

# Called to Account

The Role of Audit Committees in Local Government

A•U•D•I•T  
COMMISSION

management  
paper



**The Audit Commission**

## Summary

Few local authorities (only 8 per cent in 1995) have independent audit committees, although they are increasingly common elsewhere in the public sector and in the private sector. But the key components of corporate governance apply as much to local government as elsewhere.

The Audit Commission has therefore written this paper to encourage councillors and officers to review their procedures for establishing effective corporate governance and, in particular, those aspects relating to audit issues. It offers neither a prescriptive view that every local authority should establish an independent audit committee, nor a blueprint for such a committee. Rather, it seeks to stimulate a discussion within local authorities about whether an audit committee could bring them benefits and, if so, how best to operate one. The key messages are that:

- ◆ The key components of corporate governance in relation to audit – promoting internal control, focusing audit resources and monitoring audit performance – can be carried out by an audit committee. In most councils there is no single committee whose remit is sufficiently comprehensive to cover all these functions.
- ◆ The political dimension needs to be addressed explicitly. Audit committees appear to be more effective if their meetings are

conducted apolitically. In those councils where an apolitical discussion in an open committee meeting is impractical, a forum outside the formal committee structure (such as an audit panel) may be the best way forward.

- ◆ Councils need to promote internal control through systematic appraisal of control, demonstrating a continuing, and corporate, commitment to an anti-fraud culture and regularly reviewing their procedures to ensure probity and the proper use of resources.
- ◆ To realise the full benefits of a responsive audit, councillors should themselves oversee the approval of audit plans to ensure that resources, both internal and external, are being well directed. They should also monitor the performance of auditors to ensure that it is of a satisfactory standard.
- ◆ Slow delivery and implementation of audit recommendations at best reduces the audit's impact and at worst can allow fraud to flourish or service delivery to deteriorate. Councils should have a forum for ensuring that auditors and officers are collaborating effectively and that agreed recommendations arising from audit work are being implemented.

- ◆ To ensure the effectiveness of audit committees, councils need to consider a number of practical issues. These include composition – the audit committee's constitution, its membership and the frequency of its meetings; protocols – the committee's terms of reference, reporting arrangements and working practices; and broader issues concerning effectiveness, – such as ensuring effective leadership and that action is taken and followed up.

The questions at the end of each section of the paper are intended to prompt debate and enable councillors and officers to consider in detail the issues raised. We have drawn these together as a checklist in a pull-out centre section. In the future, these questions will be used by auditors to examine the effectiveness of local authorities' procedures in relation to corporate governance. The Commission will be keeping this issue under review.

# Introduction

## Why the Audit Commission has written this paper

1. Audit committees are increasingly common across much of the public and private sectors. They are mandatory for all health bodies, recommended by the Home Office for police authorities, and a requirement for listed companies.

2. The Audit Commission's national report on probity in local government, *Protecting the Public Purse*, published in December 1993, recommended that all local authorities should establish independent audit committees. More recently, the Government's White Paper, *Spending Public Money: Governance and Audit* (March 1996), gave broad support to audit committees in local government. However, to date few local authorities have established audit committees. A Commission survey in 1995 found that only 8 per cent of councils had one.

3. Any discussion of audit committees in local government raises issues of terminology. In local authorities, the term 'committee' generally refers to a formal committee of the council as defined by the Local Government Act 1972. Our research shows that some local authorities have given the audit committee functions to a panel. This paper uses the term 'audit committees' to refer to any member-led review body whose remit

comprehensively embraces audit activity, whether it is a formal committee of the council or an audit panel.

## Who should read this paper

4. Despite the copious literature on audit committees in other sectors, there is very little advice relating specifically to local government. This paper aims to fill that gap and to promote debate about the relevance of audit committees in local authorities. Its target audience is all councillors and senior officers. The paper should be particularly timely for bodies establishing new management arrangements as they restructure under local government reorganisation.

## How this paper should be used

5. This paper aims to encourage councillors and officers to review their procedures for establishing effective corporate governance and, in particular, those aspects relating to audit issues. This will enable them to assess whether an audit committee could bring benefits to their authority and, if so, how best to operate one. Many authorities have contacted the Audit Commission during the preparation of this paper to seek clarification and advice on the operation of an audit committee. To prompt debate and enable councillors

and officers to consider the issues raised in detail, questions are included at the end of each section. They are also drawn together as a single checklist in the centre pull-out section.

## The research on which this paper is based

6. This paper is based on research into the practices of 42 local authority audit committees, including site visits to ten authorities (eight local authorities, one pension fund authority and one police authority). We also drew on the experience of audit committees in the NHS and the private sector.

## The structure of this paper

7. The next section of this paper explores the requirements of corporate governance as they relate to audit, considers how audit committees can help and deals with some of the objections often raised to audit committees in local authorities. The following section then reviews how some authorities have met these requirements through an audit committee. The final section considers practical issues regarding audit committees in local government.

# Audit and audit committees in relation to corporate governance

8. This section looks at the key components of corporate governance in local government, how audit relates to them and how audit committees can contribute. It then examines some of the most common objections raised to audit committees in local authorities.

## Corporate governance

9. 'Corporate governance' is a relatively new term in local government, stemming principally from the Nolan Committee's review of standards in public life, and the Cadbury Committee's report on the financial aspects of corporate governance. While the phrase is new, however, the three core principles of corporate governance – openness, integrity and accountability – have always been a fundamental part of local government.

10. 'Corporate governance is about the way in which top managers execute their responsibilities and authority and how they account for that authority in relation to those who have entrusted them with assets and resources' (CIPFA, *Corporate Governance in the Public Services*). There is an ongoing debate about whether the procedures used in other sectors to execute corporate governance apply fully to local

government, largely over the principle of non-executive review. This is because the distinction between executive and non-executive directors which operates in other sectors does not exist in local government.

11. The Commission acknowledges that there are very real differences between local government and other areas of the public sector, and the private sector. Nevertheless, we believe that the principles and functions of corporate governance are relevant to any organisation, whether in the public or private sector. Therefore, while councillors' roles in local authorities are, in important respects, different from those of non-executive directors in other organisations, both share a role in reviewing and monitoring compliance with the law, and in achieving corporate objectives.

## The role of audit in corporate governance

12. Audit is mandatory in local government. Under the 1996 Accounts and Audit Regulations, it is now a council responsibility to maintain an 'adequate and effective internal audit function'. Local government is also subject by law to external audit, carried out by auditors who are appointed independently by the Audit Commission.

13. Audit is an important part of corporate governance, because it brings an objective and independent appraisal of how effectively an organisation achieves regularity, probity and value for money. Local government councillors and officers have onerous financial and legal responsibilities, and the work of internal and external audit provides a key source of assurance that these responsibilities have been met.

14. The increasing prominence of audit committees across both public and private sectors reflects the pivotal role of audit in relation to corporate governance. CIPFA (*Corporate Governance – A Framework for Public Service Bodies*) recommends that all public service bodies should establish an audit committee, comprising non-executive members, with responsibility for the independent review of the systems of internal control and of the external audit process. While CIPFA did not intend its recommendation to be applied prescriptively to local government, due to its unique legal, constitutional and operational environment, it is nevertheless keen to promote the debate about audit committees in local government.

15. Management arrangements in local government are clearly different from those in other sectors. But the key managerial issues relating to securing value for money and safeguarding an organisation's resources are the same. There are three key components of corporate governance in local authorities related to audit (Exhibit 1). These functions reflect Nolan's principles, incorporate CIPFA's guidance and should be carried out effectively in all local authorities.

Exhibit 1

Key component	Remit
Promoting internal control	<ul style="list-style-type: none"> <li>● systematic appraisal of internal controls</li> <li>● develop an anti-fraud culture</li> <li>● review financial procedures</li> </ul>
Focusing audit resources	<ul style="list-style-type: none"> <li>● agree audit plans</li> <li>● monitor audit delivery</li> </ul>
Monitoring audit performance	<ul style="list-style-type: none"> <li>● secure auditor/officer collaboration within agreed timescales</li> <li>● secure timely preparation and response to audit reports</li> <li>● monitor the finalisation of annual accounts</li> <li>● ensure implementation of audit recommendations</li> </ul>

### Audit committees

16. All the key components of corporate governance in Exhibit 1 can be carried out by an audit committee. But review often exists already in current committee structures. Our latest bulletin on fraud and corruption in local government (published in December 1995) acknowledged that corporate governance remains in good order in local government. It has therefore been argued that existing managerial arrangements fulfil the functions of an audit committee and obviate the need to establish a separate committee. This may be the case in some local authorities. But our research suggests that, in most authorities, there is no single committee whose remit comprehensively covers all the functions covered by an audit committee (Exhibit 2).

17. The case for the same committee carrying out all these functions is strong:

- ◆ They are key components of an organisation's corporate governance, and should not be sidelined in the agendas of other committees, where they may be seen as second-order priorities.
- ◆ Despite existing mechanisms, there are often problems with achieving change, such as integrating internal and external audit, or implementing agreed recommendations.
- ◆ An audit committee can help raise the profile of internal control, manage audit resources and realise the benefits of independent appraisal.

### Objections to audit committees

18. Political differences between councillors are often cited as the reason why audit committees cannot work in local government. Certainly, the political dimension needs to be addressed explicitly if an audit committee is to add value to the running of a council. Although one council we visited believed that political debate was central to the workings of its audit committee, every other council visited had agreed to conduct its audit committee meetings apolitically. In these councils, political debate is encouraged at service committee level (where audit recommendations are discussed and action agreed). However, once the recommendations are agreed, the audit committee oversees their implementation in an apolitical way.

Exhibit 2

Governance function	Finance committee	Performance review committee	Service committee	Delegation to officers	Audit committee
Promoting internal control	✓	?	?	✓	✓
Focusing audit resources	✓	?	?	✓	✓
Monitoring audit performance	?	✓	✓	?	✓

Key:  often found     rarely or never found

19. Some councils may find that their circumstances are such that an apolitical discussion is impractical in an open committee meeting. For them, an apolitical discussion in a forum outside the formal committee structure (such as an audit panel) may be the best way forward.

20. In conducting our research, we encountered a number of other objections to audit committees in local government. In the Commission's view, the potential barriers are more perceived than real (Exhibit 3).

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Exhibit 3

**Objections/Issues**

The importation of audit committees from the private sector and health service is inappropriate to local government.

The Public Accounts Committee model (where the chair is an opposition party backbencher) will not work in local authorities where there are few opposition councillors or where the council is hung.

The distinction between executive and non-executive roles which operates in other sectors is not applicable to local government.

Corporate governance is already strong in local government.

The private sector model presupposes that non-executives have specialist business skills. Elected councillors may not have a business background.

**Responses**

The function of an audit committee is to ensure that an organisation's resources are safeguarded and value for money secured. These principles are valid wherever public and private money is spent.

Local circumstances must determine the most appropriate structure and membership for any committee. Our research shows that audit committees are most effective where the chair has strong leadership qualities and enjoys broad councillor and officer respect.

Councillors determine policies and monitor their implementation. Non-executives from other sectors do not have such a broad remit. However, councillors and non-executives share a role in reviewing and monitoring compliance with the law, and in achieving corporate objectives.

This is true, but improvements can always be made. In particular, there should be a clear link between those managing audit resources and those responsible for managing service delivery and acting on agreed audit recommendations.

Politicians bring with them deep local knowledge, empathy with the needs of the local population and an outside perspective as to whether the council is achieving its objectives. Training is available, if necessary, to sharpen councillors' business skills.

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**Objections/Issues**

Audit committees are too remote from service delivery. Accountability is better served by getting the relevant service committee to receive audit reports on their particular service area.

There are enough committees as it is, without creating yet more bureaucracy.

**Responses**

Service committees should retain their prime responsibility for service delivery. There is, however, no reason why a report cannot pass from audit committee to service committee, or vice versa. The real benefits of having an audit committee are that it can:

- exercise greater corporate control over the focus of future audit work;
- pursue the management response to reports which transcend departmental boundaries; and
- ensure that agreed recommendations are actioned.

If the functions are important, the forum appropriate and the working practices right, then an audit committee will add value. This is not inconsistent with reducing the total number of committees.

21. The Commission concludes that there is a strong case in principle for establishing audit committees in local authorities and that the objections often raised against them can be addressed. Audit committees can help improve corporate governance and represent a check on how

responsibilities are being carried out. The next section of this paper looks at the practice of corporate governance and the experience of those local authorities that have already established audit committees.

# Corporate governance in practice

22. This section examines each of the key components of corporate governance in relation to audit, and gives examples of how these functions can be enhanced by an audit committee.

## Promoting internal control

- systematic appraisal of internal controls
- develop an anti-fraud culture
- review financial procedures

## Internal controls

23. The Cadbury Report defines corporate governance as 'the system by which organisations are directed and controlled'. Sound internal controls<sup>1</sup> help an organisation safeguard its assets and resources, and compliance with these controls should be monitored as part of a continual cycle. An audit committee is well placed to raise the profile of the system of internal controls and ensure that, whatever the short-term pressures, councillors have a systematic commitment to the routine aspects of council operations (see Case Study 1).

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## Case Study 1

Before the audit panel was set up at the London Borough of Tower Hamlets, over one-third of internal audit resources were spent on special investigations requested by service committees. This practice had an adverse effect on internal audit's ability to conduct routine investigations into compliance with fundamental financial controls, and potentially exposed the council to greater risk. The audit panel now ensures that internal audit work is properly planned, with due regard to risk, materiality and coverage, as well as taking into account the views of service committees.

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<sup>1</sup>'Internal control' has been defined by the Joint Working Group on Internal Control, set up in the light of the Cadbury Report, as 'the whole system of controls, financial and otherwise, established in order to provide reasonable assurance of:  
(a) effective and efficient operations;  
(b) internal financial control; and  
(c) compliance with laws and regulations'.

## Anti-fraud culture

24. As we reported in *Protecting the Public Purse*, fraud in local authorities is on the increase and becoming more sophisticated. Councils need to send a clear signal from the top that fraud will not be tolerated. This should start with a clear public statement of the council's position on fraud (see Case Study 2).

25. A council can tackle fraud in several ways, although ideally there will be consistency in the standards and approach applied across the council. One way that a council can demonstrate a continuing and corporate commitment to an anti-fraud culture is through an audit committee. Typically, an audit committee would receive:

- ◆ at least annual reports on the systems and controls in place to prevent fraud;
- ◆ periodic reports on the extent of fraud; and
- ◆ reports of special investigations (for example, four of the ten authorities visited set up their audit committee to address fraudulent activity).

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## Case Study 2

The London Borough of Lambeth has published an anti-fraud policy statement demonstrating a commitment to combat fraud and corruption wherever it is found. The policy sets the standards of integrity expected of all staff, and makes all managers responsible for:

- the prevention and detection of fraud; and
- the establishment and maintenance of systems of internal control to ensure that the council's resources are properly applied and to the activities intended.

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26. No council can rule out fraud and corruption within its own organisation. Therefore, there needs to be an effective 'whistleblowing' mechanism to enable staff and/or auditors to raise concerns without fear of undue departmental influence. An audit committee to which there is independent access creates a corporate mechanism for confidential whistleblowing.

## Review financial procedures

27. As part of its internal control systems, each council has laid down procedures for authorising and monitoring expenditure. This procedural framework typically includes standing orders and financial regulations. Councillors should themselves regularly review these and monitor compliance with statutory requirements. This helps to ensure that:

- ◆ the council's own standards remain relevant and continue to represent best practice;
- ◆ the authority is working within the law; and
- ◆ there is a systematic and independent overview of departures from the financial framework (such as the waiving of standing orders).

An audit committee provides a mechanism for doing this.

## Focusing audit resources

- agree audit plans
- monitor audit delivery

### Audit plans

28. To realise the full benefits of a responsive audit, councillors should themselves oversee the approval of audit plans to ensure that resources are being well directed. An audit committee which oversees both the planning and the delivery of audit work can help ensure that audit resources are well focused.

29. Audit is a statutory check on the use of public funds and auditors have, ultimately, to decide independently on their final work programmes. However, there should always be scope for councils to influence and tailor programmes to address local needs. There are new opportunities to improve collaboration between internal and external auditors, and to this end the Audit Commission:

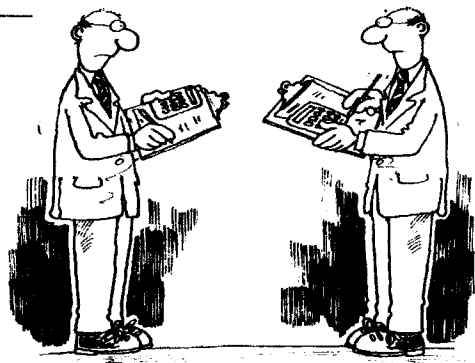
- ◆ is publishing guidance on what public bodies can expect from their auditors;
- ◆ is promoting the managed audit initiative (see Box 1); and
- ◆ has published a paper, *It Takes Two*, on the relationship between internal and external auditors.

### Box 1

While recognising the different objectives of internal and external audit, the Audit Commission nevertheless considers many aspects of their work to be complementary. There are many ways of promoting collaboration to ensure that audit resources are effectively focused. One example of joint working is the Commission's managed audit initiative which seeks to codify best practice so that internal and external auditors work collaboratively to deliver a cost-effective opinion on the financial statements.

### Audit delivery

30. Perhaps because of their compulsory nature, internal and external audit have not traditionally been treated as a resource that can be influenced by councils. This can mean either that the performance of auditors falls below satisfactory standards, or alternatively, that councils do not always realise the full benefits of audit work. Committing auditors to defined levels of service delivery is an area where an audit committee can make a real impact (Case Study 3).



collaborative working of internal and external audit

Internal audit services were contracted out in a county council in 1993. Audit delivery was below that specified in the contract, but the service was not closely monitored by the client department nor subject to committee review until an audit committee was constituted. One of the audit committee's first acts was to scrutinise the performance of internal audit. This led to the contractor replacing its contract managers and committing itself to improved delivery and enhanced reporting.

31. In the absence of an audit committee, the diversity of audit activity often means that no single committee covers the auditors' full remit. This can make it difficult for a council to manage audit as a corporate resource, since the committee responsible for monitoring the cost of audit is then rarely involved in evaluating and acting upon audit recommendations.

### Monitoring audit performance

secure auditor/officer collaboration within agreed timescales

secure timely preparation and response to audit reports

monitor the finalisation of annual accounts

ensure implementation of audit recommendations

32. Monitoring audit performance effectively requires that:

- ◆ auditors discharge their functions in accordance with statute and best professional practice; and
- ◆ officers submit financial statements and other evidence for audit review, and respond promptly to legitimate audit concerns.

The working relationship between officers and auditors should be reviewed by councillors and an audit committee is well placed to do this.

33. The review of policies and service delivery is the responsibility of service and performance review committees. Neither auditors nor an audit committee have a role in determining policy. However, both may legitimately contribute to corporate governance in that:

- ◆ auditors can make recommendations about the management and effectiveness of service delivery; and
- ◆ audit committees can monitor the timely preparation of financial statements and audit reports, and the management response to agreed recommendations.



Slow delivery and implementation of recommendations reduces the audit's impact

**Auditor/officer collaboration**

34. Slow delivery and implementation of recommendations reduces the audit's impact and can allow fraud to flourish or service delivery to deteriorate. Audit committees can play a key role in ensuring that auditors and officers collaborate effectively. This can enable auditors' reports to be dovetailed into the relevant service committee cycles and ensure that officers respond promptly to completed audit reports (see Case Study 4). This collaboration applies as much to the completion of value-for-money studies as it does to the certification of the financial accounts. In particular, an audit committee can test the degree of the collaboration in terms of the extent to which the managed audit has been applied.

**Management response**

35. Many audits result in recommendations for improvement. An audit committee can ensure that officers consider these recommendations promptly, and act on them where auditors have raised valid concerns (see Case Study 5).

**Financial accounts**

36. The 1996 Accounts and Audit Regulations require councils to approve financial statements by 30 September. Councillors are rarely involved in overseeing the preparation of accounts – in only one authority in our research was this the case. However, financial statements are a key aspect of corporate governance and accountability. An audit committee can be an effective body

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*Case Study 4*

The audit committee of Berkshire County Council is agreeing deadlines for the external auditors to deliver their value-for-money reports. Getting the auditors to meet the council's committee cycle reduces the time taken to prepare audit reports and get the recommendations agreed and implemented.

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*Case Study 5*

The audit panel of the London Borough of Tower Hamlets has halved the time required to respond to audit recommendations through a system of follow-up, including plans delineating responsibility for action, timescales and a review of outstanding recommendations. Where compliance is slow, service chairs and chief officers are summoned to account for the delay and to explain what remedial action is being taken.

for ensuring that the council prepares its financial accounts promptly. The audit committee can also review the director of finance's statements on the operation of system controls.

### **Implementation**

37. Agreed recommendations arising from audit work need to be implemented. Councils should have a forum for considering the contribution of internal and external audit and for ensuring that audit is, in practice, adding value to corporate governance.

38. Audit committees can be a powerful vehicle for securing implementation of audit recommendations and thereby improve the operation and delivery of council activities. In particular, an audit committee can effectively co-ordinate action where recommendations apply either to more than one service or across all council operations. All of the authorities we visited with audit committees credited them with achieving change, and in some cases their impact was clearly significant (see Case Study 6).

### **Developing a corporate response to audit**

39. The section above has described the key components of corporate governance in relation to audit and demonstrated how an audit committee can bring a corporate perspective to fulfilling these

responsibilities. The benefits of using an audit committee to underpin these aspects of corporate governance are summarised in Box 2.

40. The next section of this paper explores the different ways that a council can in practice tackle the functions discussed above.

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### *Case Study 6*

Leicester City Council's initial impetus for establishing its audit panel was concern at the poor response to internal audit recommendations. The audit panel helped to increase the profile and effectiveness of internal audit by providing a formal forum in which managers, who had not previously responded to audit reports, were required to do so. Within a year, outstanding audit recommendations (some of which dated back six years) had been dealt with. Since that success, it has proved unnecessary to refer further internal audit reports to the panel, which has changed its focus to concentrate on consideration of Audit Commission reviews, both local and national.

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### *Box 2*

The key benefits cited by authorities from our field visits are that an audit committee can promote:

- better integration of internal and external audit;
- better anti-fraud awareness and action;
- more effective follow-up and implementation of audit recommendations;
- quicker response times; and
- more systematic appraisal of internal controls.

*'We continue to develop and strengthen our Audit Panel as part of our commitment to improving our systems of control and overall corporate management.'*

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## **Considering the case for an audit committee**

Is there a committee that monitors compliance with internal controls?

Has an anti-fraud strategy been well publicised and its principles systematically pursued?

Is there a formal process of reporting frauds to councillors?

Does the council formally review and endorse its financial procedures each year?

Is there a committee that focuses audit resources?

Has the council taken steps to improve the collaboration between internal and external audit?

Have standards been set for audit delivery?

Is there a committee that monitors performance on audit issues?

Do auditors and officers collaborate to complete work within agreed timescales?

Does the council set and monitor targets for the publication of its financial statements?

Are councillors aware of the key audit recommendations and how long their implementation takes?

Is there a committee that considers audit activity and management's response to it? Does this committee pursue the management response to audit reports that transcend departmental boundaries?

Does the council have an effective audit committee? If not, should one be established?



# How audit committees can work effectively

41. The earlier sections of this paper have argued that audit committees can play an important role in underpinning corporate governance in local government. This final section offers practical advice to councils that are considering establishing an audit committee or improving the effectiveness of an existing one. It covers three key areas:

- ◆ composition;
- ◆ protocols; and
- ◆ effectiveness.

42. As with any committee, the exact constitution, terms of reference and working practices of audit committees should be tailored by each council to reflect its local circumstances. We hope that this section of the paper will help councillors and officers to think through some of the choices available.

## Composition

### Constitution

- full committee/sub-committee/panel
- public v private

### Membership

- councillor v councillor/officer
- size

### Frequency of meetings

## Constitution

43. Audit panels tend to be joint working parties for councillors and officers, with business being conducted in private. The main benefits of this approach are responsiveness (being outside the committee meeting cycle) and privacy (which can allow business to be conducted away from the glare of publicity). However, the closed nature of a panel detracts from the principles of public openness, and the informal status of a panel may either mitigate against its effectiveness, or concentrate an inappropriate level of power outside a council's standard committee structure. A council with an audit panel could address these issues in part by making the panel report to the council in some manner, so that the results of its work are aired in public. There is also merit in holding a meeting in public once a year to allow decisions and policies to be aired fully.

44. Sub-committee status enables councillors to give greater consideration to issues than is often possible at a full committee. For example, a full finance committee agenda may be too busy with budget and resource management to allow for proper consideration of audit issues. In these cases, an audit sub-committee means that time can be dedicated to the control environment and to the use of audit resources. The principal drawback of a sub-committee is that it may lack sufficient status to raise issues of concern or monitor the implementation of audit recommendations which pertain to full service committees. However, a sub-committee can ensure that key issues are fed to the parent committee.

**45.** Full committee status signals a public, high-level commitment to discharging key aspects of corporate governance. This is particularly valuable when implementing recommendations that transcend departmental boundaries. However, there may be practical, political obstacles to full committee status (as described in paragraph 19).

**46.** CIPFA's guidance to public sector bodies is that audit committees should be constituted at a high-level and report directly to their governing bodies. Among the authorities that currently have an audit forum involving councillors, 10 per cent are full committees, 80 per cent sub-committees (usually of finance or performance review), and 10 per cent private panels. Two of the councils we visited were in the process of reconstituting their audit panels as full committees in order to enhance their status.

#### **Membership**

**47.** Membership flows from the status accorded to the audit committee. If a panel approach is adopted, membership can combine councillors and officers as equals. We have seen some successful models based on joint councillor/officer membership. But full

committees can take regular input from officers, while recognising the difference between councillors' and officers' roles. They can also allow auditors independent access to councillors, should the need arise.

**48.** Membership should represent the constituent interests serving on the council, with sufficient numbers to drive the agenda, but not too many to stifle action. The authorities visited had between three and 17 councillors serving on their committee. The average number was six, which while higher than the private sector average of three, may be appropriate to support the diversity of activities and views found in local government.

#### **Frequency**

**49.** Frequency of meetings should be driven by the scale of business. CIPFA recommends at least three meetings per year. Our study sites ranged from ad hoc to monthly meetings, with 52 per cent meeting either three or four times per year. This is consistent with the frequency of audit committee meetings found in other sectors.

## Protocols

### Remit

Terms of reference

### Reporting arrangements

Relationships with other committees

### Working practices

### Remit

50. Seventy per cent of councils visited have adopted the CIPFA framework on terms of reference for their audit committees, although many omit the review of either the financial statements or the management response to audit. There are strong reasons why audit committees should incorporate these functions into their remit:

- ◆ Monitoring management response is one of the key functions of an audit committee. It preserves the difference between member review and officer implementation, while ensuring that agreed audit recommendations do get acted upon.

- ◆ The Accounts and Audit Regulations 1996 require a council or a committee of the council formally to adopt the financial statements. Although any committee could do this, it falls naturally within the remit of an audit committee.

51. The remit should establish the audit committee's role in taking a corporate overview of the council's control environment. This will involve reviewing the performance of other committees in responding to audit recommendations, as well as keeping the relationship between service chairs and chief officers under regular review. Clearly this cross-committee remit can be a source of potential conflict, and it is important that the terms of reference define clearly the powers and responsibility of the audit committee.

**Reporting arrangements**

52. The relationship of the audit committee to other committees is important. A council should identify the main relationships (primarily with service, finance and performance review committees) and dovetail its meetings with those committees' agendas. It is also important to clarify both the route by which reports go to the audit committee and what happens to them subsequently. This will ensure that responsibility for agreeing recommendations, determining the necessary actions

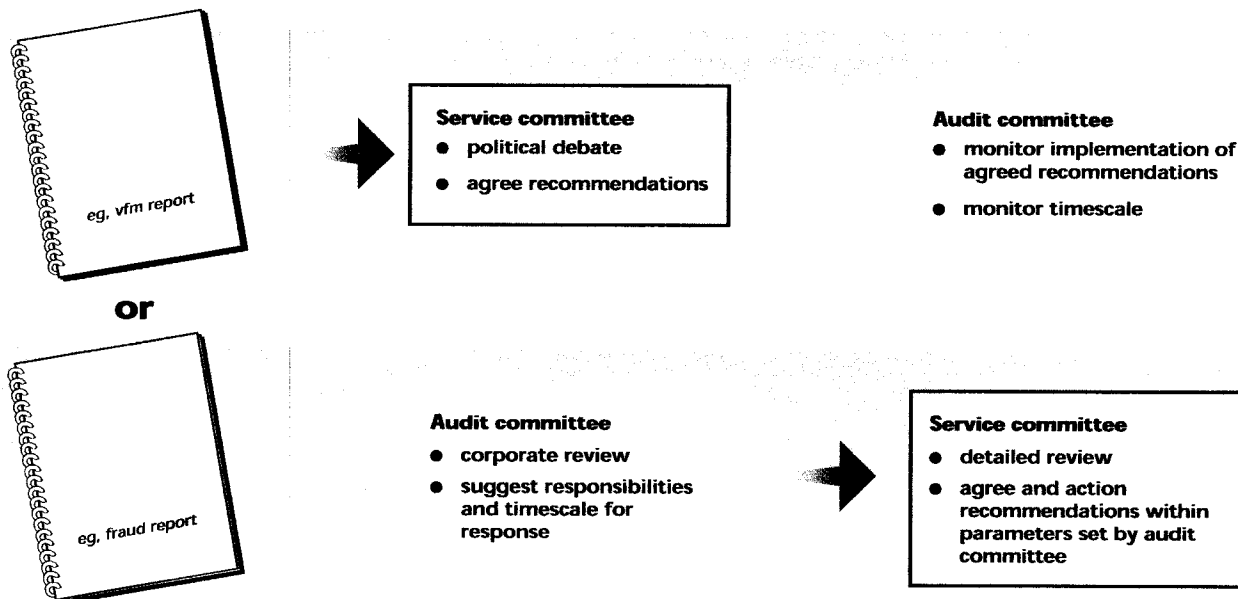
(including timescale) and monitoring implementation are clearly set out.

53. Reporting protocols can help ensure that reports do not slip through the net. For example, many authorities prefer value-for-money audit reports to be considered and agreed in the first instance by the relevant service committee. This enables the service committee to test the recommendations in the light of local priorities and take ownership of the issues raised. Once agreed, an audit committee can perform an

independent monitoring role in testing the speed and extent of the recommendations' implementation. Alternatively, a report on fraud within a department may benefit from independent review. In this case, an audit committee could take the lead role and feed the lessons learned back to the service committee. In both examples, the audit committee plays a key role in facilitating and monitoring action (Exhibit 4). Auditors should be available to offer constructive support to either committee.

Exhibit 4

Different types of audit reports can be cleared in different ways.



## Working practices

**54.** An audit committee needs to define its terms of engagement and working protocols. These should include:

- ◆ auditors' and officers' rights of access;
- ◆ careful consideration of officers' statutory responsibilities (eg, s151 officer) and of functions delegated to officers;
- ◆ ability to call officers and/or service chairs; and
- ◆ ability to drive its own agenda and influence the agenda of other committees.

By defining its working practices clearly an audit committee can maximise its impact and reduce the time taken to effect change (see Case Study 7).

**55.** It is easy for the initial momentum of an audit committee to be lost. In several cases, we found that audit committees set up to deal with specific difficulties, such as major frauds or poor implementation of audit recommendations, were gradually allowed to lapse and disband once the specific problem had been solved. It is worth re-emphasising that the main business of an audit committee is a continuous review of the control environment, which will not only uncover existing problems but help prevent future ones from developing. For this reason, a fixed reporting cycle is preferable to ad hoc arrangements.

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## Case Study 7

The audit committee of a police authority aims to receive its committee papers a fortnight in advance of the meeting. This enables members to submit questions for officers in advance. Officers prepare their answers before the meeting, which means that committee time is appropriately used and many agenda items can definitively be dealt with at a single meeting.

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**56.** The business of the audit committee should be planned well in advance. This involves agreeing:

- ◆ a timetable to cover the major events in the financial year (Exhibit 5, overleaf); and
- ◆ a typical agenda for each meeting to ensure that adequate coverage is given to the key issues (Exhibit 6, overleaf).

This approach to planning helps ensure that the committee's full remit is covered, and that all councillors, officers and auditors are working to a common purpose.

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*Exhibit 5*

**Winter**

Discuss and respond to  
external auditors'  
management letter

Agree external audit plan

**Summer**

Respond to external  
audit reports on vfm

Respond to external audit  
feedback on results of  
managed audits

Adopt accounts prepared  
by Director of Finance

**Spring**

Agree internal audit plan

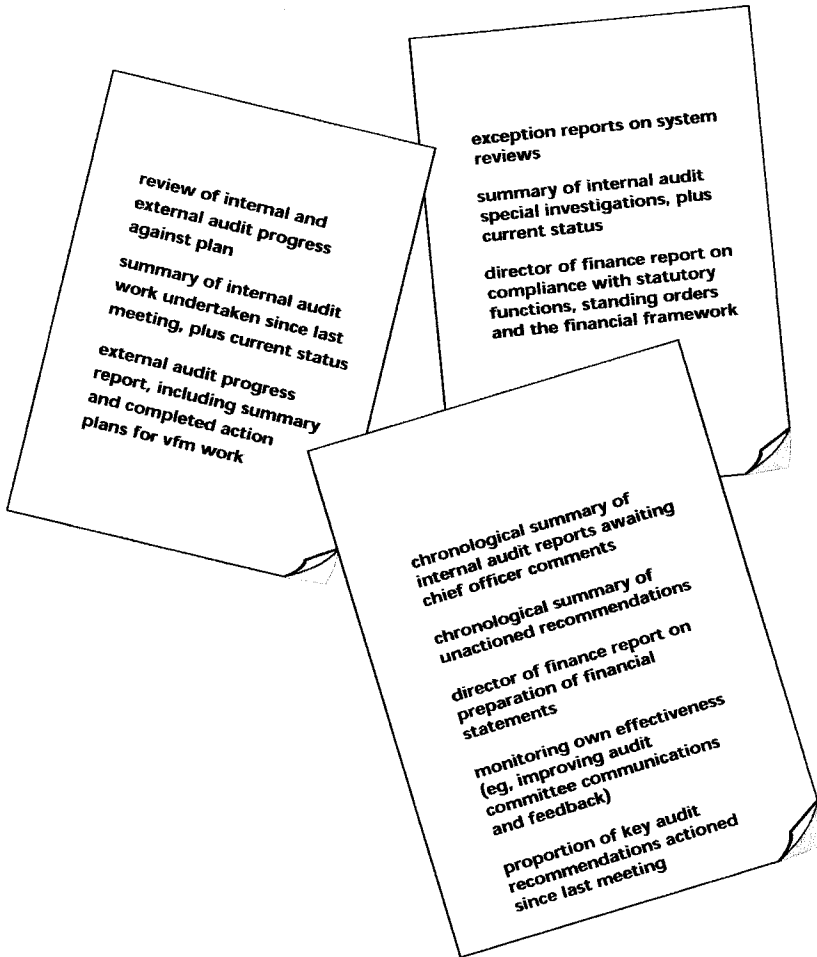
Respond to vfm reports

Respond to review of  
systems

Director of Finance report on  
compliance with legislation  
and internal codes of  
practice

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Exhibit 6



### Effectiveness

**Responsibilities      Leadership      Action      Follow-up**

#### Responsibilities

57. The powers and responsibilities of an audit committee should be defined clearly to ensure that it works within its remit and covers it fully. In practice, this means recognising the difference between an audit committee and, say, a performance review committee. An audit committee's remit is broad, and to deliver this in full requires disciplined control of the agenda. Maintaining a balanced agenda can help an audit committee ensure that it covers its remit fully (see Case Study 8).

By controlling the agenda and remaining action-oriented, the chair will be in a strong position to realise the full benefits of an audit committee. A financial background can be helpful, but is less important

than an enquiring mind, a willingness to ask challenging questions, and an ability to see the wood for the trees. Some councils provide training specifically for their audit committee councillors (see Case Study 9).

#### Leadership

58. Effective leadership is a key success factor in enhancing the committee's influence. Audit committees are most effective where the chair has strong leadership qualities, is a senior figure, and enjoys the respect of councillors and officers.



an ability to see the wood for the trees...



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Case Study 8

The audit committee's annual programme at the London Pensions Fund Authority is determined at the start of each year, but within a strategic framework covering all of the Authority's activities over the medium term. This is established by the committee's members having regard to the advice received both from the Authority's officers and from the external auditors to ensure maximum efficiency in the application of audit resources, as well as appropriate prioritisation of the audit workloads. This is regularly reassessed to ensure that the programme remains relevant, that it balances the functions of the committee and gives equal weight to standard controls, special investigations, regularity and value-for-money work.

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Case Study 9

When Chester City Council established an audit panel, many councillors knew little about internal audit. As part of the process of training councillors, the city produced a leaflet which addressed the questions most commonly asked by councillors. The questions in the leaflet include:

Why do we have an internal audit section?

What do you mean by reviewing internal control?

What do you mean by 'systems audit' and 'regularity audits'?

Aren't auditors looking only for error and fraud?

How are audit assignments conducted?

Can I make any comments on your findings?

Who decided which areas are to be audited?

What is the Audit Services Panel?

Are there any other services you offer?

What about internal audit costs?

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**Action**

**59.** A key measure of effectiveness is securing action to implement agreed recommendations. The committee will have no direct involvement in implementing change, but can set the framework and timescale within which change will happen. Often this will involve co-ordinating responses across a number of services, and ensuring that different committees respond promptly to audit reports. Given the potential number of councillors and officers involved, it is essential that who does what is clear to all parties.

**60.** It may be that much of an audit committee's agenda deals with a satisfactory control environment where no change is necessary. Lack of specific actions at any particular meeting does not reduce the importance of maintaining corporate vigilance through an audit committee.

**Follow-up**

**61.** Follow-up is one of an audit committee's central tasks, and is an area where other committees often fail. Once change has been agreed, it is essential that progress is monitored, reasons for non-compliance dealt with and corrective action taken. Persistent problems should be raised with the full council, but in most cases simply having a committee with a specific remit to monitor progress should be sufficient to ensure that action is taken.

## **Making audit committees work in practice**

Will the audit committee be constituted as a full committee of the council?

Are there sufficient councillors to drive the agenda without stifling action? Does membership reflect the diversity of activities and views within the council?

Does the audit committee's remit comprehensively embrace audit activity and ensure timely management responses to audit?

Will the audit committee take responsibility for adopting the council's financial statements?

Have reporting lines with officers, auditors and other committees been clarified?

Are the audit committee's terms of reference and working practices defined?

Is the audit committee's agenda planned around a defined annual cycle to ensure full coverage of its remit?

Does the chair of the audit committee provide sound leadership?

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**The Audit Commission for Local  
Authorities and the National Health  
Service in England and Wales**

1 Vincent Square  
London SW1P 2PN  
Tel: 0171 828 1212  
Fax: 0171 976 6187

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