

LONDON BOROUGH OF HARROW

Meeting:	Overview and Scrutiny Committee
Date:	1 July 2004
Subject:	Establishment of an Audit Committee
Key decision:	No
Responsible Chief Officer:	Executive Director – Business Connections
Relevant Portfolio Holder:	Finance and Human Resources and Performance Management
Status:	Part 1
Ward:	All
Enclosures:	Appendix 1: Overview and Scrutiny Terms of Reference

1. **Summary/ Reason for urgency (if applicable)**

- 1.1 This report sets out the reasons for establishing an Audit Committee. The report covers the principles behind an Audit Committee, possible terms of reference, and options for the structure.

2. **Recommendations**

That the Overview and Scrutiny Committee

- i) Recommends to Council that the terms of reference of the Overview and Scrutiny Committee are amended to incorporate the terms of reference set out in the body of the report at Paragraph 5.5**
- ii) Considers establishing an Audit Committee as a sub committee of the Overview and Scrutiny Committee with the terms of reference set out in the body of the report at paragraph 5.5**

REASON: To improve the Council's corporate governance arrangements.

3. **Policy Context (including Relevant Previous Decisions)**

- 3.1 The Council's external auditors, Deloitte and Touche recommended in their 2002-2003 Annual Audit Letter that the council give consideration to the setting up of an Audit Committee.
- 3.2 Overview and scrutiny Committee on 2nd March 2004 requested that a report be submitted to the next meeting on proposals for such a committee.

4. **Relevance to Corporate Priorities**

- 4.1 The Council must have effective corporate governance arrangements in place to support the delivery of services.
- 4.2 Corporate Governance is the framework of accountability to users, stakeholders and the wider community within which organisations take decisions and lead and control their functions and achieve their objectives. In the guidance for local authorities issued by SOLACE/CIPFA there are five dimensions to corporate governance:
- Community focus
 - Service delivery arrangements
 - Structures and processes
 - Risk management and internal control
 - Standards of conduct
- 4.3 Corporate governance is very wide ranging and covers engagement with the public and other stakeholders as well as internal controls and procedures.
- 4.4 An Audit Committee, alongside the existing Standards Committee, would have an important role to play in monitoring the Council's governance arrangements and promoting good practice.

5. **Background Information and options considered**

Principles of an Audit Committee

- 5.1 The CIPFA Code of Practice for Internal Audit (2003) includes a section on Audit Committees - it states that the main objective of an audit committee is to independently contribute to the organisation's overall process for ensuring that an effective internal control environment is maintained. With the requirement to make wider statements of internal control, audit committees are required to look beyond financial control matters such as safeguarding of assets, accounting and financial information, and instead provide assurance on the wider arrangements relating to all internal control activities.
- 5.2 Within the public sector Audit committees are specifically precluded from having an Executive role. This is set out in the Treasury's Audit Committee Handbook (October 2003) for all government departments and Executive Agencies but is applicable to other public sector bodies. It also accords with the recommendations made in the Sharman Report and those of the Higgs and Smith reports. This is further exemplified in the Learning and Skills Council's (DfES) Guidance on the Internal Audit Code of Practice in its relationship with Further Education colleges and Sixth forms. This is in contrast to the private sector, where an Audit Committee has a role, through the board, on behalf of shareholders.

- 5.3 In the council responsibility for effective governance, including management of Internal Audit, financial regulations, financial reporting, risk management, and so on lies with the Executive. An audit committee would provide
- Independent assurance of the adequacy of the risk management framework and the associated internal 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
 - Assurance that any issue arising from the process of drawing up, auditing and certifying the authority's annual accounts is properly dealt with

Terms of Reference of an Audit committee

- 5.4 The existing terms of reference (T of R) for the Overview and Scrutiny Committee are attached at appendix A.
- 5.5 In line with the principles outlined above, proposed terms of reference for an audit committee are set out below:
- To monitor the adequacy and effectiveness of the authority's corporate governance arrangements (except areas that are the responsibility of the Standards Committee) including systems of internal control and its arrangements for risk management and make recommendations for change as appropriate (*to replace existing T of R, f*)
 - To seek assurance that value for money is being achieved by the Council
 - To approve the financial statements of the authority including the new Statement of Internal Control
 - To consider matters arising from External Audit work which are required to be communicated to those charged with governance under the Statement of Auditing Standards (SAS610)
 - To receive and consider the annual audit letter and make recommendations as appropriate (*to replace existing T of R, k*)
 - To scrutinise/comment on the Internal Audit three year strategic plan and annual plan (*to replace existing T of R, l*)
 - To monitor progress against the Internal Audit plan and receive summaries of audit work completed and key recommendations (*to replace existing T of R, l*)
 - To scrutinise/comment on the External Audit plan
 - To monitor progress against the External Audit plan and receive summaries of audit work completed and key recommendations
 - To review the management response to audit recommendations and progress on implementation of recommendations
 - To recommend action where audit recommendations are not being implemented
 - To monitor the Council's approach to tackling fraud and corruption and promote an anti-fraud culture
- 5.6 The Audit Committee's work on corporate governance would complement the work of the Standards Committee. Responsibility for the Members' Code of Conduct, the Protocol on Councillor/Officer relations and the Officers Code of Conduct would remain with the Standards Committee. In addition the Standards Committee has oversight of the Council's whistleblowing policy.

5.7 The Account and Audit Regulations 2003 require the publication of a Statement of Internal Control with the financial statements from 2003/04 onwards. The statement should represent the end result of a review of internal control and risk management, and include a description of the internal control environment, the review process, and any significant issues. The body approving the statement should seek to satisfy itself that it has obtained sufficient, relevant and reliable evidence to support the disclosures made. Following approval the statement is signed by the Chief Executive and the Leader of the Council.

Structure, Membership and Attendance

5.8 There are three options for establishing a formal audit committee

- i) Expand the terms of reference of the Overview and Scrutiny Committee to include the role of an audit committee, and ensure that part of each meeting is set aside for audit committee business
- ii) Establish a sub committee of Overview and Scrutiny to deal with audit committee business
- iii) Establish a new committee

5.9 Option 3 is not recommended as the role of an audit committee is entirely consistent with the role of the existing overview and scrutiny committee. The establishment of a new committee would inevitably result in the terms of reference of Overview and Scrutiny being curtailed. Items f, k, and l in the existing terms of reference would have to be transferred to the new committee.

5.10 Overview and Scrutiny secured additional resources this year to support its work on the assumption that it would be taking on the role of an Audit Committee. The intention was to second a member of staff from Internal Audit to the scrutiny team and for this resource to assist particularly with the functions of the Audit Committee. If a new committee is created outside Overview and Scrutiny, then this resource should be redirected towards the new committee.

5.11 The Audit Committee function should not sit with the executive. Under the Accounts and Audit Regulations 2003 “the statement of accounts shall be approved by a resolution of a committee of the relevant body or otherwise by a resolution of the members of the body meeting as a whole” and under the Local Authorities (Functions and Responsibilities) (England) (Amendment) Regulations 2001 approval of the accounts is a function that must not be undertaken by the Executive. Therefore, assuming that the Audit Committee undertakes this function, it cannot be part of the Executive.

5.12 An ad hoc committee is being established to receive the Council’s draft accounts for 2003/04. However, under the proposed terms of reference, in future responsibility for approving the accounts would be delegated to the Audit Committee.

5.13 The views of Members are sought on options 1 and 2 in paragraph 5.8. A sub committee would have the advantage that it would be easier to convene a special meeting if required. In addition members of a sub committee can be drawn from the wider pool of non-executive members and do not have to sit on Overview and Scrutiny Committee to qualify. This pool would not include assistant portfolio holders.

5.14 As explained above the audit committee will have a fairly wide ranging remit which extends beyond financial matters. Therefore the Members should ideally be drawn from

a range of disciplines. Training on Audit Committee matters will be built into the Member development programme.

5.15 The Audit Committee meetings should be attended by the Chief Internal Auditor and, as required, the External Auditor, and other officers.

6. Consultation

6.1 None required.

7. Finance Observations

7.1 The remit of an Audit Committee would cover both financial and non-financial matters.

8. Legal Observations

8.1 The report proposes the Council giving the Committee specific functions beyond overview and scrutiny. When the Constitution was adopted, specific functions which are or cannot be Cabinet/Executive functions (other than development control and Standards) were allocated to General Purposes & Licensing Committee and, if agreed, this would be a change from that "division of responsibilities.

9. Conclusion

9.1 Members are asked to consider establishing an Audit Committee, either by expanding the remit of Overview and Scrutiny or by establishing a Sub Committee of Overview and Scrutiny.

10. Background Papers

10.1 NONE

11. Author

11.1 Myfanwy Barrett, Director of Financial and Business Strategy. (020 8420 9252)

Overview and Scrutiny Committee

Terms of Reference

The overview and scrutiny committee has the following power and duties:

- a) to co-ordinate and manage the scrutiny function for the Council
- b) to develop a work programme for scrutiny in consultation with the Executive
- c) to develop and oversee protocols for reviews and referrals
- d) to have specific responsibility for policy development support and scrutiny of the civic budget, statutory plans as appropriate and major cross-cutting issues
- e) to examine the council's performance generally, using information from Best Value implementation plans, Best Value Performance Indicators, the comprehensive performance assessment, and other performance management frameworks
- f) to examine the Council's corporate governance framework and make recommendations for change as appropriate
- g) to be responsible for the use of allocated resources for scrutiny to support its functions
- h) to establish such sub-committees as it considers necessary to achieve effective scrutiny of the Executive and senior officers of the Council
- i) to review, make reports and make recommendations to the Council and/or the Executive in respect of any Council functions
- j) to consider, report and make recommendations on any matter affecting the area and/or those who live, work or travel through Harrow
- k) to receive and consider the Audit Management Letter and make recommendations as appropriate
- l) to receive and consider the Annual Plan and the Annual Report of the Chief Internal Auditor and make recommendations as appropriate
- m) to report to the Council annually on the work of the scrutiny function
- n) to conclude reviews promptly, normally within six months