

Committee	Public Accounts Select Committee	item No. 9
Report Title	Report on the Creation of an Audit Committee	
Ward	n/a	
Contributors	Executive Director for Resources	
Class	part 1	date: 21 November 2006

1. Executive Summary

- 1.1 At the Public Accounts Committee on the 25 July 2006 it was agreed that an options paper be prepared on the setting up of an Audit Committee.

2. Recommendations

- 2.1 On balance it is recommended that an independent audit advisor panel be established. Members of the panel should be independent and remunerated to ensure they have the relevant seniority and experience and who can command the respect of members and the local community.

3. Background

- 3.1 At the 25 July 2006 PAC there was a general discussion on PAC's role in relation to the expectations that it carries out some of the functions of an Audit Committee. There has been consideration by CIPFA (Chartered Institute of Public Finance & Accountancy) of the role of Audit Committees in local government generally. CIPFA conclude that good corporate governance requires independent, effective assurance about the adequacy of financial management and reporting. CIPFA also conclude this is best delivered by an audit committee independent from the executive and scrutiny functions.
- 3.2 Effective audit committees help raise the profile of internal control, risk management and financial reporting issues, within an organisation as well as providing a forum for discussion of issues raised by internal and external auditors. CIPFA believes these functions are best delivered by an audit committee separate from executive and scrutiny functions and chaired independently from both of these functions. The Committee must have a clear right of access to full Council and other Council Groups and Committees.
- 3.3 Another consideration is that to achieve level 4 for Use of Resources the Council must adopt this Audit Committee function. Moreover, to achieve level 2 and 3, the Council must be able to demonstrate the core functions of an Audit Committee (as identified in the CIPFA guidance) are being undertaken by members.
- 3.4 This paper sets the debate about how to ensure that matters relating to the general issue of audit and systems of internal control are appropriately dealt with in

authorities. It recognises that there are several different approaches, and that CIPFA guidance suggests that a separate audit committee should be established.

4. CIPFA's Guidance

4.1 CIPFA Guidance states that best practice is to establish audit committees to:

- Consider the effectiveness of risk management, the control environment and associated anti-fraud and anti-corruption arrangements
- Seek assurances that action is being taken on risk related matters identified by auditors and inspectors
- Be satisfied on the Council's assurance arrangements including the Statement of Internal Control
- Approve but not direct the Council's audit strategy
- Receive the annual report of the Council's Head of Internal Audit and inspection agencies
- Ensure that the relationships between internal and external agencies are effective and that the value of the audit process is promoted
- Review the financial statements, external auditors' opinion and reports to members, and monitor management action in response to issues raised by external audit
- and that there should be a separate audit committee to deal with such matters.

5. Current practice

5.1 Whilst to date, Lewisham Council acknowledges the essential nature of such activities, and has made arrangements to make sure that they are treated with the utmost gravity, however, we have not established an audit committee.

5.2 Instead, in Lewisham, arrangements to date have been that the Public Accounts Select Committee has within its terms of reference the monitoring of the Council's annual audit plan and the receipt of reports on the outcome of audits and reviews conducted by the Council's internal and external auditors and/or inspectorates. The purposes set out for audit committees in the CIPFA guidance would broadly fall within the terms of Lewisham's Public Accounts Select Committee in the performance of its function.

5.3 In addition, with an increasing emphasis on risk management and internal control, the Council has established an internal control board to question its practice and examine its management of risk, as well as general financial management, audit issues and corporate governance. The Council has appointed an experienced ex-Chief Executive, Bill Roots, to chair this board. His considerable financial expertise enables him to challenge robustly and to question Council activity in all of the areas which the CIPFA guidance says should fall to the audit committee. The Internal Control Board requires the attendance of all of the Council's management team and

this arrangement ,which has enhanced the Council's focus on audit and risk issues, ought to be developed to give it an even higher and more independent profile.

5.4 The typical workloads and timescales of a body set up for audit matters would include the following work areas:

Annual Accounts

- Review / Approval of Statement of Accounts (June and September)
- Review / Approval of annual Statement of Internal Control (SIC) (June)

External Audit Reports

- Annual Audit & Inspection Plan (March)
- Annual Audit & Inspection Letter (Jan)
- Annual Report on the Accounts (September)

Internal Audit

- Annual Internal Audit Plan (Jan – Mar)
- Quarterly progress reports
- Annual report of Head of Internal Audit (June)

Risk Management

- Quarterly update on implementation of Risk Management strategy
- Half yearly report – review of corporate risks
- Annual report on review of the risk management process

Counter-Fraud

- Half yearly Report

6. Options

6.1 Continue with PAC carrying out functions of an audit Committee

The debate at PAC to date have centred on whether the members of the commitment have the capacity to expand their role and take on the functions of an Audit Committee. The PAC felt that specialist training would be required to allow them to undertake the task and with the current agendas they were unsure that the committee would be able to devote the necessary time to carrying out the function of an audit committee.

6.2 Separate Audit Committee with members drawn from the authority

Officers are of the view that a separate committee would not necessarily be the best way to fulfil the role of an audit committee proposed by CIPFA. First, any committee would need to be drawn from members of the authority, which itself is the body whose arrangements would be under scrutiny. If an Audit Committee is to be challenging and inspire confidence in its impartiality, those carrying out the audit function should be independent of the authority

6.3 Independent audit advisory panel

A small independent audit advisory panel could be appointed, consisting of those with skills appropriate to the role they would perform. The terms of reference of the independent audit advisory panel would include all those matters which CIPFA recommends for Audit Committees, and it would report both to the full Council (in relation to systems of internal control and Council accounts) and to the Executive on matters within its remit (for example our response to the reports of external auditors). The Panel's reports would also be considered by Overview and Scrutiny and the Public Accounts Committee in the course of their general scrutiny function. They would then make recommendations to the Council or to the Executive as appropriate.

The audit advisory panel could report to Public Accounts Select Committee and the Executive Committee on a half yearly basis and report to Council on an annual basis in line with the timetable for report the final accounts.

7. Legal Implications

- 7.1 Under the Local Government Act 2000, there is a split between those issues which are reserved to the Council, (whether by full Council or a committee appointed by the Council), and those matters which are reserved to the executive, in Lewisham's case the directly elected mayor or as delegated by him. The law is reflected in a number of regulations, which allocate functions and responsibilities either to Council or to the Mayor. By definition those matters not allocated elsewhere are an executive responsibility and fall to the Mayor to decide.
- 7.2 By virtue of the Local Authorities (Functions and Responsibilities) (England) (Amendment) Regulations 2001 (SI2001/2212) the function of approving the authority's accounts, income and expenditure and balance sheet, or record of payments and receipts is a Council function. By virtue of Regulation 4 of the Accounts and Audit Regulations 2003, the Council is responsible for ensuring that the financial management of the authority is adequate and effective and that it has a sound system of internal control which facilitates the effective exercise of its functions and includes arrangements for the management of risk.
- 7.3 The 2003 Regulations require the Council at least once a year to conduct a review of the effectiveness of its system of internal control. The results of that review may be considered either by the Council as a whole or by a committee appointed by it. Following that consideration, a statement of internal control is approved and signed by the person presiding.
- 7.4 Under the same Regulations the Council must review the effectiveness of its system of internal audit. The findings of that review form part of the statement of internal control. This therefore is reviewed either by Council or a committee appointed by it.
- 7.5 The Council's statement of accounts having been prepared in accordance with the Regulations must be considered either by the full Council or a committee of it and approved by resolution and signed by the person presiding at that meeting.

- 7.6 The functions specifically referred to in the 2003 Regulations may therefore be delegated by the Council to a Committee though in practice in Lewisham they are fulfilled by the council itself. An audit committee would only be able to operate in respect of functions specifically reserved as a non-executive function as identified in these implications.
- 7.7 It is not compulsory to establish an audit committee under the 2003 regulations, and the functions can be carried out by the Council in full session, though members attention is drawn to the CIPFA guidance.
- 7.8 Currently the terms of reference of the Overview and Scrutiny Public Accounts Select Committee (PAC) includes the following:-
- "To monitor and review the Council's annual audit plan and to receive reports on the outcome of audit and review conducted by the Council's internal and external auditors and/or inspectorates.". By law and by the Council's Constitution the PAC, as other overview and scrutiny committees has its powers limited to the making of recommendations to the Council or Executive, and the overview and scrutiny of decisions and performance. The review of the statement of internal control, the review of internal audit and the signing off of accounts cannot be delegated here. Decisions in relation to those functions, under the present arrangements need to be taken by the full Council as now though it would be entirely appropriate for Council to have regard to the comments of PAC. Any change that might be proposed to the terms of reference of PAC, or in relation to the establishment of an Audit Committee would required formal approval by Council as it would represent a constitutional change".
- 7.9 It would be lawful for the Council to appoint professional advisors in the form of an Advisory Panel to advise it on financial and accounting practice, internal control and internal audit and other more general audit issues, though the Council could not lawfully subjugate its view blindly to that of the Panel. The views of its professional advisors would be a relevant consideration in decisions about such matters.

BACKGROUND PAPERS

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