous improvement in the Council's governance arrangements, and to achieve as high a rating as possible under the CPA arrangements. One of the options open to the Council in demonstrating the robustness of its governance arrangements is to establish an Audit and Governance Committee along the lines outlined in this report. It is suggested that Overview and Scrutiny Committee is consulted on this option prior to this Committee making recommendations to Council.

Options

28. To promote the establishment of a new Audit and Governance Committee on the basis outlined in this report or on a revised basis, or to recommend no action on this matter at the present time.

Resource implications:

From existing resources as far as possible. The number of meetings being serviced from Research & Democratic Services is increasing and the introduction of a new Committee will therefore add to that trend. The resourcing of member meetings will therefore need careful monitoring.

Community Plan/BVPP reference: Not applicable

Relevant Statutory Power: None

Background Papers: Audit Commission's Use of Resources Audit Score Feedback

4. INTERNAL CONTROL (extract taken from Audit Commission website)		
How well does the council's internal control environment enable it to manage its significant business risks?		
Key line of enquiry		
4.2 The council has arrangements in place to maintain a sound system of internal control		
Audit Focus		
Evidence that:		
<ul style="list-style-type: none"> the council reviews and reports on its system of internal control the council has an audit committee or equivalent and an internal audit function 		
Criteria for Judgement		
Level 2	Level 3	Level 4
<p>* An appropriate member group has responsibility for review and approval of the SIC and considers it separately from the accounts.</p> <p>* The council has conducted an annual review of the effectiveness of the system of internal control and reported on this in the SIC.</p> <p>* The sources of assurance to support the SIC have been identified and are reviewed by senior officers and members.</p> <p>* There are action plans in place to address any significant internal control issues reported in the SIC.</p> <p>* The core functions of an audit committee, as identified in the CIPFA guidance, are being undertaken by members.</p> <p>* The council has an internal audit function that operates in accordance with the CIPFA code of practice for internal audit in local government.</p>	<p>* The council has put in place an assurance framework that maps the council's strategic objectives to risks, controls and assurances.</p> <p>* The assurance framework provides members with information to support the SIC.</p> <p>The council can demonstrate that it is effectively delivering the core functions of an audit committee, as identified in the CIPFA guidance; that it provides challenge to the Executive when required and provides for effective leadership on governance, financial reporting and audit issues.</p> <p>The procedure notes/manuals for key financial systems are reviewed and updated as appropriate.</p> <p>The standing orders, standing financial instructions and scheme of delegation are reviewed and updated as appropriate.</p> <p>* Compliance with standing orders, standing financial Instructions and the scheme of delegation is monitored by management, and any breaches identified and appropriate action taken.</p>	<p>The assurance framework is fully embedded in the council's business processes.</p> <p>The council can demonstrate corporate involvement in/ownership of the process for preparing the SIC.</p> <p>An audit committee has been established that is independent of the executive function, with terms of reference that are consistent with CIPFA's guidance. It provides effective challenge across the council and independent assurance on the risk management framework and associated internal control environment to members and the public, and can demonstrate the impact of its work.</p> <p>The standing orders, standing financial instructions and scheme of delegation make specific reference to partnerships.</p> <p>Governance arrangements with respect to partnerships are subject to regular review and updating.</p>