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<b>REPORT TO:</b>	<b>AUDIT SUB COMMITTEE</b>	<b>AGENDA ITEM: 7</b>
<b>DATE OF MEETING:</b>	<b>17 December 2014</b>	<b>CATEGORY: RECOMMENDED</b>
<b>REPORT FROM:</b>	<b>HEAD OF INTERNAL AUDIT PARTNERSHIP</b>	
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<b>SUBJECT: WARD(S) AFFECTED:</b>	<b>Effectiveness of Audit Committees ALL</b>	<b>REF: TERMS OF REFERENCE: FM 09</b>

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## **1.0 Recommendations**

- 1.1 To note the CIPFA guidance
- 1.2 To carry out a self-assessment based on the CIPFA template.

## **2.0 Purpose of Report**

- 2.1 This report provides members with a synopsis of the latest Chartered Institute of Public Finance and Accountancy (CIPFA) guidance on Audit Committees, together with the self-assessment on good practice.

**NOTE: It would be helpful if Members could review the self-assessment questionnaire in Appendix 3 prior to the Meeting.**

## **3.0 Detail**

- 3.1 In December 2013 CIPFA published "Audit Committees – Practical Guidance for Local Authorities and Police". This document sets out CIPFA's guidance on the function and operation of audit committees, giving their view of best practice. It includes their 2013 Position Statement which replaces the one issued in 2005. The Position Statement (see appendix 1) emphasise the importance of audit committees and their role as a key component of governance.
- 3.2 The Guidance states that the purpose of an audit committee is to provide to those charged with governance independent assurance on the adequacy of the risk management framework, the internal control environment and the integrity of the financial reporting and annual governance processes.
- 3.3 The Guidance sets out the CIPFA position statement, then expands on;
  - The Purpose of Audit Committees
  - The Core Functions of an Audit Committee
  - Possible Wider functions of an Audit Committee
  - Independence and Accountability
  - Membership and Effectiveness – including potential causes of difficulty and potential improvement options

3.4 The Guidance specifies the key regulations which could be addressed by the terms of reference of an Audit Committee and provides some suggested Terms of Reference. A separate report to this meeting covers the draft amendments to the Committee's terms of reference.

3.5 A knowledge and skills framework for Audit Committee members is also provided (see Appendix 2) and a Self -assessment of good practice (see Appendix 3)

#### **4.0 Financial Implications**

4.1 None

#### **5.0 Legal Implications**

5.1 None

#### **6.0 Corporate Implications**

6.1 None

#### **7.0 Community Implications**

7.1 None

#### **8.0 Background Papers**

8.1 None

### **CIPFA Position Statement : Audit Committees in Local Authorities and Police**

- 1 Audit Committees are a key component of an authority's governance framework. Their function is to provide an independent and high-level resource to support good governance and strong public financial management.
- 2 The purpose of an audit committee is to provide to those charged with governance independent assurance on the adequacy of the risk management framework, the internal control environment and the integrity of the financial reporting and annual governance processes. By overseeing internal and external audit it makes an important contribution to ensuring that effective assurance arrangements are in place.
- 3 The core functions of an audit committee are to:
  - be satisfied that the authority's assurance statements, including the Annual Governance Statement, properly reflect the risk environment and any actions required to improve it and demonstrate how governance supports the achievement of the authority's objectives.
  - In relation to the authority's internal audit functions:
    - Oversee its independence, objectivity, performance and professionalism
    - Support the effectiveness of the internal audit process
    - Promote the effective use of internal audit within the assurance framework.
  - Consider the effectiveness of the authority's risk management arrangements and the control environment. Review the risk profile of the organisation and assurances that action is being taken on risk-related issues, including partnerships with other organisations.
  - Monitor the effectiveness of the control environment, including arrangements for ensuring value for money and for managing the authority's exposure to the risks of fraud and corruption.
  - Consider the reports and recommendations of external audit and inspection agencies and their implications for governance, risk management or control
  - Support effective relationships between external audit and internal audit, inspection agencies and other relevant bodies, and encourage the active promotion of the value of the audit process.
  - Review the financial statement, external auditor's opinion and reports to members, and monitor management action in response to the issues raised by external audit.
- 4 Audit committees can also support their authorities by undertaking a wider role in other areas including:

- Considering governance, risk or control matters at the request of other committees or statutory officers
- Working with local standards committees to support ethical values and reviewing the arrangements to achieve those values
- Reviewing and monitoring treasury management arrangements in accordance with the CIPFA Treasury Management Code of Practice
- Providing oversight of other public reports, such as the annual report.

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

- Act as the principal non-executive, advisory function supporting those charged with governance
- In local authorities, be independent of both the executive and the scrutiny functions: in police bodies, be independent of the executive or operational responsibilities of the police and crime commissioner or chief constable.
- Have clear rights of access to other committees/functions, for example scrutiny and service committees, corporate risk management boards and other strategic groups
- Be properly accountable to the authority's board or equivalent bodies
- Meet regularly – at least four times a year, and have a clear policy on those items to be considered in private and those to be considered in public
- Be able to meet privately and separately with the external auditor and with the head of internal audit
- Include, as regular attendees, the chief financial officer(s) or appropriate senior and qualified substitute, the chief executive, the head of internal audit and the appointed external auditor. Other attendees may include the monitoring officer (for standards issues) and the head of resources (where such a post exists). These officers should also be able to access the committee, or the chair, as required. The committee should have the right to call any other officers or agencies of the authority as required.
- Report regularly on their work, and at least annually report an assessment of their performance.

6 Good audit committees are characterised by:

- A membership that is balanced, objective, independent of mind, knowledgeable and properly trained to fulfil their role
- A membership that is supportive of good governance principles and their practical application towards the achievement of organisational objectives
- Unbiased attitudes – treating auditors, the executive and management fairly

- The ability to challenge the executive and senior managers when required.

## Audit Committee Members – Knowledge and Skills Framework

### Core areas of knowledge

Knowledge Area	Details of core knowledge required	How the audit committee member is able to apply the knowledge
Organisational knowledge	An overview of the governance structures of the authority and decision-making processes. Knowledge of the organisational objectives and major functions of the authority	This knowledge will be core to most activities of the audit committee including review of the Annual Governance Statement, internal and external audit reports and risk registers
Audit Committee role and functions	An understanding of the audit committee's role and place within the governance structures. Familiarity with the committee's terms of reference and accountability arrangements. Knowledge of the purpose and role of the audit committee	This knowledge will enable the audit committee to prioritise its work in order to ensure it discharges its responsibilities under its terms of reference and to avoid overlapping the work of others.
Governance	Knowledge of the six principles of the CIPFA/SOLACE Good Governance Framework and the requirements of the Annual Governance Statement (AGS). Knowledge of the local code of governance	The committee will plan the assurances it is to receive in order to adequately support the AGS. The committee will review the AGS and consider how the authority is meeting the principles of good governance.
Internal audit	An awareness of the key principles of the <i>Public Sector Internal Audit Standards</i> and the <i>local Government Application Note</i> . Knowledge of the arrangements for delivery of the internal audit service in the authority and how the role of the head of internal audit is fulfilled.	The audit committee has oversight of the internal audit function and will monitor its adherence to professional internal audit standards. The audit committee will review the assurances from internal audit work and will review the risk-based audit plan. The committee will also receive the annual report, including an opinion and information on conformance with professional standards. In relying on the work of internal audit, the committee will need to be confident that professional standards are being followed.
Financial management and accounting	Awareness of the financial statement that a local authority must produce and the principles it must follow to produce the. Understanding of good financial management principles. Knowledge of how the organisation meets the requirements of the role of the chief financial officer, as required by the <i>CIPFA Statement on the Role of the Chief Financial officer in Local Government</i> .	Reviewing the financial statements prior to publication asking questions. Receiving the external audit report and opinion on the financial audit. Reviewing both external and internal audit recommendations relating to financial management and controls. The audit committee should consider the role of the CFO and how this is met when reviewing the AGS.
External Audit	Knowledge of the role and functions of the external auditor and who currently undertake this role. Knowledge of the key reports and assurances that external audit will provide. Knowledge about arrangements for the appointment of auditors and quality monitoring undertaken.	The audit committee should meet with the external auditor regularly and receive their reports and opinions. Monitoring external audit recommendations and maximising benefit from audit process. The audit committee should monitor the relationship between the external auditor and the authority and support the delivery of an effective service.
Risk management	Understanding of the principles of risk management, including linkage	In reviewing the AGS, the committee will consider the robustness of the authority's

Knowledge Area	Details of core knowledge required	How the audit committee member is able to apply the knowledge
	<p>to good governance and decision making.</p> <p>Knowledge of the risk management policy and strategy of the organisation.</p> <p>Understanding of risk governance arrangements, including the role of members and of the audit committee.</p>	<p>risk management arrangements and should also have awareness of the major risks the authority faces.</p> <p>Keeping up to date with the risk profile is necessary to support the review of a number of audit committee agenda items, including the risk-based internal audit plan, external audit plans and the explanatory foreword of the accounts. Typically, risk registers will be used to inform the committee.</p> <p>The committee should also review reports and action plans to develop the application of risk management practice.</p>
Counter- fraud	<p>An understanding of the main areas of fraud risk the organisation is exposed to.</p> <p>Knowledge of the principles of good fraud risk management practice (Red Book 2)</p> <p>Knowledge of the organisation's arrangements for tackling fraud.</p>	<p>Knowledge of fraud risks and good fraud risk management practice will be helpful when the committee reviews the organisation's fraud strategy and receives reports on the effectiveness of that strategy. An assessment of arrangement should support the AGS and knowledge of good fraud risk management practice will support the audit committee member in reviewing that assessment.</p>
Values of good governance	<p>Knowledge of the Seven Principles of Public Life.</p> <p>Knowledge of the authority's key arrangements to uphold ethical standards for both members and staff.</p> <p>Knowledge of the whistleblowing arrangements in the authority.</p>	<p>The audit committee member will draw on this knowledge when reviewing governance issues and the AGS.</p> <p>Oversight of the effectiveness of whistleblowing will be considered as part of the AGS. The audit committee member should know to whom concerns should be reported.</p>
Treasury management (only if it is within the terms of reference of the committee to provide scrutiny)	<p><i>Effective Scrutiny of Treasury management</i> is an assessment tool for reviewing the arrangements for undertaking scrutiny of treasury management. The key knowledge areas identified are:</p> <ul style="list-style-type: none"> <li>• Regulatory requirements</li> <li>• Treasury risks</li> <li>• The organisation's treasury management strategy</li> <li>• The organisation's policies and procedures in relation to treasury management</li> </ul>	<p>Core knowledge on treasury management is essential for the committee undertaking the role of scrutiny.</p>

### **Specialist Knowledge that adds value to the Audit Committee**

Knowledge area	Details of supplementary knowledge	How the audit committee member is able to add value to the committee
Accountancy	Professional qualification in accountancy	<p>More able to engage with the review of the accounts and financial management issues coming before the committee.</p> <p>Having an understanding of the professional requirements and standards that the finance function must meet will provide helpful context for discussions of risks and resource issues.</p> <p>More able to engage with the external</p>

Knowledge area	Details of supplementary knowledge	How the audit committee member is able to add value to the committee
		auditors and understand the results of audit work.
Internal audit	Professions qualification in internal audit	This would offer in-depth knowledge of professional standards of internal audit and good practice in internal auditing. The committee would be more able to provide oversight of internal audit and review the output of audit reports.
Risk management	Risk management qualification. Practical experience of applying risk management. Knowledge of risks and opportunities associated with major areas of activity.	Enhanced knowledge of risk management will inform the committee's oversight of the development of risk management practice. Enhanced knowledge of risks and opportunities will be helpful when reviewing risk registers.
Governance and legal	Legal qualification and knowledge of specific areas of interest to the committee, for example constitutional arrangements, data protection or contract law,	Legal knowledge may add value when the committee considers areas of legal risk or governance issues.
Service knowledge relevant to the functions of the organisation	Direct experience of managing or working in a service area similar to that operated by the authority. Previous Scrutiny Committee experience.	Knowledge of relevant legislation, risks and challenges associated with major service areas will help the audit committee to understand the operational context.
Programme and project management	Project management qualifications or practical knowledge of project management principles.	Expert knowledge in this area will be helpful when considering project risk management or internal audit reviews.
IT systems and IT governance	Knowledge gained from management or development work in IT	Knowledge in this area will be helpful when considering IT governance arrangements or audit reviews of risks and controls.

### **Core Skills**

Skills	Key elements	How the audit committee member is able to apply the skill
Strategic thinking and understanding of materiality	Able to focus on material issues and overall position, rather than being side-tracked by detail	When reviewing audit reports, finding will include areas of higher risk, or materiality to the organisation, but may also contain more minor errors or control failures. The audit committee member will need to pitch its review at an appropriate level to avoid spending too much time on detail.
Questioning and constructive challenge	Able to frame questions that draw out relevant facts and explanations. Challenging performance and seeking explanation while avoiding hostility or grandstanding.	The audit committee will review reports and recommendations to address weaknesses in internal control. The audit committee member will seek to understand the reasons for weaknesses and ensure a solution is found.
Focus on improvement	Ensuring there is a clear plan of action and allocation of responsibility	The outcome of the audit committee will be to secure improvements to the governance, risk management or control of the organisation, including clearly defined actions and responsibilities. Where errors or control failures have occurred, then the audit committee should seek assurances that appropriate action has been taken.
Able to balance practicality against theory	Able to understand the practical implications of recommendations to understand how they might work in practice.	The audit committee should seek assurances that planned actions are practical and realistic.
Clear communication	Support the use of plain English in	The audit committee will seek to ensure that

Skills	Key elements	How the audit committee member is able to apply the skill
skills and focus on the needs of users	communications, avoiding jargon, acronyms, etc	external documents such as the Annual Governance Statement and the explanatory foreword to the accounts are well written for a non-expert audience.
Objectivity	Evaluate information on the basis of evidence presented and avoiding bias or subjectivity.	The audit committee will receive assurance reports and review risk registers. There may be differences of opinion about the significance of risk and the appropriate control responses and the committee member will need to weigh up differing views.
Meeting management skills	Chair the meeting effectively: summarise issues raised, ensure all participants are able to contribute, focus on the outcome and actions from the meeting.	These skills are essential for the audit committee chair to help ensure that meetings stay on track and address the items on the agenda. The skills are desirable for all other members.

## Self-assessment of Good Practice and Effectiveness

<b>Good practice questions</b>	<b>Yes</b>	<b>Partly</b>	<b>No</b>
<b>Audit committee purpose and governance</b>			
1 Does the authority have a dedicated audit committee?			
2 Does the audit committee report directly to full council?			
3 Do the terms of reference clearly set out the purpose of the committee in accordance with CIPFA's Position Statement?			
4 Is the role and purpose of the audit committee understood and accepted across the authority?			
5 Does the audit committee provide support to the authority in meeting the requirements of good governance?			
6 Are the arrangements to hold the committee to account for its performance operating satisfactorily?			
<b>Functions of the committee</b>			
7 Do the committee's terms of reference explicitly address all the core areas identified in CIPFA's Position Statement? <ul style="list-style-type: none"> <li>• Good governance</li> <li>• Assurance framework</li> <li>• Internal audit</li> <li>• External audit</li> <li>• Financial reporting</li> <li>• Risk management</li> <li>• Value for money</li> <li>• Counter-fraud and corruption</li> </ul>			
8 Is an annual evaluation undertaken to assess whether the committee is fulfilling its terms of reference and that adequate consideration has been given to all core areas?			
9 Has the audit committee considered the wider areas identified in CIPFA's Position Statement and whether it would be appropriate for the committee to undertake them?			
10 Where coverage of core areas has been found to be limited, are plans in place to address this?			
11 Has the committee maintained its non-advisory role by not taking on any decision-making powers that are not in line with its core purpose?			
<b>Membership and support</b>			
12 Has an effective audit committee structure and composition of the committee been selected? This should include: <ul style="list-style-type: none"> <li>• Separation from the executive</li> <li>• An appropriate mix of knowledge and skills among the membership</li> </ul>			

<b>Good practice questions</b>	<b>Yes</b>	<b>Partly</b>	<b>No</b>
<ul style="list-style-type: none"> <li>• A size of committee that is not unwieldy</li> <li>• Where independent members are used, that they have been appointed using an appropriate process.</li> </ul>			
13 Does the chair of the committee have appropriate knowledge and skills?			
14 Are arrangements in place to support the committee with briefings and training?			
15 Has the membership of the committee been assessed against the core knowledge and skills framework and found to be satisfactory?			
16 Does the committee have good working relations with key people and organisations, including external audit, internal audit and the chief financial officer?			
17 Is adequate secretariat and administrative support to the committee provided?			
18 Has the committee obtained feedback on its performance from those interacting with the committee or relying on its work?			
19 Has the committee evaluated whether and how it is adding value to the organisation?			
20 Does the committee have an action plan to improve any areas of weakness?			

## **Evaluating the effectiveness of the audit committee**

### **Key**

- 5 Clear evidence is available from a **number** of sources that the committee is actively supporting improvements across all aspects of this area. The improvements made are **clearly identifiable**.
- 4 clear evidence from **some** sources that the committee is actively and effectively supporting improvement across some aspects of this area
- 3 The committee has had mixed experience in supporting improvement in this area. There is some evidence that demonstrates their impact but there are also **significant gaps**
- 2 There is some evidence that the committee has supported improvements, but the **impact** of this support is **limited**.
- 1 **No evidence** can be found that the audit committee has supported improvements in this area.

<b>Areas where the audit committee can add value by supporting improvement</b>	<b>Examples of how the audit committee can add value and provide evidence of effectiveness</b>	<b>Self-evaluation examples – areas of strength and weakness</b>	<b>Overall assessment; 5 – 1 (see key above)</b>
Promoting the principles of good governance and their application to decision making	Providing robust review of the AGS and the assurances underpinning it. Working with key members/governors to improve their understanding of the AGS and their contribution to it. Supporting review/audits of governance arrangements. Participating in self-assessments of governance arrangements. Working with partner audit committees to review governance arrangements in partnerships.		

<b>Areas where the audit committee can add value by supporting improvement</b>	<b>Examples of how the audit committee can add value and provide evidence of effectiveness</b>	<b>Self-evaluation examples – areas of strength and weakness</b>	<b>Overall assessment; 5 – 1 (see key above)</b>
Contributing to the development of an effective control environment	Monitoring the implementation of recommendations from auditors. Encouraging ownership of the internal control framework by appropriate managers. Raising significant concerns over controls with appropriate senior managers.		
Supporting the establishment of arrangements for the governance of risk and for effective arrangements to manage risks.	Reviewing risk management arrangements and their effectiveness, e.g..risk management benchmarking. Monitoring improvements. Holding risk owners to account for major / strategic risks.		
Advising on the adequacy of the assurance framework and considering whether assurance is deployed efficiently and effectively.	Specifying its assurance needs, identifying gaps or overlaps in assurance. Seeing to streamline assurance gathering and reporting. Reviewing the effectiveness of assurance providers, e.g. internal audit, risk management, external audit.		
Supporting the quality of the internal audit activity, particularly by underpinning its organisational independence	Reviewing the audit charter and functional reporting arrangements. Assessing the effectiveness of internal audit arrangements and supporting improvements.		
Aiding the achievement of the authority's goals and objectives through helping to ensure appropriate governance, risk, control and assurance arrangements.	Reviewing major projects and programmes to ensure that governance and assurance arrangements are in place. Reviewing the effectiveness of performance management arrangements.		
Supporting the development of robust arrangements for ensuring value for money.	Ensuring that assurance on value for money arrangements is included in the assurances received by the audit committee. Considering how performance in value for money is evaluated as part of the AGS.		
Helping the authority to implement the values of good governance, including effective arrangements for countering fraud and corruption risks.	Reviewing arrangement against the standards set out in CIPFA's <i>Managing the Risk of Fraud</i> (Red Book 2) Reviewing fraud risks and the effectiveness of the organisation's strategy to address those risks. Assessing the effectiveness of ethical governance arrangements for both staff and governors.		

<b>Areas where the audit committee can add value by supporting improvement</b>	<b>Examples of how the audit committee can add value and provide evidence of effectiveness</b>	<b>Self-evaluation examples – areas of strength and weakness</b>	<b>Overall assessment; 5 – 1 (see key above)</b>
Promoting effective public reporting to the authority's stakeholders and local community and measures to improve transparency and accountability	Improving how the authority discharges its responsibilities for public reporting; for example, better targeting at the audience, plain English. Reviewing whether decision making through partnership organisations remains transparent and publicly accessible and encouraging greater transparency.		