

# **AUDIT COMMITTEE PRINCIPLES IN LOCAL AUTHORITIES IN SCOTLAND**

## **A GUIDANCE NOTE**



**in Scotland  
DIRECTORS OF FINANCE SECTION**

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## **Foreword**

Foreword and acknowledgements  
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*To be inserted*

# **1 Introduction**

## **Purpose and Scope of Guidance**

- 1.1 This document has been produced to help local authorities in Scotland to apply audit committee principles. It is descriptive rather than prescriptive, recognising that each authority will wish to reflect its own style of operations. Specifically it does not suggest a single model solution. Local authorities in Scotland have various structures, as described in Appendix 2, but deliver a common set of services to their citizens. The same is true of audit: all councils are audited and exercise some form of self-scrutiny, but the structures that are employed to carry out these functions vary considerably.
- 1.2 Similarly the guidance does not seek to define “best practice”. Many local authorities are in the process of implementing audit committee principles or refining the way in which they seek to achieve them and, while there are clear features of “good practice” which this document will describe, “best practice” will develop over time.
- 1.3 The principles apply equally to all sizes of local authority and also to bodies such as joint boards. How they are applied will however depend on many factors including the decision making structure of the authority and its size. Smaller authorities and single purpose bodies, such as joint fire boards, may consider it appropriate to adopt different solutions to those which would suit larger, more complex organisations.
- 1.4 The guidance has been prepared as a practical tool to aid all those with an interest in, or responsibility for, audit committee principles and, as such, it should be of use to elected members, senior officers, internal and external auditors.

## **Context and Structure of the Guidance**

- 1.5 It is considered that all local authorities should be able to demonstrate that they are complying with audit committee principles in order to meet the requirements of good corporate governance. The document has been designed as a practical tool to enable this. The document is therefore presented in two distinct parts. The core guidance is contained in Chapters 2 to 6. Audit committee principles are defined and practical guidance in how to deliver the principles is set out. The guidance contains practical tools including a model terms of reference for an audit committee and a matrix of key features which will enable local authorities to assess the extent to which they are applying audit committee principles.
- 1.6 The second section will also be of particular use to local authorities. The wider corporate governance framework and the place of audit committee principles within that framework is described at Appendix 1.
- 1.7 A reflection of practical realities are reflected in the guidance. A description of the way in which audit committee principles are currently applied in a selection of authorities has therefore been included. A sample of different committee structures

has also been included to illustrate the diversity that exists and to demonstrate that regardless of the local authority's structure, it will be capable of delivering audit committee principles. These contextual elements are included in Appendix 2.

- 1.8 There are already a number of publications covering issues related to this guidance, specifically the importance of good corporate governance and the role, responsibilities and essential independence of internal and external audit. Some of these are listed in the bibliography at Appendix 3.

### **Terminology**

- 1.9 For simplicity, the phrase "local authority" is used throughout even though audit committee principles apply equally to other local government organisations.
- 1.10 Similarly, the phrase "audit committee" is used throughout the guidance note to mean that part, or those parts, of the member structure of a local authority which contribute to the delivery of audit committee principles even though it is recognised that authorities themselves use a wide range of names.
- 1.11 Certain officers have also been given standardised names, for example the Chief Finance Officer, under Section 95 of the Local Government (Scotland) Act 1973, is referred to throughout as the Chief Finance Officer (CFO) and the Head of Internal Audit (HIA) is described as such, even though in many authorities different job titles are used.

### **Status of the Guidance**

- 1.12 The development of this guidance note included field visits to selected local authorities to identify current models for the implementation of audit committee principles. Additionally, consultation was held with key stakeholders and the draft guidance was considered by CIPFA's Audit Panel.
- 1.13 The product is intended to provide practical guidance to facilitate the implementation of audit committee principles in local authorities in Scotland. The CIPFA Directors of Finance Section commend this guidance as good practice.

## 2 Audit Committee Principles

- 2.1 The expression “audit committee principles” has passed into common usage in both the public and private sectors. Perhaps inevitably it has come to have a number of different meanings depending on the context and intention of those using it. The origins of the expression, used with particular reference to local authorities, can be traced back to the *Report of The Commission on Local Government and The Scottish Parliament* (the “McIntosh” report) published by the then Scottish Office in 1999, although the principles themselves were not defined.
- 2.2 Given that the fundamental purpose of this document is to give guidance to local authorities in Scotland on the application of audit committee principles then it is appropriate at this point to be clear about what these principles are. That is the aim of this section of the guidance.
- 2.3 Set out below are three fundamental principles that uniquely define the expression “audit committee principles”. These principles, which build on the ‘Principles of the Audit Committee’ as expressed in CIPFA’s Code of Practice for Internal Audit are that there should be effective mechanisms in place to provide:
- independent assurance of the adequacy of the risk management framework and the associated control environment within the authority;
  - 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
  - assurance that any issues arising from the process of drawing up, auditing and certifying the authority’s annual accounts are properly dealt with.

### Structures

- 2.4 In stating these principles, the term “mechanisms” is used although in practical terms it is difficult to envisage a situation where there would not also be identifiable and distinct structures in place to give effect to these mechanisms and to monitor their effectiveness. Often there is an audit committee at the heart of this structure and a clear view was expressed in the McIntosh report that such committees should be established:

*"We see particular advantage in the creation of audit committees, drawn from outside the political leadership and working on a non-partisan basis, to provide independent reassurance to the council and its electorate that the council's resources are used properly and cost-effectively".*

- 2.5 Notwithstanding the clear position adopted by McIntosh, this guidance is intended to deal with the application of audit committee *principles*. It makes no assumption that authorities will have an audit committee although the guidance is clear (see paragraph 3.2 below) that the creation of an audit committee (or similar group) to give effect to the implementation of audit committee principles should be considered good practice.

## **Independence**

- 2.6 Also, although the term “independent” has been used, it is acknowledged that in practical terms the mechanisms described as defining audit committee principles will exist within the framework of the local authority. Good practice, as described later, would suggest that an audit committee should be constituted as a formal committee of the Council meaning that independence could be argued to be less than total. The theoretical accuracy of this point is acknowledged so, in practice, the mechanisms should aim to minimise the extent to which independence is compromised.
- 2.7 In particular it is important to ensure that the audit committee does not play any role in the day to day operational or strategic management of the authority. If the committee is to be independent then it is important to ensure that it is not a decision making body with respect to the policy and service areas. The committee should therefore make recommendations in these areas for referral back to full Council for ratification. It will, of course, be able to make decisions on the audit related items which are within its agreed remit.
- 2.8 If it is felt appropriate to give the audit committee a wider remit than that implied by the three principles then it would be important to ensure that this wider role did not compromise the committee’s ability to give effect to the principles.

## **Related Issues**

- 2.9 In support of the three core principles authorities may wish to consider the extent to which other conditions exist, including but not restricted to:
- the existence of strong and effective working relationships between and amongst internal audit, external audit and the various inspection agencies;
  - an audit process whose value is understood by the authority and its managers; and
  - mechanisms to ensure the initial and continuing training and development of those charged with the responsibility of implementing audit committee principles.
- 2.10 Also, the role of audit committees and the application of audit committee principles cannot be considered without also taking into account the wider issue of corporate governance. To the extent that audit committees are an element of good corporate governance then those core principles should be understood to be inherited by the audit committee.

## **Benefits**

- 2.11 There are many benefits that adherence to audit committee principles will bring to a local authority and to its key stakeholders. These will be dependent upon the effectiveness of the mechanisms adopted in practice and so the following list is not exhaustive. Typically, the adoption of audit committee principles should deliver the following benefits:
- assist compliance with the financial regulations, standing orders, statutory duties and regulatory responsibilities ;

- improve the adequacy of internal control, risk assessment and risk management procedures;
- increase confidence of stakeholders in the process of scrutiny of financial and non-financial performance information;
- raise the profile of internal audit within the authority;
- assist in ensuring that best value and value for money are achieved;
- minimise the extent to which the local authority may be at risk from illegal actions; and
- assist the local authority to achieve its objectives.

### **Practical Application of the Principles**

2.12 Chapter 3 seeks to set out a broad model for the practical delivery of audit committee principles. The proposed model is, by design, descriptive and not prescriptive. This will allow the practical development of audit committee principles to be influenced by the requirements of local administrative and governance arrangements. To accompany the practical guidance a model remit for an audit committee is at Chapter 5 and a summary of the key features which need to be in place for adherence to audit committee principles to be demonstrated is included in the form of a matrix at Chapter 6.



### **3 Delivering Audit Committee Principles**

3.1 Audit committee principles will be delivered if there are effective mechanisms in place to provide:

- independent assurance of the adequacy of the risk management framework and the associated control environment within the authority;
- 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
- assurance that any issues arising from the process of drawing up, auditing and certifying the authority's annual accounts are properly dealt with.

3.2 It is not considered that this can be achieved without the existence of a group of elected members specifically charged with ensuring that the mechanisms exist and are effective. This would be the absolute minimum role of an audit committee. In practice, such a committee would be well placed to do the tasks necessary to provide the assurances and scrutiny itself and it is considered good practice that the remit of the audit committee should be designed to require it to do this.

3.3 Audit committee principles are intended to provide reassurance to all the stakeholders of the authority, internal and external. It is therefore considered good practice that the audit committee should be formally constituted within the governance arrangements of the authority, reporting directly to the full Council. However, this guidance accepts that it may be possible to deliver audit committee principles without the audit committee being formally constituted.

3.4 It should be noted at this point that, in its 2001/02 Overview Report, Audit Scotland expressed the view that "All councils should not only have Audit Committee mechanisms in place, but they should be committed to making sure that they are effective." It is considered that the effectiveness of an audit committee is greatly enhanced by the status and accountability that formal constitution brings.

3.5 The practical guidance which follows is based on the existence of a formal committee. However, even if a less formal group is considered adequate, much of the guidance will still apply.

3.6 The guidance first considers various issues around the administration of the committee. It then takes each of the core principles and the supporting features in turn and considers the role of the committee in delivering them.

#### **Remit and Membership**

3.7 At the outset, the committee should have clear terms of reference or a set remit which has been agreed by the full council and which describes precisely the role of the committee. If the committee is charged with delivering each of the audit committee principles, then its role will include:

- Forming a judgement on risk management procedures within the council and the impact of these on internal controls;
  - Consideration of non-financial performance where this affects the authority's exposure to risk and weakens the control environment;
  - Approval and subsequent monitoring of the internal audit strategy and periodic internal audit plan. A product of this process will be the formation of a view by the committee of the effectiveness of internal audit; and
  - Consideration of the annual statement of accounts.
- 3.8 Although it is considered that audit committee principles would be supported by a process which results in the strategy and plans of the Head of Internal Audit being formally approved by the audit committee, it will be important that the professional judgement of the HIA is not challenged inappropriately. The main role of the audit committee is to ensure that proper practice was followed in determining the strategy and the plans.
- 3.9 The Chair of the committee should be a competent elected member of integrity and be prepared to challenge. As part of his/her duties the chair should encourage open discussion at meetings and should not seek to restrict debate. Local authorities may wish to consider selection of the chair from outwith the administration. In addition to underpinning independence this would be consistent with the principles of openness and inclusivity, integrity and accountability as described in Appendix 1. However, the important thing is that discussion and challenge are apolitical wherever possible and the chosen chair should have the personal qualities necessary to achieve this.
- 3.10 The committee may function more effectively with a small membership to enable efficient discharge of the committee role and responsibilities. The chair will require to consider a balance of views on any particular matter and this would be served by an additional two members in addition to the chair. One further member would provide a further supportive view to a balanced discussion. Consequently, a minimum membership of four elected members (including the chair) should be considered. It is acknowledged however, that again local requirements will have an influence. A further option which the local authority may wish to explore is the possibility of cooption of non elected members to serve on the audit committee.
- 3.11 Given the likely financial content of information which will come before the committee, it is desirable that one of the members should have an awareness of financial matters. A lack of awareness of financial matters should not in itself however, preclude committee membership and the benefits of a critical lay view should not be underestimated. Both the members and the council should ensure that any necessary action is taken to ensure that committee members can discharge their responsibilities effectively.

### **Meetings**

- 3.12 The frequency of committee meetings will be prescribed within the council's committee and planning cycle. A typical cycle of meetings within the framework of a

model timetable will consider ongoing audit and regulatory matters in addition to the annual matters summarised in the following table:

February/ March	Approval of Internal Audit periodic plan & review of strategy
June	Annual assurance from Internal Audit/Provision of assurance to council. Consideration/Review of annual statement of accounts.
September /October	Review of audit certificate and consideration of matters arising from audit. Review progress of internal audit plan
December	Consideration of annual report to members from external auditor.

- 3.13 It will be a matter for each local authority to determine the extent to which meetings are held in public. In particular, the committee will at times be required to consider matters which are confidential, where Standing Orders in respect of closed sessions can be applied. In general, regard should be had to the principle of openness and inclusivity.
- 3.14 As well as the members of the committee, and the public if appropriate, other people may be invited to attend, for example:
- other elected members;
  - officers including the Chief Finance Officer and Head of Internal Audit; and
  - external Auditor

### **Papers**

- 3.15 The papers for an audit committee may, by nature, be technical in detail and consequently, agenda papers should be submitted in good time to enable all members and officers to review them properly. It may be appropriate for papers to go out considerably more in advance than the usual week so that consideration can be given, in the light of the topics to be discussed, as to which other members or officers should be invited to attend the meeting.
- 3.16 The governance arrangements of the committee should determine the level of detail which requires to be provided to members. By way of example, a report received from an external or internal auditor may not require to be included in full form as part of the agenda. It may be appropriate for an executive summary and action plan to be submitted. The level of detail should be adequate however to enable the member to form an opinion on the substance of the matter and any progress made on implementation of agreed actions.
- 3.17 It may be considered appropriate to provide the audit committee with only a selection of reports or summary reports. In this case it will be important that the selection of the reports and/or the way in which they are summarised identifies the main issues. When the HIA's annual report is received there should be no issues raised in that report which have not already been brought to the attention of the audit committee during the year.

3.18 Specific practical issues relating to papers are expressed in tabular form below:

Document/Task	Committee Role	Possible Committee Consideration
Terms of Reference/Remit	Adherence to the terms of reference.	Are the terms being adhered to as anticipated? Has the role of the committee expanded? Do the terms of reference require to be amended?
Agenda & Papers	Review the papers and ensure that there is an understanding of the matters to be discussed	Are the papers received in good time to ensure that they can be considered in the necessary depth? Is the content of the agenda and the quantity of papers appropriate for the time set aside for the meeting?

### The Control Environment

- 3.19 The first principle states that there should be an effective mechanism in place to provide **independent assurance of the adequacy of the risk management framework and the associated control environment within the authority.**
- 3.20 The control environment will generally be the overall awareness, actions and attitude of members and managers regarding internal controls in the authority. The control environment encompasses both management style and the corporate culture of an authority. It is the broad background against which all other controls are operated. Against this background, internal control specifically can be defined as:
- “the whole system of controls, financial and otherwise, established by management in order to carry on.. business..in an orderly and efficient manner, ensure adherence to management policies, safeguard the.. assets and secure..the completeness and accuracy of the records.”*
- 3.21 There is a range of types of internal controls. Consideration of internal control by the committee will concern how risk is assessed and managed within the council.
- 3.22 Generally, risk will be present where there is any factor which could preclude the achievement of the objectives of the council. Although committee members will not be required to identify risks, the audit committee should ensure that a risk assessment has in fact been carried out and subsequently managed.
- 3.23 They may also be a role for the audit committee to provide assurance to the council, in the form of an annual audit committee report. This report would cover the whole of their remit but, given the importance of managing risk, would specifically include the committee’s assessment of the effectiveness of the risk assessment and management processes.

- 3.24 The assessment of risk by the local authority will be a key consideration for the Head of Internal Audit who will prepare an internal audit strategy and periodic plans based on the results of this assessment. The committee will wish to ensure that risk assessment has been carried out prior to preparation of the plans before they formally approve the strategy and periodic plans. There is a clear distinction between the approval process and preparation of the plans based on the professional judgement of the Head of Internal Audit. Formal approval is consistent with the principle of accountability but should be automatic provided proper practice has been followed.
- 3.25 The committee will also wish to monitor progress against the plans formally and the Head of Internal Audit will therefore need to report on progress against the plan to each committee meeting. Progress can also be monitored by committee members from the receipt and timing of internal audit reports.
- 3.26 Where there is limited progress, the committee may wish to explore the reasons for this and in particular address whether:
- internal audit is appropriately resourced to meet the planned audit activity; and
  - internal audit resources have been diverted to non-audit assignments outwith the strategy or periodic plan.
- 3.27 Consideration of the control environment also extends to monitoring the implementation of recommendations made as a result of the audits carried out, whether within the plans or as exceptional audits. The outcome of the work of both the internal and external auditor will be an assessment of the effectiveness of internal controls in the form of audit reports. Detailed discussion on the content of the report and the improvement actions required will generally be matters for the officers of the council prior to committee consideration. These discussions will take place as part of the audit process and be completed prior to submission of the audit report.
- 3.28 The committee will however need information to enable it to monitor implementation of the improvement actions agreed. This will include actions arising not only from audit reports but also from the reports of other external inspection agencies.
- 3.29 Practical delivery of this principle is expressed in tabular form below:

<b>Document/Task</b>	<b>Committee Role</b>	<b>Possible Committee Consideration</b>
Internal Audit Strategic Plan	Review the plan in good time before commencement of the planned activity.  Approval of the plan.	Was the plan prepared after a suitable risk assessment? Does the Head of Internal Audit have the required resources? Is there a proper balance between planned audit activity and reactive work?
Internal Audit Operational Plan & Progress Reports	Review the plan Approval of the plan. Review the progress report to assess progress	Was the plan prepared after a suitable risk assessment? Is there any slippage against planned activity?

	against the plan.	What is the reason for any slippage against planned activity?
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<b>Document/Task</b>	<b>Committee Role</b>	<b>Possible Committee Consideration</b>
Internal Audit Reports	Review the report and consider any wider implications.	What risks do identified control weaknesses pose to the local authority? Have improvement actions been amicably agreed? Are improvement actions being implemented on time?
External audit/Inspection agency reports	Review the report and consider any wider implications. Committee members are not required to approve reports by external auditors/inspectors	What risks do identified control weaknesses pose to the local authority? Have improvement actions been amicably agreed? Are improvement actions being implemented on time?
Risk assessment	Ensuring that risk assessment has been carried out.  Providing assurance to the council in the form of an annual audit committee report	Will high risk activities be incorporated into the audit plan?

- 3.30 The Head of Internal Audit should, at least on an annual basis, be able to provide the committee and CFO with a formal statement which gives assurance on the effectiveness, or otherwise, of internal controls. This process will, in part enable the committee to provide a broader formal assurance to council.
- 3.31 Local authorities are presently required by the Code of Practice on Local Authority Accounting in the United Kingdom to incorporate a document described as the statement on the system of internal financial control.
- 3.32 The Code also recognises that a local authority may decide to publish a wider-ranging statement on the system of internal control and/or a statement on the adoption of a local code of corporate governance. In such an instance the Code recognises that a local authority may include these statements in place of the statement on the system of internal financial control in their statement of accounts.

<b>Document/Task</b>	<b>Committee Role</b>	<b>Possible Committee Consideration</b>
Annual report from Head of Internal Audit	Review of the report.	Is the content and conclusion from the report an accurate reflection of the issues considered by the committee in

		the previous year?
Annual Audit Committee Report/Review	<p>Provision of overall assurance to the Council</p> <p>Contribution to the preparation of the report.</p> <p>Contribution to the Internal Financial Control Statement, the wider Internal Control Statement or the Corporate Governance Statement</p>	<p>Based on the matters examined at committee can an unqualified report be approved?</p> <p>What are the implications of control weaknesses identified and reported?</p>

### **Risk Related Performance**

- 3.33 The second principle states that there should be an effective mechanism in place to provide **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.**
- 3.34 Risk may be found in aspects of performance which are not necessarily financial in nature. While the risk associated with managing and handling cash and other associated assets is clear, the risks associated with weaknesses in the service planning process may be less apparent. It is essential therefore that not only is there a robust risk assessment process incorporated within the governance of an authority (covered in the principle above) but that this is used to highlight areas of performance which may affect the authority’s exposure to risk and weaken the control environment.
- 3.35 These aspects of performance fall clearly within the remit of the audit committee although many other aspects of performance scrutiny are the legitimate responsibility of service related committees.
- 3.36 Risk related performance issues will most likely emerge from internal or external audit reports or in reports from other inspection processes. The committee’s role in reviewing these and ensuring that improvement actions are implemented, as discussed above, will therefore also serve to help it deliver this principle.

### **Annual Accounts and the External Auditor**

- 3.37 The third principle states that there should be an effective mechanism in place to provide **assurance that any issues arising from the process of drawing up, auditing and certifying the authority’s annual accounts are properly dealt with.**
- 3.38 The process of compilation, auditing and certifying the annual statement of accounts is a statutory process. The governing regulations are the Local Authority Accounts

(Scotland) Regulations 1985. The regulations require that an abstract of the accounts for each financial year is prepared and submitted to both the authority and the Controller of Audit by 30 June.

- 3.39 The statutory nature of this key aspect of financial accountability and the consequent audit process give it a high profile and it may be a key area of consideration for the committee. The audit committee may be given a role in providing an overview of the progress from commencement of compilation to receipt of audit certificate.
- 3.40 It will be a matter for each local authority to determine the extent of the audit committee's role in the process. That role may include an advisory and review role of the annual accounts prior to audit. It may however be that the role can be limited to a consideration of progress of the process overall without an active consideration of the statement of accounts.

<b>Document/Task</b>	<b>Committee Role</b>	<b>Possible Committee Consideration</b>
Project plan for compilation of accounts by 30 <sup>th</sup> June	Review of the document	Does the plan aim to achieve compilation by 30 <sup>th</sup> June? Does the plan address previous audit qualifications?
Project plan for completion of audit by 30 <sup>th</sup> September	Review of the document	Does the plan aim to achieve completion by 30 <sup>th</sup> September? Has the plan been discussed with the Chief Finance Officer?
Annual unaudited statement of accounts	Review of the accounts	Do the accounts adhere to the Code of Practice on Local authority Accounting in the United Kingdom? Has a copy been submitted to the Controller of Audit?
Audit Certificate	Consider the implications of any qualification to the certificate or content of any explanatory paragraph  Consider the nature of any qualifications/ explanatory paragraph by the auditor	Has the Chief Finance Officer taken all steps to avoid the qualification?
Annual report to members	Discussion of the report with the external auditor  Review the report to identify any material or recurring matters	What is the risk to the authority of the issues identified by the auditor? Has progress been made in implementing the actions from the previous management letter?



- 3.41 The external auditor will also prepare long term and annual audit plans. There is however no role for the committee in approving the plans. The committee should however be provided with sight of the plans. The work of the external auditor is directed by the Accounts Commission’s Code of Audit Practice and this encourages external auditors to discuss the plans with the audit committee. At this point the committee will, among other things, be able to ensure that there is coordinated effort between external and internal audit.
- 3.42 Because of the statutory basis for the work of the external auditor, it is considered that all reports from the external auditor, or the relevant extracts thereof, should be submitted for consideration by the audit committee.

### Supporting Tasks

- 3.43 Chapter 2 also identified other conditions which, if they exist, may directly support the achievement of audit committee principles. The committee also has a specific role in helping to secure these conditions:

Condition	Committee Role
The existence of strong and effective working relationships between and amongst internal audit, external audit and the various inspection agencies	<ul style="list-style-type: none"> <li>• Ensuring that the relationship is maintained by ensuring that reliance is placed on the work of internal audit, wherever possible.</li> <li>• Ensuring that there is appropriate cooperation between external and internal audit and that reliance is placed on the work of each other party</li> <li>• Ensuring cooperation, coordination and progress at all levels</li> <li>• Liaison meetings as necessary between chair of committee and Head of Internal Audit.</li> <li>• Liaison meetings as necessary between chair of committee and external auditor</li> </ul>
An audit process whose value is understood by the authority and its managers	<p>Seeking evidence that the role of audit is understood and respected by managers and staff</p> <p>Promotion of the role of audit</p>
Mechanisms to ensure the initial and continuing training and development of those charged with the responsibility of implementing audit committee principles	<p>Requesting and attending induction and continuing training for themselves both about audit committee principles and contextual issues such as finance</p> <p>Evaluating effectiveness of own training</p> <p>Ensuring appropriate training is available for others involved in the process of implementing audit committee principles</p>

## 4. Roles and Responsibilities

### Introduction

4.1 This chapter looks at the roles and responsibilities of all of those involved in implementing audit principles through an audit committee. The chapter looks specifically at the roles and responsibilities of the following stakeholders including the documents that may typically be the responsibility of:

- Elected members in general;
- Members of the Audit Committee
- Chief Finance Officer;
- Chief Officers and Chief Executive;
- Head of Internal Audit; and
- External Auditor.

### Elected Members

4.2 Fundamentally, members are in charge of the local authority. They are responsible for setting the direction and policies of the authority. They are also responsible for allocating resources and setting budgets to ensure that their plans and policies are delivered.

4.3 In practice, members delegate the day to day management of the authority to paid officers. This means that members need to find ways of reassuring themselves that officers are carrying out their wishes, and that the authority is complying with the law and relevant standards as well as with standards of corporate governance.

4.4 This reassurance is provided by many different things including:

- The existence of plans, objectives, targets and performance indicators
- Clearly written policies and procedures which set out roles and responsibilities
- Staffing structures which ensure that staff are properly trained and competent to carry out their roles
- Effective management and supervision throughout the authority
- Sound systems of control which are regularly tested and maintained
- A council structure which ensures scrutiny of management actions
- A council structure which ensures scrutiny of members' decisions
- Internal scrutiny by internal audit
- External scrutiny by external audit and other inspectors and regulators.

4.5 There is a wide range of regulatory and inspection agencies from which the Committee may receive submissions. The following list although not exhaustive provides a flavour of the range agencies and an indicator of scale of that range:

- HM Inspector of Schools;
- Communities Scotland;

- HM Inspector of Police;
- HM Inspector of Fire;
- HM Inspector of Social Work;
- Benefits Fraud Inspectorate;
- Scottish Environmental Protection Agency (SEPA);
- Inland Revenue; and
- HM Customs & Excise.

4.6 All elected members have a role to play in ensuring the good corporate governance of the authority. However, the particular aspect of this with which this guidance is concerned is adherence to audit committee principles. It is considered that good practice requires the establishment of an audit committee.

### **Members of the Audit Committee**

4.7 The audit committee plays a key role in ensuring the scrutiny of management actions and members' decisions by members for members. This is a key point. The audit committee exists to provide reassurance to members, not to the senior management of the Council.

4.8 Members of the audit committee should receive reports from internal audit and external audit. This gives the committee an overview of the authority's performance in a wide range of financial and non-financial matters. The committee is able to seek further information and/or explanations about any of the reports it receives which means it is able to hold both officers and members to account for any relevant matters which are mentioned by the auditors. The committee is able to question and challenge the findings and recommendations of internal and external auditors and it may wish to require other elected members (who are not otherwise members of the audit committee) to attend its meetings to consider matters particular to their own committee or sub-committee.

4.9 The integrity of the committee will be demonstrated by the quality of its membership, the content of its agenda and by the manner in which the members discharge their role. To be fully effective, members of the audit committee need to have certain characteristics above and beyond those which are desirable in all members. In particular, they need to:

- have a good understanding of how the whole council works and a broad understanding of the controls which exist or should exist;
- be able to distinguish between serious control weaknesses and those which are relatively minor;
- be confident about discussing audit findings with the auditors and management;
- have the power to make decisions or to make recommendations to the council, in accordance with the standing orders; and
- be respected and trusted by other members of the council to make decisions on their behalf.

- 4.10 The audit committee will play a key role in the corporate governance of a local authority. Membership of the committee will require a different skill set to that required for membership of service committees. There will therefore be a responsibility upon the local authority overall to ensure that the status of the committee attract the appropriate membership. Also, it may be necessary to provide training and support to help members gain sufficient expertise to be effective audit committee members. For example, an audit committee handbook for members could be developed as a useful reference source and guide.

### **The Chief Finance Officer**

- 4.10 Section 95 of the Local Government (Scotland) Act, 1973, states that:

*“...every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the authority has responsibility for the administration of those affairs...”*

- 4.12 It is appropriate to identify the distinction between the management responsibility of Chief Finance Officer (CFO) and the broader scrutiny role of the committee. The CFO will generally be responsible for the provision of executive advice on all financial matters to the committee.
- 4.13 The CFO in a local authority will typically be, though not always, the Director of Finance. The CIPFA paper *‘The Role of the Finance Director’* does not expressly provide for a specific role for the CFO in relation to audit committees.
- 4.14 The audit committee will almost certainly consider issues as a matter of course which have a direct impact on financial resources and there should therefore be a clear role for the CFO. It is envisaged that the CFO will be present at committee meetings when all external audit and financial reports are considered. It should also be noted that the CFO, along with other chief officers, may be the subject of positive challenge from committee members. In practical terms therefore, the CFO may feel it appropriate to attend most, if not all, meetings of the audit committee.
- 4.15 The specific reporting arrangements for internal audit may have a direct impact on the attendance by the CFO. Where the CFO is directly responsible for internal audit, the presence of the CFO may impact upon the proceedings. There may occasionally be reasons why the Head of Internal Audit wishes to discuss matters without the presence of the CFO. Equally however, there may be instances where the CFO has reason to bring matters to the attention of the audit committee without the presence of the Head of Internal Audit. Neither of these instances should occur with any frequency.
- 4.16 The CFO may be the author of reports to the committee. The typical reports and products which may come from the CFO include:
- financial performance reports;

- the draft annual statement of accounts which are in compliance with the Code of Practice on Local Authority Accounting in the United Kingdom – A Statement of Recommended Practice;
- responses to external audit reports and/or completed action plans; and
- responses to internal audit reports and/or completed action plans, where these relate to the CFO’s areas of responsibility.

4.17 The above list is not exhaustive and will be influenced by the specific remit of individual committees and local circumstances.

4.18 The CFO may be required to provide an update to committee on progress on the implementation of previous audit recommendations in his/her area of responsibility and should expect to be questioned by committee members on that progress.

### **Chief Officers and Chief Executive**

4.19 Chief Officers and the Chief Executive are responsible for the day to day running of the authority. They are accountable to members for the running of their departments and therefore for addressing the findings of audit reports. In addition, a clear role for the Chief Executive is envisaged by maintaining the strategic link between elected members and all other parties who may attend audit committee meetings.

4.20 Chief Officers will be responsible for signing off the action plans for audit recommendations and they are likely to be invited to the audit committee to discuss audit reports and action plans relating to their areas of control.

### **Head of Internal Audit**

4.21 Internal Audit is one of the ways in which the Council (members and managers) gains assurance that its policies are being observed and risks are being properly managed. The CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom defines internal audit as:

*“..an assurance function that primarily provides an independent and objective opinion to the organisation on the control environment comprising risk management, control and governance by evaluating its effectiveness in achieving the organisation’s objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources”*

4.22 The Head of Internal Audit should attend every audit committee meeting. The Code of Practice for Internal Audit in Local Government in the United Kingdom sets out the following matters which the Head of Internal Audit should bring to the attention of the audit committee:

- the terms of reference for internal audit
- the internal audit strategy
- the resourcing of Internal Audit

- the periodic plans of internal audit, progress against and material changes made to these plans, and any implications arising from their findings and opinion;
- the adequacy of management response to Internal Audit advice and recommendations;
- the Head of Internal Audit's annual report;
- the arrangements for and the results of quality assurance and performance management processes; and
- the arrangements made for co-operation between Internal Audit, External Audit and other review bodies.

4.23 Internal Audit should have unfettered access to the chair of the audit committee outwith the cycle of committee meetings. This is essential to maintain the integrity of the internal audit function.

### **External Auditor**

4.23 External Audit have a different focus from Internal Audit: they report to external stakeholders in addition to the managers of the Council. They also have to communicate to those charged with governance relevant matters relating to the audit of the financial statements. External auditors will issue:

- an audit certificate giving their opinion on the annual accounts addressed to the local authority and the Controller of Audit;
- a report addressed to the management of a local authority bringing to their attention matters arising from each discrete piece of work. These typically are in respect of, for example, the review of a financial system;
- reports to central departments and other paying agencies in respect of grant claims; and
- an annual audit report addressed to the local authority and the Controller of Audit which summarises the significant matters arising from each year's audit.

4.25 They are also required to communicate on a sufficiently prompt basis to enable those charged with governance to take appropriate action. (This is a requirement of Statement of Auditing Standards 610).

4.26 The Accounts Commission's Code of Audit Practice requires auditors to provide an opinion on a local authority's annual accounts and to review and report on the authority's corporate governance arrangements and its arrangements to manage its performance. This report, which goes to all members along with the audited accounts, should be delegated to the audit committee so that progress against the action plan is monitored.

4.27 The papers for audit committees should generally be provided to the external auditors as a matter of course. External auditors should also be invited to all meetings of the audit committee where audit business is being discussed and they can properly expect an unfettered right of attendance at all audit committee meetings except where external audit's own performance is being discussed.

## 5. Model Audit Committee Remit

### Introduction

- 5.1 It was a stated objective of this document that guidance should be descriptive and not prescriptive. The provision of a model remit could be seen as prescriptive. That is not however the intention. It is considered that it is appropriate and indeed consistent with the aim of provision of guidance of a practical nature. Clearly, it will be a matter for individual local authorities to determine the extent to which the model remit is adopted.
- 5.2 The model remit is provided on the basis of a checklist format to enable local authorities to both readily assess the existing remit and to assess any area where enhancement could be made.

<b>Model Audit Committee Remit</b>		
<b>1</b>	<b>Committee Governance</b>	
	Remit should address: <ul style="list-style-type: none"> <li>• Number of members required to be quorate</li> <li>• Basis of selection of chair (i.e. selection from outwith the administration)</li> <li>• Required expertise for committee membership</li> <li>• Frequency of meetings</li> <li>• Minimum period in which agenda papers should be issued</li> <li>• Circulation of minutes to other committees/full council</li> </ul>	
<b>2</b>	<b>Reporting Arrangements by the Committee</b>	
	Remit should address: <ul style="list-style-type: none"> <li>• Preparation of a periodic report to full council</li> <li>• Preparation of an annual report to full council</li> </ul>	
<b>3</b>	<b>Business Management Arrangements</b>	
	Remit should address: <ul style="list-style-type: none"> <li>• Whether full or extracted copies of audit/inspection reports are circulated</li> <li>• Duration of attendance at meetings by external auditor, public and media</li> </ul>	
<b>4</b>	<b>Internal Audit</b>	
	Remit should address: <ul style="list-style-type: none"> <li>• Approval and ongoing monitoring of the operational and strategic audit plans</li> <li>• Access of Head of Internal Audit to Chair</li> </ul>	

<b>5</b>	<b>External Audit</b>	
	Remit should address: <ul style="list-style-type: none"> <li>• Review external audit strategic and operational plan</li> <li>• Arrangements for ensuring effective liaison between external and internal audit</li> </ul>	
<b>6</b>	<b>Risk Management</b>	
	Remit should address: <ul style="list-style-type: none"> <li>• Ensuring the extent to which risk management procedures are satisfactorily carried out</li> </ul>	
<b>7</b>	<b>Annual Statement of Accounts</b>	
	Remit should address: <ul style="list-style-type: none"> <li>• Role of the Committee in the process prior to compilation</li> <li>• Role of the Committee after compilation of the accounts</li> <li>• Review of the audit certificate/wording and any matters reported</li> <li>• Review of the annual report to members from the external auditor</li> </ul>	
<b>8</b>	<b>Promotion of Internal Control</b>	
	Remit should address: <ul style="list-style-type: none"> <li>• Audit Committee should have a formal Charter</li> <li>• To ensure systematic appraisal of the Council's control environment and framework of internal control to provide reasonable assurance of effective and efficient operations</li> <li>• To promote the development of an appropriate risk management strategy and risk management procedures</li> <li>• To ensure the highest standards of probity and public accountability</li> <li>• To ensure sound financial procedures are in place for authorising and monitoring expenditure</li> </ul>	
<b>9</b>	<b>Focus on Audit Resources</b>	
	Remit should address: <ul style="list-style-type: none"> <li>• To review and approve the Internal Audit Charter</li> <li>• To agree internal audit plans and to ensure that internal audit work is planned with due regard to risk, materiality and coverage</li> <li>• To oversee in light of the audit plan the performance of the audit service</li> <li>• Concurring with the appointment / removal of the Head of Internal Audit.</li> <li>• To ensure that the audit function is properly resourced</li> </ul>	



<b>10</b>	<b>Monitoring Audit Performance</b>	
	Remit should address: <ul style="list-style-type: none"> <li>• To oversee and review action taken on Audit recommendations</li> <li>• To review all matters relating to external audit, including audit planning, action points and reports, and to monitor the implementation of external audit recommendations</li> <li>• To ensure that appropriate standards are maintained</li> </ul>	
<b>11</b>	<b>Scrutiny of Performance</b>	
	Remit should address: <ul style="list-style-type: none"> <li>• To review the Council's planning process.</li> <li>• To monitor Best Value Reviews</li> <li>• To review external reports and assessments</li> <li>• Request Audit Projects</li> </ul>	

5.3 In carrying out this remit the audit committee will wish to have regard to a number of issues including:

- the extent to which there exist strong and effective working relationships between and amongst the internal audit function, the external audit function and the various inspection agencies;
- the status and standing of audit and inspection in the authority;
- the adequacy of the resources that are allocated to the internal audit function;
- the adequacy of the audit planning process and management of the work programme;
- the development and maintenance of a risk aware, anti-fraud culture throughout the authority;
- the promotion of the highest possible standards of conduct and probity by Members and Officers of the authority at all times; and
- the need to ensure the appropriate integration of its work with that of the other Committees of the Council and its Officers.

## 6. The Audit Committee Principles Matrix

### Introduction

- 6.1 The purpose of the matrix is to provide an assessment tool to enable local authorities, audit committees and auditors to assess the extent to which compliance with audit committee principles is being observed.
- 6.2 The matrix provides self assessment criteria on two levels, namely:
- standard: - consistency with the standard criteria would represent a local authority working towards audit committee principles at the level of good practice;
  - model: - consistency with the model criteria would indicate that a local authority implements audit committee principles at a high level.
- 6.3 The matrix addresses first administrative features and then takes each of the three principles in turn to consider what needs to be in place to demonstrate adherence to that principle. In some cases a feature contributes to the achievement of more than one principle. In this situation it is not repeated but is included under the most appropriate heading only.
- 6.4 While local authorities should set the goal of working on a self assessment basis towards the model level, in reality the achievement of a standard level should represent a realistic medium term goal. It is expected that local authorities will develop incrementally.
- 6.5 It is also expected that over time, as authorities gain more experience in developing effective and innovative ways of delivering audit committee principles, more features will be identified for inclusion in the model level.

<b>The Audit Committee Principles Matrix</b>		
<b>Administration</b>	<b>Standard</b>	<b>Model</b>
<b>An audit committee which demonstrates by the way that it is structured and organised that it is effective</b>	A formally constituted committee, reporting directly to council and generally meeting in public	A chair drawn from outwith the administration
	Adherence to clear terms of reference	Cooption of non-elected members
	Membership which reflects the political balance of the authority	A majority of members from outwith the administration
	Effective training and development for all involved in the process	Formal audit committee charter
	Agenda papers submitted in good time to enable all members and officers to review them properly	

## The Audit Committee Principles Matrix

Principle	Standard	Model
<p><b>Independent assurance of the adequacy of the risk management framework and the associated control environment within the authority</b></p>	<p>Review and approval of Internal Audit periodic plan &amp; strategy</p> <hr/> <p>Monitoring of achievement of internal audit plan</p> <hr/> <p>Review of (summary/selection of) internal audit reports</p> <hr/> <p>Ensuring that risk assessment has been carried out</p> <hr/> <p>Review of annual report to committee from Head of Internal Audit</p> <hr/> <p>Existence of strong/effective relationship between external audit, inspection agencies and internal audit</p> <hr/> <p>Meetings as necessary between chair of committee and Head of Internal Audit and between chair of committee and external auditor</p> <hr/> <p>Assurance to CFO/Council as contribution to the Internal Financial Control Statement, the wider Internal Control Statement or the Corporate Governance Statement</p>	<p>Unfettered right of attendance by external audit at audit committee meetings</p> <hr/> <p>Ensuring that effective risk management processes are operated</p> <hr/> <p>Formal annual report from audit committee to full Council</p>
<p><b>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</b></p>	<p>Consideration of all risk related performance issues raised by auditors or other inspectors</p> <hr/> <p>Monitoring of implementation of improvement action plans</p> <hr/>	

## The Audit Committee Principles Matrix

Principle	Standard	Model
<b>Assurance that any issues arising from the process of drawing up, auditing and certifying the authority's annual accounts are properly dealt with.</b>	Review of annual statement of accounts	Review of internal project plan for compilation of accounts by 30 <sup>th</sup> June
	Review of audit certificate and consideration of matters arising from audit	
	Consideration of annual report to members from external auditor	Review of project plan for completion of audit by 30 <sup>th</sup> September
	Review of annual unaudited statement of accounts	
	Discussion of external audit plans with the external auditor	
	Consider the implications of any qualification to the audit certificate	
	Discussion of the annual report to members with the external auditor	

## Appendix 1

### Corporate Governance Framework

#### Introduction

- 1 It is not the intention of this guidance note to revisit and to fully discuss corporate governance. It is however important, to clarify where the role of audit committee principles sit within the overall framework of corporate governance. This appendix first briefly explains what is meant by corporate governance and then goes on to explain the role of audit committees and audit committee principles within it.
- 2 The term “corporate governance” has been in common use in both the public and private sectors for over a decade now. Definitions vary from those which emphasise control:

*“Corporate governance is the system by which local authorities direct and control their functions and relate to their communities”* (CIPFA, May 2001)

To those which emphasise accountability:

*“Governance is about promoting fairness, transparency and accountability”*  
(Wolfensohn, President of the World Bank, June 1999)
- 3 Corporate governance continues to attract debate and discussion as expectations of corporate behaviour and accountability change. Indeed, events abroad affect views of corporate governance in the UK and events in the private and public sectors impact on each other. For example, in January 2003, the Secretary of State for Trade and Industry made a statement to Parliament about strengthening corporate governance in the UK in response to high profile corporate failures in the USA.
- 4 Although local authorities can argue that they have always been able to demonstrate corporate governance through the democratic process and the member/officer structure, there is no doubt that this alone is not enough to satisfy contemporary expectations and the need for guidance on more formal mechanisms in the public sector was recognised as early as 1995 when CIPFA published its “Corporate Governance: A Framework for Public Service Bodies”.
- 5 Subsequently, based in part on the recommendations of the McIntosh Commission, but also drawing on the work being done more widely in the area of corporate governance, CIPFA and the Society of Local Authority Chief Executives (SOLACE) set up a working party, with representation from the Audit Commission, to address corporate governance in local government.
- 6 In May 2001, the working party produced a guidance note called “Corporate Governance in Local Government, A Keystone for Community Governance”, the “keystone report”. This provided guidance for local authorities on establishing and reporting on a voluntary code of corporate governance. This guidance was situated within five broad themes, which the Commission adopted in its framework for inspecting corporate governance arrangements within local authorities in England:
  - Community focus;
  - Structures and processes;

- Risk management and internal control;
  - Service delivery; and
  - Standards of conduct.
- 7 This same document developed the principles of corporate governance which had been identified for the private sector into three principles for the public sector and one overarching concept. The three fundamental principles were:
- openness;
  - integrity; and
  - accountability.
- 8 These principles rely on the overarching concept of leadership, provided by the local authority and by its members and managers.
- 9 Local authorities in Scotland are not bound by a specific legislative requirement to incorporate an audit committee, or a similar named committee, in the governance structure. Nevertheless there are a number of drivers and pressures both arising from legislation and from the development of good corporate governance which commonly result in the establishment of an audit committee as a part of the governance of a local authority.
- 10 The Accounts Commission has acknowledged that effective audit committees have a pivotal role in corporate governance. The Commission has in fact endorsed audit committee principles as a focus for elected members' role in audit, scrutiny and performance reporting.
- 11 The Financial Reporting Council has published a document entitled "Audit Committees Combined Code Guidance". The document, which is specifically aimed at the private sector sets out guidance designed to assist private sector boards in making arrangements for audit committees and to provide assistance to directors who may serve on audit committees.
- 12 Clearly, the specific private sector focus of the guidance means that full adoption by a local authority would be inappropriate. The guidance does however provide a general direction which has proved useful in formulating this document overall.
- 13 The 1995 CIPFA corporate governance framework stated that boards of public service bodies:
- "should establish an Audit Committee..with responsibility for the independent review of the systems of internal control and of the external audit process"*.
- 14 In Scotland, the development of corporate governance generally, allied to the statutory duty of Best Value will raise the expectation that audit committees will have a broader role than that defined in the 1995 publication.
- 15 The rest of this chapter summarises the three corporate governance principles and the concept of leadership and explains their relevance to audit committees. It concludes by outlining the roles of internal and external audit.

### **The Principle of Openness and Inclusivity**

- 16 This principle describes the desire to ensure that all stakeholders have an opportunity for real involvement in decision making. It includes consultation and partnership working as well as the provision of accurate information and access to decision makers.
- 17 As noted in the main text, it will be a matter for each local authority to determine the extent to which meetings are held in public. Regard must be had however to the above principle of openness and inclusivity. In particular, the committee will at times be required to consider matters which are confidential. It may be therefore that openness while desirable in theory may be difficult to deliver in practice. Issues to consider are the duration of attendance for certain stakeholders including the public, media and external auditors.
- 18 Additionally, there may be instances where the committee wish to hear from interested parties and individuals. Typically this may include representatives from:
- interested groups;
  - partnerships; and
  - funded bodies.

### **The Principle of Integrity**

- 19 This principle requires high standards of conduct throughout the authority so that public resources and services are managed effectively and ethically.
- 20 The audit committee helps to ensure that ethical standards are consistently maintained by acting as a potential forum for review of audit reports. It will be important to ensure that members of the audit committee are fully aware of the standards that the council wishes to apply in this area.

### **The Principle of Accountability**

- 21 This principle describes the allocation of roles and responsibilities to members and officers as well as the external scrutiny of how these roles and responsibilities are exercised.
- 22 The audit committee can play a crucial role in ensuring that officers and members are accountable for their actions. The public nature of the audit committee allows stakeholders access to the papers which go to the audit committee as well as to the meetings of the committee itself. That means that there is double accountability: first of all through the activity of the audit committee itself, which in effect is scrutinising the work of officers and members, and secondly, through public access, which in effect allows stakeholders to scrutinise the scrutineers.

## **Audit Committees as part of Corporate Governance**

- 23 Most Scottish authorities have adopted a local code of corporate governance which sets out how they will demonstrate compliance with the principles and concept. Having set out their current practices and intentions in the local code, authorities are required to review their performance from time to time. Some authorities have gone a stage further and include a statement of compliance with the code of corporate governance in their annual reports.
- 24 The five broad themes identified in the keystone report provide the five dimensions which can be used to apply the principles and concept of corporate governance in a local code. These were:
- Community focus;
  - Structures and processes;
  - Risk management and internal control;
  - Service delivery; and
  - Standards of conduct.
- 25 Of these five dimensions, risk management and internal control is the key dimension for audit attention and provides a clear focus for the audit committee. The audit committee provides a forum for monitoring and review of the operational activities of the rest of the council. This will include looking at the council's attitude and approach to risk as well as looking at the effectiveness of its internal controls.
- 26 From 1 November 2003, companies which are listed on the stock exchange are expected to comply with the recommendations of the Smith report, which have been included in the Combined Code. These recommendations considerably strengthen the role of the audit committee. Although the Smith recommendations do not apply to local authorities, they do indicate a general public mood which expects large organisations to apply significant self scrutiny to its actions. This is echoed in the proposals for councils to carry out a self-review of how they deliver best value, including the sound governance and management of resources.
- 27 The audit committee should to take a view across the whole authority of how it deals with risk, internal controls and the management of resources. By acting as a forum to receive and discuss internal and external audit reports, the audit committee is in a strong position to aid strong corporate governance.
- 28 Audit is not a passive process. Audit can bring about improvements in the areas being audited, a consequence of which may be a clearer focus by managers on performance and controls because of the scrutiny of the audit committee. A key test for the effectiveness of the audit committee will be whether it can demonstrate that it has brought about improvements in this area.



## **The Role of Internal and External Audit**

- 29 Officers and their services will from time to time be the subject of audits and audit reports. Elected members of audit committees will receive internal and external audit reports and be expected to understand the reports and to positively challenge the reports at committee. It is essential that there is an appreciation of the difference between internal and external audit and this is briefly explained.
- 30 The Code of Practice for Internal Audit in Local Government in the United Kingdom 2003 describes internal audit as:
- “..an assurance function that primarily provides an independent and objective opinion to the organisation on the control environment comprising risk management, control and governance by evaluating its effectiveness in achieving the organisation’s objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources”*
- 31 The internal auditor is an employee of the local authority. There is no statutory requirement for local authorities in Scotland to operate an internal audit function. Section 10 of Circular 5/1985 however states that local authorities are “..strongly recommended to make ..arrangements for.. internal audit..” (Audit Scotland “A Job worth doing”)
- 32 External audit is a statutory process, the duties of which are contained principally within Part VII of the Local Government (Scotland) Act 1973 and auditors, independent of the local authority, are appointed by the Accounts Commission. The external auditor will be either a directly employed member of the staff of Audit Scotland or a private firm of chartered accountants. The external auditor is required, under the terms of their appointment, to carry out duties in accordance with the Code of Audit Practice. The Code requires auditors to provide an opinion on the statement of accounts of a local authority and, as part of the wider dimension public sector audit, review and report on:
- the corporate governance arrangements; and
  - the authority’s arrangements to manage its performance.
- 33 External audit provides an annual certificate on the annual accounts although the opinion, like the audit overall, is given from a wider perspective than that of the accounts.
- 34 The internal and external auditor should liaise and where appropriate the external auditor should be able to place reliance upon the work of the internal auditor.

## **Appendix 2**

### **Examples of Current Practice in Local Authorities in Scotland**

#### **Introduction**

- 1 Chapter 2 defined and described audit committee principles as they apply to local government. The development of practical guidance as to how these might be delivered also requires to acknowledge that Councils in Scotland are structured in many different ways and that the progress they have already made towards delivering audit committee principles is also very varied.
- 2 This chapter therefore considers these two contextual issues:
  - the committee structure of local authorities in Scotland; and
  - examples of local authorities working towards the implementation of audit committee principles.

#### **Committee Structures - Background**

- 3 In the years since the reorganisation of Scottish local government in 1996 local authority committee structures have been evolving rapidly. The councils elected in 1995 to govern the newly created unitary authorities adopted a range of structures but many were a service based structure, similar to those of the previous regional and district authorities but now covering the full range of services.
- 4 As part of its review, the McIntosh Commission examined the political organisation of councils and concluded that many councils had overburdened themselves and their members with committees. It recommended that councils should re-examine their committee structures as part of a wider review of the conduct of their business and that, in doing so, they should direct particular attention to executive models and to reformed and simplified forms of the committee system.
- 5 The Commission also specifically referred to the advantages of audit committees, working on a non-partisan basis, to provide independent reassurance to the council and its electorate that the council's resources are used properly and cost effectively.
- 6 The consultative nature of the Commission's review, as well as its specific recommendations, stimulated much debate and led to the appointment by Scottish Ministers of the Leadership Advisory Panel (LAP) in August 1999. The panel's task was to advise councils on the reviews which the McIntosh Commission had recommended they should undertake into their decision making processes and those reviews led to some significant changes in the governance structures adopted.
- 7 In April 2001, in its report, the Leadership Advisory Panel identified the scrutiny function as one of the key themes central to the development of effective modernised structures and stated that the concept of scrutiny should go wider than a pure audit and/or Best Value challenge process.

8 Committee structure developments since then have therefore taken place against a background of increasing emphasis on both “audit” and “scrutiny”, although it must be stressed that these are functions identified as important, not committees which necessarily need to exist. In the context of this paper it is the following of audit committee principles as described at chapter 2 which is central, whether that involves an audit committee or not.

9 The way in which audit committee principles are followed will depend in part on the decision making structure in place and so, by way of context, it is useful to consider the types of committee structure currently in place.

### **Committee Structures currently in place**

10 The Leadership Advisory Panel identified three categories of structures:

- Devolved and partially devolved structures;
- Streamlined committee structures; and
- Executives.

11 It noted at that time that three councils had opted for a devolved or partially devolved structure, 23 had opted to streamline their committee structures by reducing the numbers of committees and six had chosen to move to an executive structure. However, they also acknowledged that some structures had features of more than one category.

12 There are now still examples of all three types and three authorities have been selected which illustrate these at Annex A to this appendix:

- Argyll & Bute Council as an example of a devolved structure (refer Diagram 1);
- Orkney Islands Council as an example of a streamlined committee structure (refer Diagram 2); and
- City of Edinburgh Council as an example of an Executive structure (refer Diagram 3).

13 There are also now many different combinations and variations. Some “streamlined committee structures” include committees which are based around groups of services while others are more cross cutting, or thematic. Most councils which have an Executive or Cabinet also have a supporting structure which is either basically geographical (e.g. Scottish Borders Council), basically service orientated (e.g. East Lothian Council) or both (e.g. The City of Edinburgh Council).

14 Renfrewshire Council, as represented in Diagram 4 in Annex A, has a structure which on paper resembles an Executive but their “Policy Boards” take decisions within their competence which may then be called in by the “Leadership Board”. This can be contrasted with City of Edinburgh Council where decisions are made by the Executive with the Scrutiny Panels empowered to call them in for further discussion.

- 15 It is apparent, from a review of current structures, that, whatever the basic type of structure, there is room within it for an audit committee if that is the way in which the council chooses to take forward audit committee principles.
- 16 However, it is also clear that whether such a committee exists, and how far its remit extends, cannot be deduced simply by reviewing the structure since there is a wide range of terminology in use. There are committees, sub-committees and panels whose title includes, usually no more than two of:
- “audit”;
  - “policy”;
  - “performance”;
  - “monitoring”;
  - “standards”;
  - “scrutiny” and/or
  - “ethics”.
- 17 The scope of some of these committees clearly extends beyond audit and, in others, the name (e.g. “Scrutiny Committee”) does not make it clear whether the audit function is covered at all.

#### **Examples of how Audit Committees currently operate**

- 18 Visits to four local authorities identified a range of approaches. These are outlined here to inform the general debate about the options available for implementation of audit committee principles.
- 19 Annex B to this appendix provides summarised information about how “Audit Committees” operate in the following four local authorities studied:
- City of Edinburgh Council;
  - Fife Council;
  - Renfrewshire Council; and
  - West Lothian Council.
- 20 Each of the four local authorities visited has a member group which has the consideration of audit matters within their remit but the name of this group and its remit varies. All four groups are considered to be effective within their own Councils, thus immediately illustrating that there is no one model which could ever be taken as representing “best practice”.
- 21 Each local authority will need to determine the best model to suit its circumstances and the purpose of this section is to highlight the range of existing practice, as illustrated by these four authorities, to place the practical guidance in the main text in context.

#### **Remit of Audit Committees**

- 22 In all four authorities the member group, styled here as an audit committee (although only one is called that) has a high status, reporting directly to Council. One audit committee deals almost exclusively with audit related issues, for another one audit represents the majority of its workload, but with other aspects developing, one effectively operates in two “modes”, audit and resource management, clearly distinguished from each other and the fourth addresses strategic service reviews, with audit forming a separate component of its remit.

### **Composition of Audit Committees**

- 23 All four local authorities aimed to reflect in the membership of the committee the overall political balance of the Council. Experience suggested, however, that the consequence of this was a tendency for the audit committee to increase in size of membership.
- 24 In two of the authorities the audit committee is chaired by a member of the administration, in the other two it is not. In one case the comment was made that although an independent chair might be considered preferable, it might not be achievable in practice. In one authority, not one of the four visited, the entire membership of the audit committee is drawn from outwith the administration.
- 25 The periods for which members are appointed (or voted) onto the committee also varies, highlighting the need to balance continuity, and the enhanced expertise that brings, against the benefits of having a new point of view introduced at regular intervals.

### **Operational Issues**

- 26 Although the meeting cycle for the committees in the four authorities is different, most operate around a basic quarterly cycle for audit matters. In practice the meeting cycle will depend on the amount and variety of the work undertaken by the committee, including any non-audit work it might have.
- 27 There is variation about which officers attend but the factors which underlie the decision are more consistent. These include not only the subject matter on the agenda but also the impact that the choice of officers has on the profile of audit and the need to demonstrate the independence of audit.
- 28 The process undertaken by officers to both accompany and support the work of the members also varied. This reflected the extent of member involvement in the detail of audit work. Where members were less involved in detailed matters, processes existed for officers to address these.

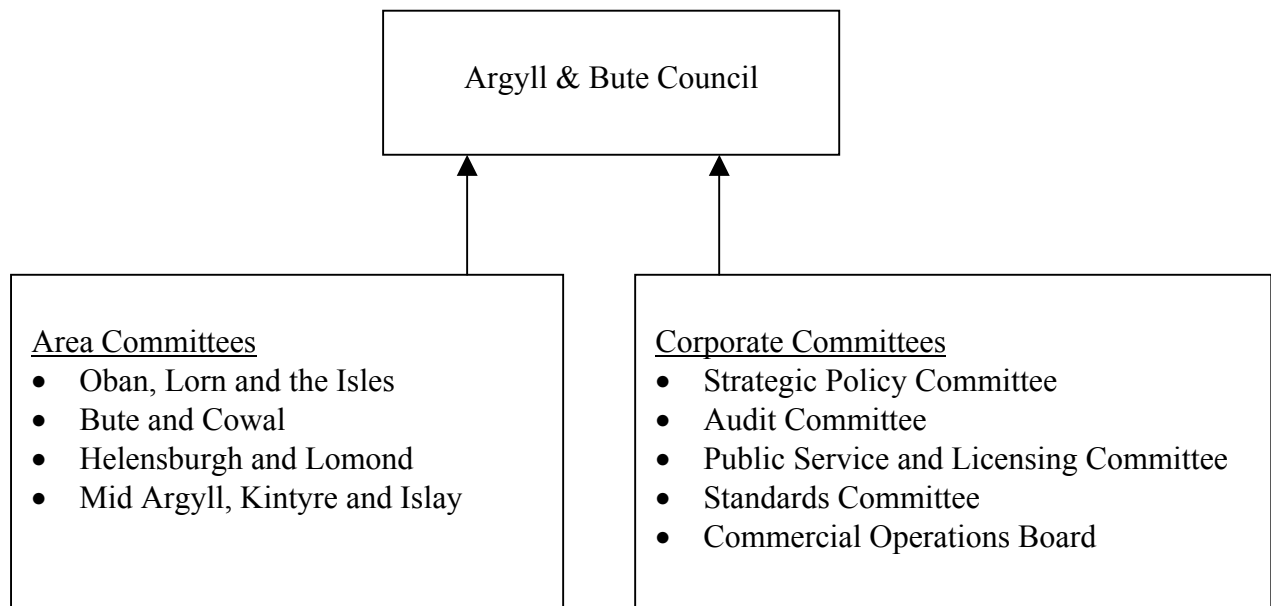
### **Support to members**

- 29 There was variation in the support provided to members. Two local authorities had prepared handbooks specifically explaining the audit role while others had more general procedural guidance. Similarly some ran training or briefing sessions, while others acknowledged that they could do more.

- 30 The nature of the role the audit committee and the matters considered render it essential that an appropriate level of support and training be provided on an ongoing basis. This guidance will form part of the toolkit required by members to discharge their duties as members of an audit committee effectively.

## Appendix 2 – Annex A

### Diagram 1 - Argyll & Bute Council



### Diagram 2 - Orkney Islands Council

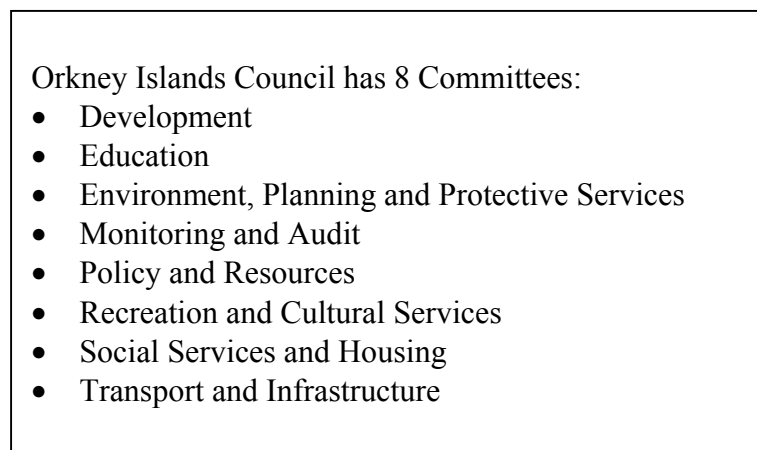


Diagram 3 City of Edinburgh Council

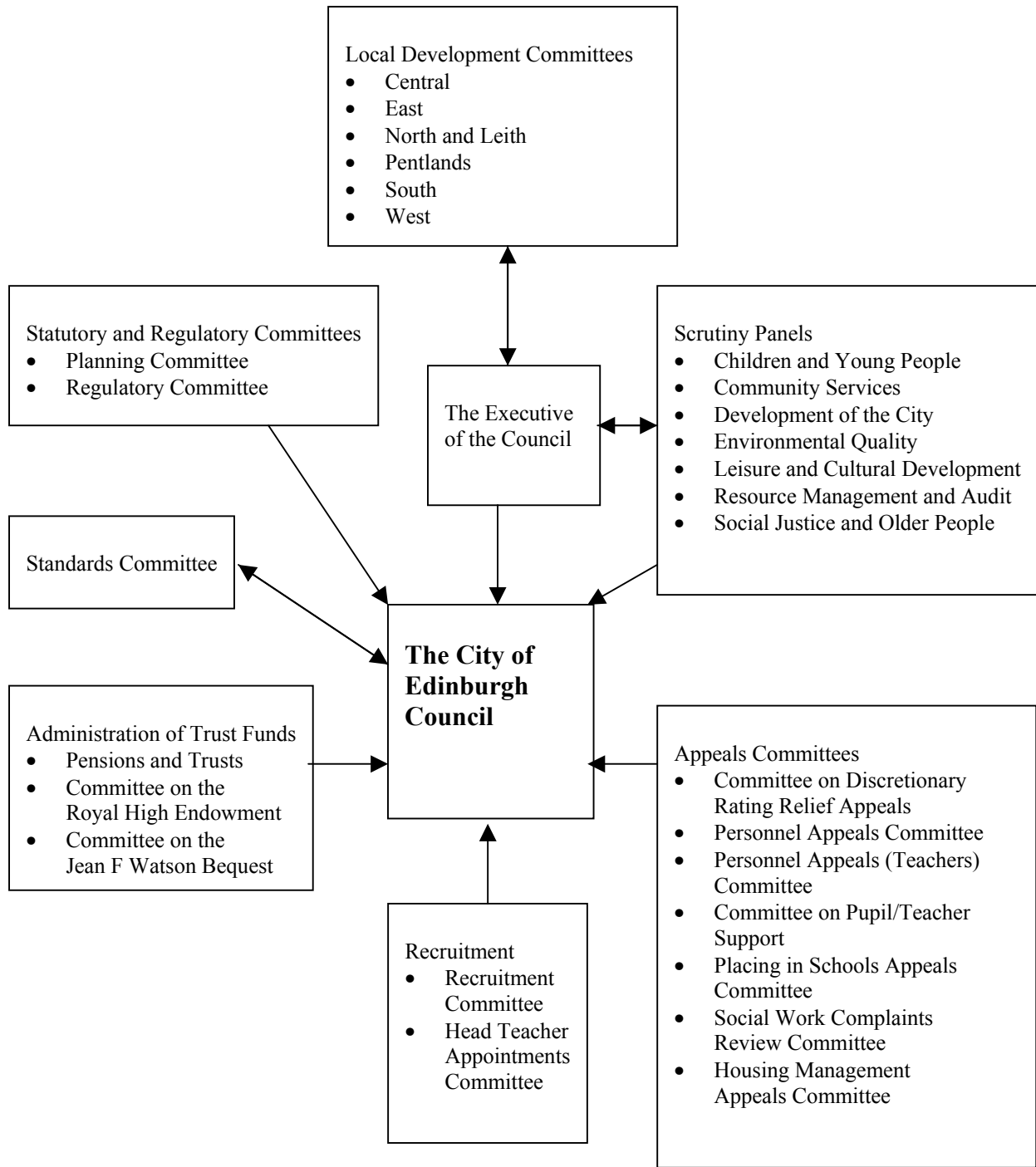
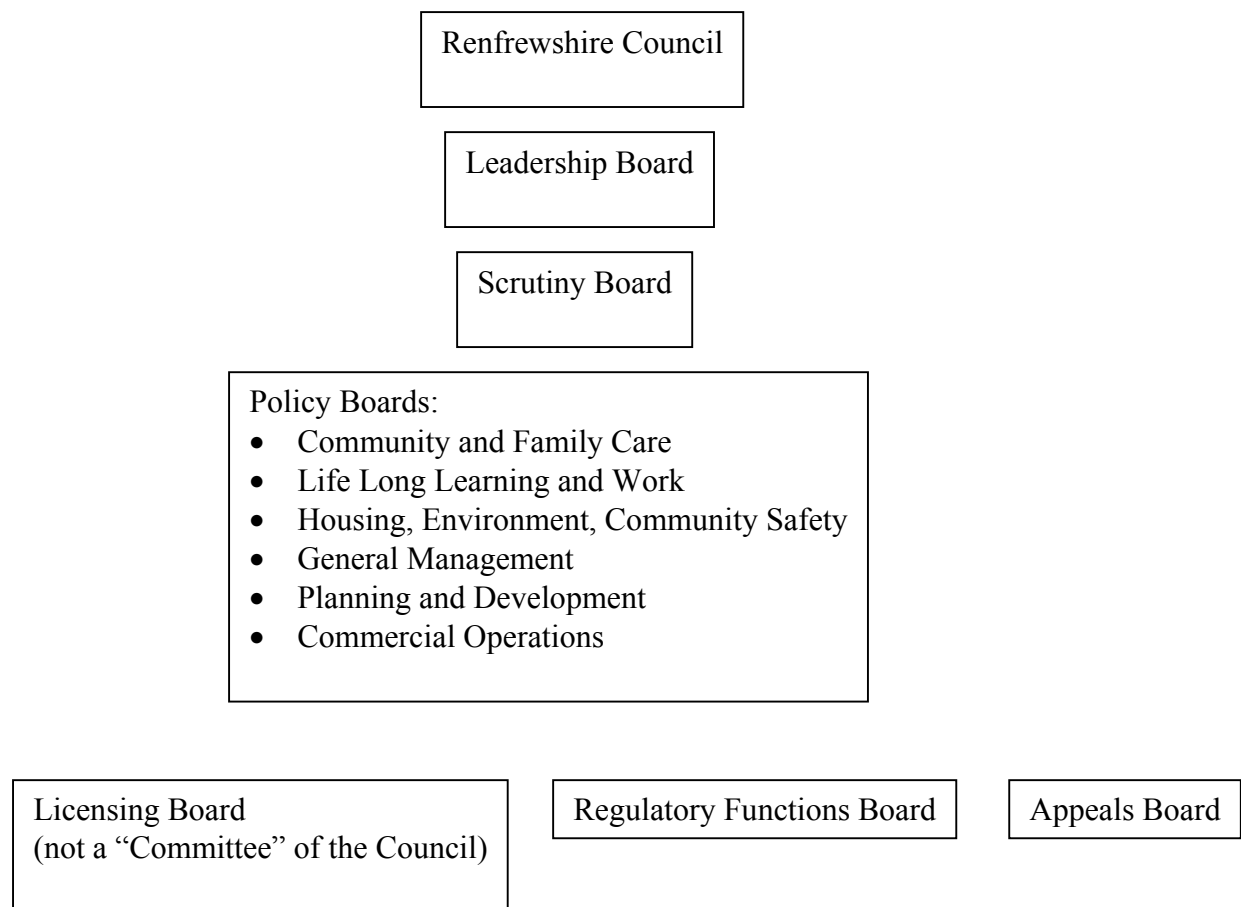




Diagram 4 – Renfrewshire Council



## Appendix 2 – Annex B

### Illustrative Models of Delivery of Audit Committee Principles

	Local Authority 1	Local Authority 2	Local Authority 3	Local Authority 4
Name of member group	Resource Management and Audit Scrutiny Panel	Standards and Audit Committee	Scrutiny Board	Audit Committee
Composition	9 Councillors voted on by Council for one year at a time. Convenor drawn from the opposition and generally stays in place longer	11 Councillors appointed for full term of administration in proportion to make up of Council. At present, Chair is not from largest party. No formal vice-chair.	7 Councillors. Convenor and Vice-Convenor (not same party) appointed by Council, others nominated by parties in (approximate) proportion to make up of Council. Convenor and Vice-Convenor unchanged since Board established 2 years ago but 4 others have changed. Convenor drawn from administration	7 Councillors, appointed by Council for full term of administration. Chair is member of the current political administration.
Place in Council Structure	One of 7 panels established to scrutinise the decisions of the Executive. Panels report to Council. They have no executive role. This panel also receives a report from the Council on the annual accounts and management letter.	Full committee, clerked with minutes kept and reported to full Council	One of 10 Boards supporting Council. A “Leadership Board” also exists to co-ordinate across Policy Boards and it can call in their decisions for review.	Full committee, clerked with minutes kept and reported to full Council.

	<b>Local Authority 1</b>	<b>Local Authority 2</b>	<b>Local Authority 3</b>	<b>Local Authority 4</b>
Place of audit within remit	Only part of remit but clearly distinguished. Panel meets monthly but in Audit mode only quarterly with audit business taken first.	Majority of remit and workload relates to Audit. Meets every 8 weeks, as other committees	Small part of remit. Business usually concerned with Board's annual programme of strategic service reviews. Board has scheduled meetings every 6 weeks but usually meets more often, e.g. to take evidence from other agencies about reviews. Audit items are on agenda as often as necessary, which is at least quarterly.	Exclusively deals with audit related issues currently. Meetings are formal in style, take place 4 times a year.
Attendees	Executive members and associated directors attend by invitation (depending on agenda) Director of Finance always attends when in audit mode. External and internal audit all attend all meetings in audit mode	Chief Executive and Chief Internal Auditor. Head of Finance, or representative. External Audit representatives are Partner and/or Audit.	Service reviews have lead officers and witnesses are called. Chief Internal Auditor (or representative) attends for audit items. External audit attend occasionally.	Chief Executive, Head of Finance, Internal Audit Manager, Chief Legal Officer. representative of External Audit attends regularly
Related officer groups	Chief Executive's audit group meets to discuss audit issues at management level. Pre agenda meeting between key officers including HIA and the panel convenor although it is not the Group that meets the Convenor.	no related officer group	An Audit Panel, chaired by the Chief Executive, considers the more detailed aspects of audit, including follow up of recommendations.	no related officer group



	<b>Local Authority 1</b>	<b>Local Authority 2</b>	<b>Local Authority 3</b>	<b>Local Authority 4</b>
Balance of involvement members/officers	Panel focuses on main issues, action plans and implementation of action plans and they report to Council on follow up and implementation of recommendations. The Panel also considers the annual accounts and the management letter referred by the Council. They do not receive detailed internal audit reports but receive the agreed action plans.	Committee receives external audit reports with service department responses as well as summary of internal audit issues.	Scrutiny Board involvement in audit is high level/strategic, i.e. audit plan and annual audit report. They have no involvement with individual audits and associated recommendations. The Audit Panel fulfils the more detailed aspects of audit committee principles.	Committee is notified of any external audit recommendations agreed to and not implemented and any internal audit recommendations ranked critical agreed to and not implemented. Also approves annual audit plan and receives annual report on plan, takes external audit report and considers one-off issues (e.g. fraud)
Support to members	Audit Awareness sessions for panel members and a handbook describing the audit committee role	Some training, e.g. in roles of external and internal audit, and intending to do more.	Briefing session to Scrutiny panel when first established explained audit roles and responsibilities.	Guidance note prepared, specifically targeted at audit committee members but no specific audit training given.

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