

METROPOLITAN BOROUGH OF WIRRAL

CABINET –22 SEPTEMBER 2005

REPORT OF THE DEPUTY CHIEF EXECUTIVE/DIRECTOR OF CORPORATE SERVICES

THE POTENTIAL OPERATION OF AN AUDIT COMMITTEE

1 EXECUTIVE SUMMARY

The purpose of this report is to present to Cabinet, findings regarding the operation of audit committees. To set out guidance on the operation of such committees and how they operate within other local authorities.

2 BACKGROUND

2.1 At its meeting on 5 September 2005 Cabinet considered an Audit Report on the Cheshire Lines Building. Cabinet resolved:

(1) (10:0) That this Cabinet

(a) acknowledges that the Public Interest Report and the Audit Summary Report raise serious issues about the way this Council conducted its business in relation to the Cheshire Lines Building and the associated issues of the letting of the Facilities Management Contract and the procurement of fixtures and fittings;

(b) recognises that there were failings both in the way officers conducted their business and in the way that members carried out their responsibilities;

(c) believes that it is the prime responsibility of members to act to protect the public interest and that to do so they need to be provided with full, detailed and appropriate information on which to take decisions in the public interest;

(d) welcomes the opportunity that these reports give to learn from the mistakes that were made and to move forward with an Action Plan designed to prevent such mistakes from ever occurring again and to hold to account any who disregard necessary procedures in the future;

(e) agrees to monitor closely progress in the implementation of the Action Plan and also asks that a further report be brought to the Cabinet of September 22nd outlining the structure, reporting patterns and responsibilities of an Audit Committee and detailing how it would relate to the rest of the committee structure and in particular to the Finance and Corporate Management Select Committee. It also asks for information on any current guidelines on the operation of an Audit Committee or examples of best practice elsewhere.

(2) (10:0) That the updated Action Plan, now circulated by the Chief Executive, be endorsed.

2.2 Pursuant to that resolution the information requested by Cabinet has been sought. In order to comply with the Protocols for production of Cabinet Agendas there were only 3 available working days for officers to prepare this report. This is an extremely important subject which merits detailed consideration. Therefore, further reports to Cabinet are likely to be required to provide all the relevant information which has been requested.

3 THE ROLE OF AN AUDIT COMMITTEE AND RELEVANT GUIDANCE

3.1 The role and function of an Audit Committee has long been established in the private sector. It has also become established in some public organisations, for example Central Government, the further and higher education sectors and non-governmental organisations. Increasingly organisations within these sectors have developed their own audit committees. The Chartered Institute for Public Finance Accountancy (CIPFA) has produced a position statement on "Audit Committee Principles in Local Government". A copy of the position statement is attached as Appendix A to this report. It states;

Audit committees are a key component of corporate governance. They are a key source of assurance about the organisations arrangements for managing risk, maintaining an effective control environment and reporting on financial and non-financial performance.

Guidance on implementing and running audit committees in local government lags behind other sectors. CIPFA will therefore be publishing further guidance, drawn from practical examples and experience of other parts of the public sector in 2005.

3.2 As yet further guidance has not been issued. However, the position statement does set out CIPFA's views on the necessary features for an Audit Committee these are divided in to 4 categories, a statement of purpose, core functions, features and structure and administration. The suggested content of each of these categories is set out in the statement at Appendix A. However, one element which requires further consideration is the statement that:

Although no single model of committee is prescribed, all should

- *Be independent of the Executive and Scrutiny functions...*

3.3 The CIPFA Position Statement was circulated to Heads of Internal Audit, the Office of the Deputy Prime Minister (ODPM), the Society of Local Authority Chief Executives (SOLACE) and the Audit Commission. Following the receipt of comments on the statement the statement was considered again by the Public Finance and Management Board of CIPFA on 12 May 2005. A copy of the report to that Board is attached as appendix B to this report.

3.4 As long ago as 1996 the Audit Commission produced a Management Paper entitled "Called to Account – the Role of Audit Committees in Local Government". A copy of that paper is attached to this report as Appendix C. The report is of limited assistance given the time which has elapsed since it was published during which time the modernisation of local government decision

making has taken place. However, some of the principles contained in that report remain relevant. The Audit Commission remains of the view that each local authority should establish an Audit Committee and has been involved in the development of the CIPFA guidance.

- 3.5 The Treasury Department produced “The Audit Committee Handbook” in October 2003. This is aimed at Central Government organisations and boards. However, some of the principles can be applied to local authorities. A copy is attached as Appendix D to this report.

5 AUDIT COMMITTEES IN OTHER LOCAL AUTHORITIES

- 5.1 As indicated above the Audit Commission advice to local authorities since as long ago as 1996 has been that each should establish an Audit Committee. This remains the position of the Audit Commission and is re-inforced by other bodies such as CIPFA.
- 5.2 When the Audit Commission Management Paper was produced in 1996 research suggested that only 8% of local authorities had established an Audit Committee at that time. It has not been possible to identify any more recent research in to the number of local authorities which have established an Audit Committee.
- 5.3 The constitutions of the other metropolitan authorities in Merseyside has been considered. Of these Knowsley Metropolitan Borough Council (“Knowsley”) is the only authority with an Audit Committee. The Committee in Knowsley is called the Governance and Audit Committee. It does not fall within the Executive or Scrutiny roles. However, its membership consists of 4 Cabinet members and 2 other councillors. A copy of the terms of reference of Knowsley’s Governance and Audit Committee is attached as Appendix E to this report. Knowsley also has a Corporate Performance Scrutiny Committee which fulfils the overview and scrutiny role on a number of financial and legal issues. A copy of the extract of Knowsley’s constitution which sets out the areas covered by the Corporate Performance Scrutiny Committee is attached as appendix F to this report.
- 5.4 Chester City Council also has an Accounts Committee. This is also separate from the Executive and Scrutiny roles. However, its terms of reference as set out in the constitution appear more limited than those of the Governance and Audit Committee in Knowsley.
- 5.5 Clearly more information is required to inform officers and members on how Audit Committees operate in other areas. Therefore, a questionnaire has been sent to all 42 local authorities in the North West and all local authorities in England with an excellent rating under the Comprehensive Performance Assessment. A copy of the questionnaire is attached as Appendix G to this report. Details of responses received will be reported to the Cabinet meeting.

6 THE TERMS OF REFERNCE OF AN AUDIT COMMITTEE/ FREQUENCY OF MEETINGS

- 6.1 The CIPFA Position Statement identifies the Core Functions of an Audit Committee. It states:

Audit Committees will:

- *Approve (but not direct) internal audit's strategy, plan and performance.*
- *Review summary internal audit reports and the main issues arising, and seek assurance that action has been taken where necessary.*
- *Consider the reports of external audit and inspection agencies.*
- *Consider the effectiveness of the authority's risk management arrangements, the control environment and associated anti fraud and anti corruption arrangements. Seek assurances that action is being taken on risk related issues identified by auditors and inspectors.*
- *Be satisfied that the authority's assurance statements, including the Statement on Internal Control, properly reflect the risk environment and any actions required to improve it.*
- *Ensure that there are effective relationships between external and internal audit, inspection agencies and other relevant bodies, and that the value of the audit process is actively promoted.*
- *Review the financial statements, external auditor's opinion and reports to members, and monitor management action in response to the issues raised by external audit.*

6.2 It further states that in terms of structure and administration all should:

- *Be independent of the Executive and Scrutiny functions.*
- *Have clear reporting lines and rights of access to other committee /functions, for example scrutiny and service committees, corporate risk management boards and other strategic groups.*
- *Meet regularly – at least four times a year with a quorum, and have a clear policy on those items to be considered in private and those to be considered in public.*
- *Meet separately with the external auditor at least once a year.*
- *Include, as regular attendees, the Responsible Finance Officer, Chief Executive, Head of Internal Audit and Appointed External Auditor and Relationship Manager. Other attendees may include the Monitoring Officer (for standards issues) and the Head of Resources (where such a post exists) The committee should have the right to call any other officers or agencies of the council as required.*
- *Be properly trained to fulfil their role.*

6.3 In the limited number of constitutions of other authorities which it had been possible to review the Audit Committees have been separate from the Executive and Scrutiny roles. However, clearly in Knowsley as there are 4 Cabinet members on the Committee it cannot be described as entirely independent from the Executive.

6.4 If an Audit Committee were to be established then its place within the constitution would need to be clearly identified. The available Guidance suggests that the role should not be one of scrutiny of decisions but one of monitoring. It should operate in an apolitical way. Once decisions have been made and, in some circumstances scrutinised, the Audit Committee would be responsible for ensuring that systems are in place to ensure that those decisions are implemented. This work should be carried out in an apolitical way.

6.5 If an Audit Committee were to be established then it is possible that the scope of the Finance and Corporate Management Select Committee would need to be reviewed. At present its scope is:

The planning, provision and management of the Council's budget, capital, revenue borrowing, assets and its audit arrangements. Provision, planning and management of the Council's human resources strategy and financial and legal services. Overseeing local democracy and the achievement of effective, transparent decision making by the Council. The development, review and co-ordination of the Council's overall framework and policy for best value

6.6 It would appear that there would be an inevitable overlap between the work of the Select Committee and the audit committee. However, the role of the Audit Committee should be one of monitoring of processes rather than decisions and the operation of services. Therefore, it may be that the Select Committee would retain its current scope in the same way that Knowsley's Corporate Management Select Committee retains a scrutiny and review role in relation to aspects of finance.

6.7 Clearly further work needs to be undertaken to identify the models which have been used in other authorities to incorporate audit Committees within the decision making framework. This work has been started and is continuing. Further progress will be reported to Cabinet at its meeting.

7 EQUAL OPPORTUNITIES IMPLICATIONS

There are none arising directly from this report.

8 HUMAN RIGHTS IMPLICATIONS

There are none arising directly from this report.

9 LOCAL AGENDA 21 IMPLICATIONS

There are none arising directly from this report.

10 COMMUNITY SAFETY IMPLICATIONS

There are none arising directly from this report.

11 PLANNING IMPLICATIONS

There are none arising directly from this report.

12 LOCAL MEMBER SUPPORT IMPLICATIONS

This report affects the entire Borough.

13 BACKGROUND PAPERS

No background papers were used in the preparation of this report.

14 RECOMMENDATION

Cabinet is asked to consider the information contained in this report. Cabinet will then need to determine the action which it wishes to take in relation to the possible establishment of an Audit Committee.

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