

**AUDIT COMMITTEE EFFECTIVENESS: PRACTICAL GUIDANCE**

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**1.0 EXECUTIVE SUMMARY**

- 1.1** This is an introduction paper for discussion in relation to CIPFA's guidance on the function and operation of audit committees in local authorities which provides a view of best practice for audit committees in local authorities throughout the UK.
- 1.2** The guidance incorporates CIPFA's 2013 Position Statement: Audit Committees in Local Authorities. This statement sets out CIPFA's view of the role and functions of an audit committee.
- 1.3** The Position Statement emphasises the importance of audit committees being in place in all local authorities. It also recognises that audit committees are a key component of governance. It states:
- The purpose of an audit committee is to provide to those charged with governance<sup>1</sup> independent assurance on the adequacy of the risk management framework, the internal control environment and the integrity of the financial reporting and annual governance processes.*
- 1.4** Attention is drawn to the attached Appendices D & E which are self-assessment tools for an audit committee. Discussion requires to take place with regards to whether a) The audit committee wishes to undertake a self-assessment using these and b) The format and timeline of any such review.
- 1.5** Without prejudging the outcome of any self-assessment utilising appendices D & E, it may be the case that revisions will be then required to the Audit Committee Terms of reference and therefore it would be also appropriate to note detail of Appendix B.
- 1.6** Improving the effectiveness of the Audit Committee is a priority area as discussed at the Audit Committee away day. In order to ascertain a baseline position it would be beneficial if members could complete appendix D on an individual basis and submit their return to the Chief Internal Auditor.

**2.0 Recommendations:**

- 2.1** Discussion document only

## APPENDICES

Appendix B

Appendix D

Appendix E

## APPENDIX B

### Suggested Terms of Reference – Local Authorities

This appendix contains suggested terms of reference for local authorities.

In developing the terms of reference for an organisation, care should be taken to ensure that the specific regulations appropriate for the authority are taken into account.

In addition, where the terms of reference refer to internal audit, regard should be had for how the internal audit charter has allocated responsibilities to the committee. Some of the internal audit responsibilities identified in the terms of reference may not be carried out by the audit committee, but by others.

### **SUGGESTED TERMS OF REFERENCE – LOCAL AUTHORITIES**

#### **Statement of purpose**

Our audit committee is a key component of [name of authority]'s corporate governance. It provides an independent and high-level focus on the audit, assurance and reporting arrangements that underpin good governance and financial standards.

The purpose of our audit committee is to provide independent assurance to the members [or identify others charged with governance in your authority] of the adequacy of the risk management framework and the internal control environment. It provides independent review of [name of authority]'s governance, risk management and control frameworks and oversees the financial reporting and annual governance processes. It oversees internal audit and external audit, helping to ensure efficient and effective assurance arrangements are in place.

#### **Governance, risk and control**

- To review the council's corporate governance arrangements against the good governance framework and consider annual governance reports and assurances.
- To review the Annual Governance Statement prior to approval and consider whether it properly reflects the risk environment and supporting assurances, taking into account internal audit's opinion on the overall adequacy and effectiveness of the council's framework of governance, risk management and control.
- To consider the council's arrangements to secure value for money and review assurances and assessments on the effectiveness of these arrangements.

- To consider the council's framework of assurance and ensure that it adequately addresses the risks and priorities of the council.
- To monitor the effective development and operation of risk management in the council.
- To monitor progress in addressing risk-related issues reported to the committee.
- To consider reports on the effectiveness of internal controls and monitor the implementation of agreed actions.
- To review the assessment of fraud risks and potential harm to the council from fraud and corruption.
- To monitor the counter-fraud strategy, actions and resources.

## **Internal audit**

- To approve the internal audit charter.
- To review proposals made in relation to the appointment of external providers of internal audit services and to make recommendations.
- To approve the risk-based internal audit plan, including internal audit's resource requirements, the approach to using other sources of assurance and any work required to place reliance upon those other sources.
- To approve significant interim changes to the risk-based internal audit plan and resource requirements.
- To make appropriate enquiries of both management and the head of internal audit to determine if there are any inappropriate scope or resource limitations.
- To consider reports from the head of internal audit on internal audit's performance during the year, including the performance of external providers of internal audit services. These will include:
  - a) Updates on the work of internal audit including key findings, issues of concern and action in hand as a result of internal audit work.
  - b) Regular reports on the results of the Quality Assurance and Improvement Programme.
  - c) Reports on instances where the internal audit function does not conform to the Public Sector Internal Audit Standards and Local Government Application Note, considering whether the non-conformance is significant enough that it must be included in the Annual Governance Statement.
- To consider the head of internal audit's annual report:
  - a) The statement of the level of conformance with the Public Sector Internal Audit Standards and Local Government Application Note and the results of the Quality Assurance and Improvement Programme that supports the statement – these will indicate the reliability of the conclusions of internal audit.

- b) The opinion on the overall adequacy and effectiveness of the council's framework of governance, risk management and control together with the summary of the work supporting the opinion – these will assist the committee in reviewing the Annual Governance Statement.
- To consider summaries of specific internal audit reports as requested.
  - To receive reports outlining the action taken where the head of internal audit has concluded that management has accepted a level of risk that may be unacceptable to the authority or there are concerns about progress with the implementation of agreed actions.
  - To contribute to the Quality Assurance and Improvement Programme and in particular, to the external quality assessment of internal audit that takes place at least once every five years.
  - To consider a report on the effectiveness of internal audit to support the Annual Governance Statement, where required to do so by the Accounts and Audit Regulations
  - To support the development of effective communication with the head of internal audit.

### **External audit**

- To consider the external auditor's annual letter, relevant reports, and the report to those charged with governance.
- To consider specific reports as agreed with the external auditor.
- To comment on the scope and depth of external audit work and to ensure it gives value for money.
- To commission work from internal and external audit.
- To advise and recommend on the effectiveness of relationships between external and internal audit and other inspection agencies or relevant bodies.

### **Financial reporting**

- To review the annual statement of accounts. Specifically, to consider whether appropriate accounting policies have been followed and whether there are concerns arising from the financial statements or from the audit that need to be brought to the attention of the council.
- To consider the external auditor's report to those charged with governance on issues arising from the audit of the accounts.

### **Accountability arrangements**

- To report to those charged with governance on the committee's findings, conclusions and recommendations concerning the adequacy and effectiveness of their governance, risk management and internal control frameworks; financial reporting arrangements, and internal and external audit functions.

- To report to full council on a regular basis on the committee's performance in relation to the terms of reference and the effectiveness of the committee in meeting its purpose.

## APPENDIX D

### Self-assessment of Good Practice

This appendix provides a high-level review that incorporates the key principles set out in CIPFA's Position Statement: Audit Committees in Local Authorities and Police and this publication. Where an audit committee has a high degree of performance against the good practice principles then it is an indicator that the committee is soundly based and has in place a knowledgeable membership. These are the essential factors in developing an effective audit committee.

A regular self-assessment can be used to support the planning of the audit committee work programme and training plans. It can also inform an annual report.

|   | Good practice questions   | Yes | Partly | No |
|---|---|-----|--------|----|
| <b>Audit committee purpose and governance</b> |   |     |        |    |
| 1   | Does the authority have a dedicated audit committee?  |     |        |    |
| 2   | Does the audit committee report directly to full council?<br>(Applicable to local government only.)                   |     |        |    |
| 3   | Do the terms of reference clearly set out the purpose of the committee in accordance with CIPFA's Position Statement? |     |        |    |
| 4   | Is the role and purpose of the audit committee understood and accepted across the authority?                          |     |        |    |
| 5   | Does the audit committee provide support to the authority in meeting the requirements of good governance?             |     |        |    |
| 6   | Are the arrangements to hold the committee to account for its performance operating satisfactorily?                   |     |        |    |
| <b>Functions of the committee</b>             |   |     |        |    |
| 7   | Do the committee's terms of reference explicitly address all the core areas identified in CIPFA's Position Statement? |     |        |    |
|   | • Good governance   |     |        |    |
|   | • Assurance framework   |     |        |    |
|   | • Internal audit  |     |        |    |
|   | • External audit  |     |        |    |
|   | • Financial reporting   |     |        |    |
|   | • Risk management   |     |        |    |
|   | • Value for money or best value   |     |        |    |
|   | • Counter fraud and corruption  |     |        |    |
| 8   | Is an annual evaluation undertaken to assess whether the  |     |        |    |

|                                       |  |  |  |  |
|---------------------------------------|--|--|--|--|
|                                       | committee is fulfilling its terms of reference and that adequate consideration has been given to all core areas?   |  |  |  |
| 9                                     | Has the audit committee considered the wider areas identified in CIPFA's Position Statement and whether it would be appropriate for the committee to undertake them? |  |  |  |
| 10                                    | Where coverage of core areas has been found to be limited, are plans in place to address this?   |  |  |  |
| 11                                    | Has the committee maintained its non-advisory role by not taking on any decision-making powers that are not in line with its core purpose?                           |  |  |  |
| <b>Membership and support</b>         |  |  |  |  |
| 12                                    | Has an effective audit committee structure and composition of the committee been selected?<br>This should include:   |  |  |  |
|                                       | <ul style="list-style-type: none"> <li>• Separation from the executive</li> </ul>  |  |  |  |
|                                       | <ul style="list-style-type: none"> <li>• An appropriate mix of knowledge and skills among the membership</li> </ul>  |  |  |  |
|                                       | <ul style="list-style-type: none"> <li>• A size of committee that is not unwieldy</li> </ul>   |  |  |  |
|                                       | <ul style="list-style-type: none"> <li>• Where independent members are used, that they have been appointed using an appropriate process.</li> </ul>                  |  |  |  |
| 13                                    | Does the chair of the committee have appropriate knowledge and skills?   |  |  |  |
| 14                                    | Are arrangements in place to support the committee with briefings and training?  |  |  |  |
| 15                                    | Has the membership of the committee been assessed against the core knowledge and skills framework and found to be satisfactory?                                      |  |  |  |
| 16                                    | Does the committee have good working relations with key people and organisations, including external audit, internal audit and the chief financial officer?          |  |  |  |
| 17                                    | Is adequate secretariat and administrative support to the committee provided?  |  |  |  |
| <b>Effectiveness of the committee</b> |  |  |  |  |
| 18                                    | Has the committee obtained feedback on its performance from those interacting with the committee or relying on its work?   |  |  |  |
| 19                                    | Has the committee evaluated whether and how it is adding value to the organisation?  |  |  |  |
| 20                                    | Does the committee have an action plan to improve any areas of weakness?   |  |  |  |

## APPENDIX E

### Evaluating the Effectiveness of the Audit Committee

#### Assessment key

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



| Areas where the audit committee can add value by supporting improvement  | Examples of how the audit committee can add value and provide evidence of effectiveness   | Self-evaluation, examples, areas of strength and weakness | Overall assessment:<br>5 – 1<br>See key above |
|--|---|---|---|
| Promoting the principles of good governance and their application to decision making   | <p>Providing robust review of the AGS and the assurances underpinning it.</p> <p>Working with key members/governors to improve their understanding of the AGS and their contribution to it.</p> <p>Supporting reviews/audits of governance arrangements.</p> <p>Participating in self-assessments of governance arrangements.</p> <p>Working with partner audit committees to review governance arrangements in partnerships.</p> |   |   |
| Contributing to the development of an effective control environment.   | <p>Monitoring the implementation of recommendations from auditors.</p> <p>Encouraging ownership of the internal control framework by appropriate managers.</p> <p>Raising significant concerns over controls with appropriate senior managers.</p>  |   |   |
| Supporting the establishment of arrangements for the governance of risk and for effective arrangements to manage risks.        | <p>Reviewing risk management arrangements and their effectiveness, e.g. risk management benchmarking.</p> <p>Monitoring improvements.</p> <p>Holding risk owners to account for major/strategic risks.</p>  |   |   |
| Advising on the adequacy of the assurance framework and considering whether assurance is deployed efficiently and effectively. | <p>Specifying its assurance needs, identifying gaps or overlaps in assurance.</p> <p>Seeking to streamline assurance gathering and reporting.</p> <p>Reviewing the effectiveness of assurance providers, e.g. internal audit, risk management, external audit.</p>  |   |   |

| Areas where the audit committee can add value by supporting improvement  | Examples of how the audit committee can add value and provide evidence of effectiveness   | Self-evaluation, examples, areas of strength and weakness | Overall assessment:<br>5 – 1<br>See key above |
|--|---|---|---|
| Supporting the quality of the internal audit activity, particularly by underpinning its organisational independence.                                       | Reviewing the audit charter and functional reporting arrangements. Assessing the effectiveness of internal audit arrangements and supporting improvements.  |   |   |
| Aiding the achievement of the authority's goals and objectives through helping to ensure appropriate governance, risk, control and assurance arrangements. | Reviewing major projects and programmes to ensure that governance and assurance arrangements are in place. Reviewing the effectiveness of performance management arrangements.  |   |   |
| Supporting the development of robust arrangements for ensuring value for money.  | Ensuring that assurance on value for money arrangements is included in the assurances received by the audit committee. Considering how performance in value for money is evaluated as part of the AGS.  |   |   |
| Helping the authority to implement the values of good governance, including effective arrangements for countering fraud and corruption risks.              | Reviewing arrangements against the standards set out in CIPFA's <i>Managing the Risk of Fraud</i> (Red Book 2). Reviewing fraud risks and the effectiveness of the organisation's strategy to address those risks. Assessing the effectiveness of ethical governance arrangements for both staff and governors. |   |   |
| Promoting effective public reporting to the authority's stakeholders and local community and measures to improve transparency and accountability.          | Improving how the authority discharges its responsibilities for public reporting; for example, better targeting at the audience, plain English. Reviewing whether decision making through partnership organisations remains transparent and publicly accessible and encouraging greater transparency.           |   |   |



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[Enter name of Committee here –  
Audit, Council, Communities etc.]

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## **2.0 RECOMMENDATIONS**

3.1

3.2

## **5.0 CONCLUSION**

5.1

5.2

## **6.0 IMPLICATIONS**

6.1 Policy

6.2 Financial

6.3 Legal

6.4 HR

6.5 Equalities

6.6 Risk

6.7 Customer Service

**For further information contact:** Kevin Anderson, Internal Audit, 01369 708505

## **APPENDICES**

Appendix B

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