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# AUDIT COMMITTEE PRINCIPLES IN LOCAL AUTHORITIES IN SCOTLAND

A GUIDANCE NOTE



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## MINISTERIAL FOREWORD



I welcome this guidance which highlights the case for applying audit committee principles to reinforce corporate governance practices in Scottish local government.

Good corporate governance practice, including the independent assurance of both financial and non-financial performance, will increase the public's confidence that local authorities are complying with their statutory duties, have adequate controls and risk management systems in place and are working to secure best value.

I hope that all Scottish local authorities will find this guidance useful in their efforts to achieve continuous improvement in their performance.

Andy Kerr MSP  
Minister for Finance & Public Services

## FOREWORD AND ACKNOWLEDGEMENTS



I have great pleasure in introducing this guidance on audit committee principles in local authorities in Scotland. Audit committee principles are a key component of corporate governance and the CIPFA Directors of Finance Section continue to lead this agenda in Scotland by the publication of this guidance note. Notably, audit committee principles are defined for the first time and formed the core for development of the principles in Scotland.

The guidance was the subject of consultation with all key stakeholders in Scotland. All comments were carefully considered and many directly influenced the final product. I would like to express my thanks to all those who made a contribution.

The development work on the guidance included a practical examination of the operation of audit committee principles in local authorities in Scotland. I would like to thank my colleagues in the following authorities who readily agreed to participate in the development of this guidance:

Donald McGougan, City of Edinburgh Council;  
Bill Hughes, Renfrewshire Council;  
Brian Lawrie, Fife Council; and  
Alan Logan, West Lothian Council.

The guidance was produced in partnership with the CIPFA in Scotland Professional & Technical Task Team and I would therefore like to thank the team members for their efforts in drafting the guidance:

Lynn Bradley; Paula Gilder; Gordon Ferrier; and Don Peebles.

In conclusion I would commend this guidance to local authorities in Scotland and would anticipate that it will become the key tool in the delivery of audit committee principles in Scottish local authorities.

Gordon Edwards MA CPFA  
Corporate Director of Finance & ICT  
Aberdeen City Council  
& Chair, CIPFA Directors of Finance Section

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## 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 since, although the principles apply equally to all sizes of local authority and also to bodies such as joint boards, how they are applied will depend on many factors including the decision making structure and make up of the authority and its size.
- 1.2 Many local authorities are in the process of implementing audit committee principles or refining the way in which they seek to achieve them. The purpose of the document is to assist in this process by providing clear workable guidance on established features of good practice
- Terminology**
- 1.3 The term “audit committee” is used throughout the guidance note to mean that part, or those parts, of the member structure of a local authority that contribute to the delivery of audit committee principles. In practice, it is recognised that authorities may have different names for such structures.
- 1.4 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**
- 1.5 In preparing the guidance, consultation was held with key stakeholders and the guidance was considered and welcomed by both the CIPFA Audit Panel and Audit Scotland.
- 1.6 The guidance in this document is based on identified good practice and available reference material and is commended by the CIPFA Directors of Finance Section as good practice.

## AUDIT COMMITTEE PRINCIPLES

- The Principles**
- 2.1 There are three fundamental principles which define the expression “audit committee principles” and these 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**
- 2.2 Often there is an audit committee at the heart of the structure in place to give effect to these mechanisms and to monitor their effectiveness. A clear view was expressed in the McIntosh report that such committees should be established.
- 2.3 Although this guidance is intended to deal with the application of audit committee principles and makes no assumption that authorities will have a single audit committee, the guidance is clear that the creation of an audit committee (or equivalent) to give effect to the implementation of audit committee principles is good practice.

## DELIVERING AUDIT COMMITTEE PRINCIPLES

- Introduction**
- 3.1 This chapter describes a broad model for the practical delivery of audit committee principles and includes;
- a proposed remit for an audit committee at Chapter 5; and
  - a self-assessment matrix identifying the key features which demonstrate adherence to audit committee principles at Chapter 6.
- 3.2 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.” The effectiveness of an audit committee is greatly enhanced by the status and accountability that accrue if it is formally constituted within the decision making structure of a local authority.
- 3.3 Audit committee principles can only be achieved if there is (one or more) formal group(s) of elected members specifically charged with ensuring that the mechanisms exist to deliver them and that they are effective.
- Governance and Business Management Arrangements**
- 3.4 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.
- 3.5 Audit committee principles would be supported by a process which results in the strategy and plans of the HIA being formally presented to the audit committee. The role of the audit committee is not to challenge the professional independence of internal audit but to ensure that proper practice is followed in determining the strategy and the plans.
- 3.6 As part of his/her duties the Chair of the audit committee should be prepared to encourage open discussion at meetings and should not seek to restrict debate. Discussion and challenge should be apolitical and the chosen chair should have the personal qualities necessary to achieve this.
- 3.7 The committee may function more effectively with a small membership to enable efficient discharge of the committee’s 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 an additional view where there is a balanced discussion. Membership should include at least as many members drawn from outwith the administration as the political balance would suggest. Consequently, a minimum membership of four elected members (including the chair) should be considered. It is acknowledged however, that local requirements may also influence the size and composition of the committee

- 3.8 Within the terms of this guidance, it is for each Council to decide the relationship and breadth of the committee's membership and operations, however, independent thinking should be a key and demonstrable feature of the audit committee.
- 3.9 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. In any case training and support should be provided to assist members to discharge their duties, and expert advice can be sought if required.
- 3.10 The frequency of committee meetings will be prescribed within the council's committee and planning cycle. Over the course of the year a typical cycle of meetings will consider ongoing audit and regulatory matters in addition to annual matters for example, the presentation of the Internal Audit Plan in February/March and consideration of the External Auditor's Annual Report to Members in December.
- 3.11 Although committees of the Council are by law open to the public, there will be matters which will require to be heard in private because they deal with either exempt or confidential information, both of which are defined in legislation. Regard should however be had to the principle of openness and inclusivity.
- 3.12 As well as the members of the committee other people may be invited to attend, for example;
  - other elected members;
  - officers including the CFO and HIA; and
  - external auditor.

3.13 The papers for an audit committee may be technical in detail. Consequently, agenda papers should be submitted in good time to enable all members and officers to review them properly and to determine who should be invited to attend the meeting.

3.14 The governance arrangements of the committee should determine the level of detail to be provided to members. In the interests of operational efficiency the audit committee may be provided 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, and the action taken to address these. When the HIA's annual report is received there should be no significant issues raised in that report which have not already been brought to the attention of the audit committee during the year.

**Principle 1: The Control Environment**

3.15 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.**

3.16 The control environment is the background against which all other controls are operated. Internal control includes all the council policies and procedures which seek to ensure the orderly conduct of business, the safeguarding of assets, and the timely production of accurate and complete financial information.

3.17 Consideration of internal control by the committee will be concerned with how risk is assessed and managed within the council. Generally, risk will be present where there is any factor which could preclude the achievement of the objectives of the council.

3.18 The committee will wish to seek assurance from the HIA that appropriate risk assessment has been carried out as part of the preparation of the internal audit plans when they are presented. The committee will monitor progress against the plans and the HIA will therefore need to report on progress against the plan on a regular basis.

- 3.19 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/or internal audit resources have been diverted to non-audit assignments outwith the internal audit plan.
- 3.20 Consideration of the control environment also extends to monitoring the implementation of recommendations made as a result of the audits carried out. The committee will require sufficient information to enable it to ensure that agreed improvement actions are being implemented. This will include actions arising not only from audit reports but also from the reports of other external inspection agencies.
- 3.21 The HIA should, at least on an annual basis, provide the committee and CFO with a formal annual statement which gives assurance on the effectiveness, or otherwise, of internal controls. This should be consistent with the matters raised at the committee during the course of the year. The HIA's statement should inform the council's statement on the system of internal financial control (or, if relevant the statement on internal controls or corporate governance) within the statement of accounts. The statement on the system of internal financial control is a requirement of the Code of Practice on Local Authority Accounting in the United Kingdom.

**Principle 2: Risk Related Performance**

- 3.22 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.**
- 3.23 Risk may be found in aspects of both financial and non financial performance. It is essential therefore that not only is there a robust risk assessment process incorporated within the governance of an authority but that this is used to inform the audit planning process.
- 3.24 Risk related performance issues often emerge from internal or external audit reports or in reports from other inspection processes. The committee's role in reviewing the main issues arising from these and their resolution, as discussed above, will therefore also serve to help it deliver this principle.

**Principle 3: Annual Accounts and the External Auditor**

3.25 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.

3.26 The process of compilation, auditing and certifying the annual statement of accounts is a statutory process. For this reason it is considered that the annual report to members and any other significant reports referred to in the annual report from the external auditor should be submitted for consideration by the audit committee. The committee should thereafter oversee the implementation of any action plan agreed between council officers and the external auditor.

3.27 The external auditor will also prepare long term and annual audit plans. Although there is no role for the committee in approving these plans, the committee should be provided with sight of the plans. The work of the external auditor is directed by the Accounts Commission's Code of Audit Practice which 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.

3.28 Because of the statutory basis for the work of the external auditor, it is considered that the audit planning memorandum should be placed before the audit committee. Thereafter, reports judged to include matters of significant interest should be submitted to the committee. Instances where recommendations have not been implemented will be of interest to committee.

**Supporting Tasks**

3.29 There are other conditions which may directly support the achievement of audit committee principles, and these include:

- The existence of strong and effective working relationships between and amongst internal audit, external audit and the various inspection agencies. This is evidenced by the degree of formal reliance placed by external audit on the work of internal audit, and by the consideration of the planned external audit or other inspection agency work in formulating the internal audit plan;

- An audit process whose value is understood by the authority and its managers. It should be one of the roles of the audit committee to seek evidence that the role of audit is understood and respected by managers and staff and actively promoted; and
- Mechanisms to ensure the initial and continuing training and development of those charged with the responsibility of implementing audit committee principles.

## ROLES AND RESPONSIBILITIES

- Introduction** 4.1 This chapter describes the roles and responsibilities of those involved in implementing audit committee principles. These are:
- Elected members;
  - Members of the Audit Committee;
  - CFO;
  - Chief Officers and Chief Executive;
  - HIA; and
  - External Auditor.
- Elected Members** 4.2 Elected Members are responsible for setting the strategic 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 The reassurance that officers are discharging their duties in line with council policy and direction, and that the authority is complying with the law and relevant standards as well as with standards of corporate governance is provided by the policies, structures and management arrangements in place throughout the council. It is also provided by the existence of effective scrutiny mechanisms in relation to both management action and members' decisions.
- 4.4 All elected members have a role to play in ensuring the good corporate governance of the authority. Good practice requires the establishment of an audit committee of some form as a central focus for effective scrutiny.
- Members of the Audit Committee** 4.5 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 appropriate decisions and 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 remitted decisions on their behalf.

4.6 In view of the different skill set required, it will 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.

4.7 The audit committee will play a key role in the corporate governance of a local authority. There will therefore be a responsibility upon the local authority overall to ensure that the status of the committee attracts the appropriate membership.

**The Chief Finance Officer**

4.8 It is appropriate to identify the distinction between the management responsibility of the 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. 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 arrange appropriate representation at the audit committee when audit issues are being discussed, and at other meetings at the request of committee members.

**Chief Officers and Chief Executive**

4.9 Chief Officers are accountable to members for the running of their departments and therefore for addressing the findings of audit reports. In addition, they will be responsible for signing off the action plans for audit recommendations and as such may be invited to the audit committee to discuss any audit matters relating to their areas of control.

4.10 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.

- Head of Internal Audit**
- 4.11 Internal Audit is one of the principal ways in which the Council (members and managers) gains assurance that its policies are being observed and risks are being properly managed.
- 4.12 The HIA should attend every audit committee meeting at which audit business is being discussed. The Code of Practice for Internal Audit in Local Government in the United Kingdom sets out matters which the HIA should bring to the attention of the audit committee and these are as follows:
- 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 HIA'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.
- 4.13 Internal Audit should have a right of access to the chair of the audit committee at all times. This is essential to maintain the integrity of the internal audit function.
- External Auditor**
- 4.14 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 relevant matters relating to the audit of the financial statements to those charged with governance.
- 4.15 They are also required to communicate on a sufficiently prompt basis to enable those charged with governance to take appropriate action.

- 4.16 The Accounts Commission's Code of Audit Practice requires auditors to provide an opinion on a local authority's annual statement of 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.
- 4.17 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.

## AUDIT COMMITTEE REMIT

- Introduction**
- 5.1 It was a stated objective of this document that guidance should be descriptive and not prescriptive. It is appropriate and consistent with the aim of provision of guidance of a practical nature that an audit committee remit should be incorporated. Clearly, it will be a matter for individual local authorities to determine the extent to which the proposed remit is adopted or adapted.
- 5.2 The remit is provided in a format to enable local authorities readily to assess both their audit committee's existing remit and to assess any area where enhancement could be made.

**Audit Committee Remit** COMMITTEE GOVERNANCE AND BUSINESS MANAGEMENT ARRANGEMENTS  
Remit should address:

- Number of members required to be quorate
- Basis of selection of chair
- Required expertise for committee membership
- Minimum period in which agenda papers should be issued
- Circulation of minutes to other committees/full council
- Frequency of meetings
- Extent of detail of audit/inspection reports to be circulated
- Attendance at meetings by external auditor
- Reporting arrangements to full council

**ROLE / REMIT: INTERNAL AUDIT**

Remit should address:

- Consideration and ongoing monitoring of the operational and strategic audit plans
- Access of HIA to Chair
- Agreement of internal audit plans and ensuring that internal audit work is planned with due regard to risk, materiality and coverage
- Review of internal audit performance
- Monitoring and review of actions taken on audit recommendations

continued overleaf/

**ROLE / REMIT: EXTERNAL AUDIT**

Remit should address:

- Review of external audit planning memorandum
- Arrangements for ensuring effective liaison between external and internal audit
- Review of all matters relating to external audit, including audit planning, action points and reports
- Nature of monitoring the implementation of external audit recommendations

**ROLE / REMIT: RISK MANAGEMENT**

Remit should address:

- Ensuring that an appropriate corporate risk management strategy has been drawn up
- Ensuring that risk management procedures are satisfactorily carried out

**ROLE / REMIT: ANNUAL STATEMENT OF ACCOUNTS**

Remit should address:

- Role of the Committee in the final accounts process- Review of the audit certificate/wording and any matters reported
- Review of the annual report to members from the external auditor
- Reviewing the implementation of audit recommendations arising
- Ensuring that issues raised in previous financial years have been addressed

**ROLE / REMIT: CORPORATE GOVERNANCE FRAMEWORK**

Remit should address:

- Ensuring systematic appraisal of the Council's control environment and framework of internal control to provide reasonable assurance of effective and efficient operations
- Ensuring that the highest standards of probity and public accountability are demonstrated
- Review of external reports and assessments
- consideration by committee of programme of areas for scrutiny

# AUDIT COMMITTEE PRINCIPLES MATRIX

## AUDIT COMMITTEE PRINCIPLES MATRIX

- 6.1 The purpose of the matrix is to summarise in tabular form the guidance in this document thus providing 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. The matrix firstly addresses administrative features. It then addresses each of the three principles in turn to consider in terms of good practice what needs to be in place to demonstrate adherence to that principle.

Administration	Good Practice	Para Ref
<i>An audit committee which demonstrates by the way that it is structured and organised that it is effective</i>	A formally constituted committee, reporting directly to council and generally meeting in public	3.2, 3.11
	Adherence to clear terms of reference	3.4
	Membership which generally includes at least as many members drawn from outwith the administration as the political balance would suggest	3.7
	Effective training and development for all involved in the process	3.9
	Agenda papers submitted in good time to enable all members and officers to review them properly	3.13
	Regular attendance by appropriate senior officers of the Council, the HIA and the External Auditor	4.8, 4.9, 4.11, 4.17

Principle	Good Practice	Para Ref
<p><b>Principle 1: The Control Environment</b> <i>Independent assurance of the adequacy of the risk management framework and the associated control environment within the authority</i></p>	Consideration of Internal Audit periodic plan & strategy	3.18
	Monitoring of achievement of internal audit plan	3.18, 3.19
	Review of (summary/selection of) audit reports, main issues arising and implementation of recommendations	3.20
	Ensuring that risk assessment has been carried out by the HIA	3.18
	Review of annual report and assurance statement to committee from HIA	3.21
	Existence of strong/effective relationship between external audit, inspection agencies and internal audit	3.29
	Ensuring that the value of the audit process is actively promoted	3.29
<p><b>Principle 2: Risk Related Performance</b> <i>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</i></p>	Consideration of the effectiveness of the corporate risk assessment process	3.23
	Consideration of significant risk related performance issues raised by auditors or other inspectors	3.24
	Monitoring of implementation of improvement action plans	3.24
<p><b>Principle 3: Annual Accounts and the External Auditor</b> <i>Standard Assurance that any issues arising from the process of drawing up, auditing and certifying the authority's annual accounts are properly dealt with</i></p>	Review of audit certificate and consideration of matters arising from audit	3.26
	Consideration of annual report to members from external auditor and monitoring the implementation of agreed action plans	3.26
	Consideration of external audit reports, main issues arising and implementation of recommendations	3.27

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