

**CIPFA Better Governance Forum**

## **Audit Committee Update**

- Helping audit committees to be effective

**Issue 17**

**The audit committee role in reviewing the financial statements**

**Update on current developments**

**June 2015**

## Introduction

Dear audit committee member,

Welcome to Issue 17 of our briefings for audit committee members in public sector bodies.

Its aim is to provide members of audit committees with direct access to relevant and topical information that will support them in their role. It has been produced by the CIPFA Better Governance Forum and is free to our subscribing organisations. Additionally this issue is being made available to subscribers of the Finance Advisory Network.

This issue's main article focuses on the role of the audit committee when reviewing the financial statements. This is an important role of the committee but can be daunting for those unfamiliar with accountancy. The article explains some of the essentials that underpin the statements and encourages committee members to ask questions as part of their review. I hope you will find this issue helpful. We welcome feedback on these briefings and suggestions for future topics. Please let us know if we are getting them right.

Best wishes

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## Receive our Briefings Directly

This briefing will be sent to the main contact of organisations that subscribe to the CIPFA Better Governance Forum with a request that it be sent to all audit committee members.

If you have an organisational email address (for example [jsmith@mycouncil.gov.uk](mailto:jsmith@mycouncil.gov.uk)) then you will also be able to register on our website and download any of our guides and briefings directly. Register now, please click here <https://www.cipfa.org/Register>

## Previous Issues of Audit Committee Update

You can download all the previous issues from the CIPFA Better Governance Forum website. The earlier issues are on the archive site. Click on the links below to find what you need.

Issue	Principal Content	Link
<b>Issues from 2010</b>		
1	Reviewing the Audit Plan – Please note that Issue 13 provides an updated review of this topic.	<a href="#">Issue 1</a>
2	Reviewing the Annual Governance Statement – Issue 10 includes an update on this topic	<a href="#">Issue 2</a>
3	Countering Fraud – Please note that Issue 15 provides an updated review of this topic.	<a href="#">Issue 3</a>
<b>Issues from 2011</b>		
4	Strategic Risk Management, Governance Risks in 2011, Role of the Head of Internal Audit	<a href="#">Issue 4</a>
5	Understanding the Impact of IFRS on the Accounts, Key Findings from CIPFA’s Survey of Audit Committees in Local Government	<a href="#">Issue 5</a>
6	Partnerships from the Audit Committee Perspective	<a href="#">Issue 6</a>
<b>Issues from 2012</b>		
7	Assurance Planning, Risk Outlook for 2012, Government Response to the Future of Local Audit Consultation	<a href="#">Issue 7</a>
8	Commissioning, Procurement and Contracting Risks	<a href="#">Issue 8</a>
9	Reviewing Assurance over Value for Money	<a href="#">Issue 9</a>
<b>Issues from 2013</b>		
10	Public Sector Internal Audit Standards and Updates to Guidance on Annual Governance Statements	<a href="#">Issue 10</a>
11	Local Audit and Accountability Bill, the Implications for Audit Committees Update of CIPFA’s Guidance on Audit Committees	<a href="#">Issue 11</a>
12	Reviewing Internal Audit Quality, New CIPFA Publication, Audit Committees Practical Guidance for Local Authorities and Police, Regular Briefing on Current Issues	<a href="#">Issue 12</a>

Issues from 2014		
13	Reviewing the Audit Plan, Update on the Local Audit and Accountability Act, Briefing on Topical Governance Issues	<a href="#">Issue 13</a>
14	External Audit Quality and Independence, Government Consultation on Local Audit Regulations, CIPFA's Consultation on a new Counter Fraud Code, Regular Briefing on Current Issues	<a href="#">Issue 14</a>
15	CIPFA Code of Practice on Managing the Risk of Fraud and Corruption, The Audit Committee Role in Countering Fraud, Regular Briefing on Current Developments	<a href="#">Issue 15</a>
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## Workshops and Training for Audit Committee Members in 2015

### Good Governance for the Audit Committee

Our 2015 audit committee workshops will provide a topical briefing on current issues and focus in particular on the updated framework of good governance, to be launched by CIPFA and Solace during 2015.

**2 December 2015, Chester; 3 December 2015, London.**

**Further dates at York and Birmingham in 2016**

### Open training

We will be running a number of open training events for audit committee members. These will cover introductory sessions for new audit committee members and provide the opportunity for the development of knowledge and skills.

### In house training

In house audit committee training tailored to your needs is available. Options include:

- key roles and responsibilities of the committee
- effective chairing and support for the committee
- working with internal and external auditors
- public sector internal audit standards
- corporate governance
- strategic risk management
- value for money
- fraud risks and counter fraud arrangements
- reviewing the financial statements
- assurance arrangements.

For further details contact [chris.o'neill@cipfa.org](mailto:chris.o'neill@cipfa.org) or email [diana.melville@cipfa.org](mailto:diana.melville@cipfa.org) or visit the [CIPFA website](#) where we have a brochure to download outlining the support we have available for audit committees.

## The Audit Committee Guide to the Financial Statements Review

Approving the financial statements is an important part of the responsibilities of those charged with governance, whether that is the council, the board, the police and crime commissioner or chief constable.

The audit committee has a vital role in reviewing the statements and recommending their approval. In order to fulfil their governance responsibilities, audit committee members should be seeking answers to certain questions when reviewing their organisation's accounts and it is their accountant's job to answer them. Such questions might include the following:

- Has there been a robust approach to preparing the accounts that ensures the statements satisfy all statutory and best practice guidance and the [Code of Practice on Local Authority Accounting in the United Kingdom 2015/16](#) (the Code)? This Code applies to all local authorities and the police and fire sectors.
- Do you have assurance that information from financial systems can be relied upon to form the basis of the accounts?
- Have accounting policies or treatment changed during the period and why?

We will look at these in more detail below, but audit committee members need to ensure that they are satisfied with the assurance and explanations they receive in answer to their questions.

As well as compliance with accounting principles there are also certain qualitative characteristics that the accounts must have, such as understandability, relevance, reliability and comparability. You also need to be aware that statutory requirements take precedence over accounting standards, which can lead to some complicated and sometimes seemingly convoluted entries in the accounts. Audit committee members should always ask their finance teams or auditors to explain accountancy terms that are unfamiliar to them, for example, 'materiality' as the levels will be different in every organisation.

The accounts themselves should tell the organisation's financial story of the year, while the explanatory foreword should explain clearly how actual income and expenditure compares to the budgets agreed for the year, and provide explanations for any material differences. It is imperative though that you are happy the accounts tell your unique story, and not that of a neighbouring authority. They should be tailored to any local issues that have influenced the financial results, rather than slavishly follow a standard template. The financial statements themselves should explain clearly how they all fit together and demonstrate the links between the outturn position reported and the figures in the accounting statement.

So what are the main areas that the audit committee needs to consider?

### **Robust approach**

How can you be sure that a robust approach has been taken in preparing the accounts? It is worth considering if your accountancy team is properly resourced, qualified and undertakes the necessary continuing professional development (CPD) to be able to produce the accounts.

### **Reliance on systems**

The reports of your internal audit section and the annual governance statement should provide you with assurance that the systems used to produce the accounts are robust and that they can be relied upon. Have any concerns in this area been addressed?

## **Accounting policies**

With regard to accounting policies, you should consider the following questions:

- Are you aware of the main accounting policies on which the accounts are prepared?
- Have any accounting policies changed in the period, and do you understand why they have changed and what the impact has been on your financial statements?

It is good practice for the audit committee to consider and approve the accounting policies to be used in the forthcoming accounts prior to the year end, especially if subject to changes. There may also have been changes to regulations during the year which may impact on the accounts, again you need to ensure you are satisfied that these have been properly reflected and explained in the accounts.

## **Judgements and estimates**

Are you aware of where management have used their judgement or made significant estimates in the accounts? Again there are further questions to be asked, including:

- What assumptions are these judgements made on and are they robust?
- What is the impact if the estimate is wrong?

Areas covered by judgement and estimates can include accruals and provisions, property valuations, depreciation charges and the pension liability. You need to be assured that controls are in place to identify such areas, that variables and uncertainties impacting on the estimates have been considered, and whether reliance on an expert in forming the judgements and estimates has been used.

There may be issues which are unique to your particular organisation, such as a complicated lease agreement or implementing a new accounting standard, such as the revised group accounting standards for 2014/15, which may have particular accounting consequences for you. It is worth considering whether your accountants have sought the view of the authority's external auditors in the approach they have taken. Discussing such issues with auditors during the year, and bringing these matters to the audit committee's attention before the year-end, can help inform your governance considerations.

The annual report of your external auditors and their opinion on the accounts and value for money should hopefully give you assurance through an unqualified audit opinion (the only instance you want anything not to be qualified!), that professional high standards have been applied (in their opinion) in the production of the accounts, that few changes have had to be made to the accounts as a result of the audit process and that the authority has secured economy, efficiency and effectiveness in the use of its resources, including financial resilience.

If changes have been made to the accounts as a result of the audit process, then you need to establish why and that you are satisfied that the changes are necessary. The statement of responsibilities in the accounts should give you assurance from your responsible finance officer that the accounts have been prepared to give a true and fair view of the organisation's financial position and performance.

## **Accounting statements**

There are four core financial statements that share common elements so you need to be assured that the figures are consistent all the way through. Last year's closing balances should agree with this year's opening balances, and any differences due to restatement

of the prior year comparatives should be adequately explained in terms of the reason for restating and its impact on the accounts.

The movement in reserves statement (MiRS) shows the different reserves held by the authority, split between usable and unusable, and the movement on each of the reserves during the year. Consider the following:

- Are changes in the reserves consistent with your expectations based on performance reports to members?
- Are levels of usable reserves robust enough to deliver your future policies and provide resilience for expected future reductions in funding?

The consolidated income and expenditure statement (CIES) is the statement of financial performance for the year and should show whether income has exceeded expenditure for the year or vice versa. These figures are, however, prepared in accordance with accounting standards, which may be on a different basis from how they are reported for financial management purposes. A reconciliation between the two should be provided in the segmental reporting note to the accounts. It was indicated earlier that legislation overrides accounting standards. The adjusting of figures from the CIES accounting standard based figures to the legislative ones are made in the movement in reserves statement (MiRS) as 'adjustments between accounting basis and funding basis under regulations'. Again there should be a note to the accounts that explains what all these adjustments are.

The balance sheet is a snapshot of your financial position at 31 March and sets out:

- what the organisation owns and is owed (assets)
- what the organisation owes (liabilities)
- how all this is funded by the reserves which are shown in the MiRS.

The top half of the balance sheet shows whether assets exceed liabilities and this must equal the reserves in the bottom half of the balance sheet.

The final core statement is the cash flow statement, which shows the changes in cash and "cash equivalents" during the year as reflected on the balance sheet. The statement should reconcile the surplus/deficit on provision of services figure from the CIES to the change in cash balances, explaining the elements of the surplus/deficit that relate to non-cash items such as asset depreciation.

There could be other statements in the accounts depending on your organisation's responsibilities. All billing authorities should have a collection fund statement to explain the collection of council tax and business rates. Some authorities will have a Housing Revenue Account, essentially a CIES for the ring-fenced part of reserves relating to council dwellings and services to tenants, and pension fund administering authorities should include their pension fund accounts.

The organisation may also have to produce group accounts if it has material interests in other organisations. The group accounts incorporate all the core financial statements and accompanying notes for the combined group position, which may be shown combined with the organisation's own figures or as a separate section of the accounts. You need to be assured that a thorough assessment has been undertaken of all the organisation's interests, and that the correct judgement has been exercised in determining whether group accounts are required.

All of the financial statements require explanatory notes to show how the figures in the statements are constituted. There should be a note for every item judged material in

the accounts and the figures in the notes should tie back to the figures in the financial statements.

As the deadline for compiling the accounts is shortened over the next two years, everyone has a stake in ensuring the financial statements present clearly and succinctly the financial story of the organisation's year. CIPFA is reviewing the primary statements to encourage the readership of the accounts, and your colleagues in finance will welcome your support and indeed constructive challenge as a critical friend to achieve simplified and streamlined financial statements that engage the reader. Audit committee members will want to ensure the accounts are not cluttered by unnecessary information but equally that they draw out the important messages and explain the material items for the benefit of stakeholders.

Accounting practitioners constantly undertake CPD to be able to produce a set of accounts for your organisation, compliant with the Code and all statutory requirements. Audit committee members should feel in a position that they too can ask for training, to ensure sufficient challenge in the consideration and approval of the accounts. Hopefully this document goes some way towards that.

Caroline White

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## Recent Developments You May Need to Know About

### **Forthcoming consultation**

CIPFA is reviewing the [Delivering Good Governance in Local Government: Framework](#) in conjunction with Solace. The framework was established in 2007 and underpins the annual governance statements that local authorities, police and fire authorities must publish each year. The framework applies across the UK.

CIPFA has established a working group that includes stakeholders such as the National Audit Office and the Local Government Association as well as practitioners from all sectors. A representative from the Department for Communities and Local Government (DCLG) attends as an observer. The group has met once and work is underway to draw up revised principles for the framework. It is planned that consultation on the principles will take place from the end of July until September. The consultation will be publicly available on the CIPFA [website](#). The updated framework should then be complete by the end of 2015.

Audit committees should look out for the consultation and consider the implications for their work plans for 2015/16. It is intended that the new framework will underpin annual governance statements for 2015/16.

### **Reports, recommendations and guidance**

#### **Code of Audit Practice**

The National Audit Office (NAO) has published the [Code of Audit Practice](#). The Code sets out what local auditors are required to do to fulfil their statutory responsibilities under the [Local Audit and Accountability Act 2014](#). The NAO has also published guidance and information for auditors. The aim of these is to support auditors in their work and facilitate consistency of approach between auditors of the same types of entity.

#### **Audit Quality Inspections Annual Report 2014/15**

The Financial Reporting Council (FRC) produces an [annual report](#) on its inspections of audit quality in the UK and individual reports on five of the largest firms. The FRC inspected 109 private sector audits and believes that overall the quality of auditing in the UK is improving. The report, however, does identify that there is room for further improvements in the quality of auditing. While the report does cover private sector audits, the quality report is of wider interest to public sector audit committees in identifying audit quality issues.

#### **Evaluating audit quality**

The FRC has also issued a practice aid to assist audit committees in evaluating audit quality in their assessment of the effectiveness of the external audit process. This also is aimed at private sector companies and audit committees, but there are some principles which are of interest to the public sector audit committee. For more information see the FRC [website](#). The UK Corporate Governance Code (for companies) requires the audit committee report to include an explanation as to how it has assessed the effectiveness of the external audit process.

## **Good practice in managing conflicts of interest**

The Northern Ireland Audit Office has published [Conflicts of Interest: A Good Practice Guide](#) for public sector bodies on how to identify and manage conflicts of interest. The guide seeks to provide clear and simple advice for staff drafting and implementing conflict of interest policies. It should also help board members and staff in key positions to recognise when they have a conflict of interest and how they should act when such a situation arises.

## **Accountability System Statement for Local Government and Fire and Rescue Authorities**

DCLG has [issued an Accounting Officer Accountability System Statement for Local Government and for Fire and Rescue Authorities](#). It is principally concerned with their financial management and democratic accountability and sets out the current funding systems, legislation and guidance which form the system at present. The document also describes the arrangements in place for fire and rescue authorities. The statement explains how the accounting officer for the department receives assurance.

## **The Financial Resilience of Councils in Wales**

The Wales Audit Office (WAO) reviewed the robustness of management and planning arrangements to support financial resilience at each council, focusing on how councils plan and then deliver their budget commitments. The main conclusion of the report is that councils in Wales are under significant financial stress and have been active in meeting the challenge. The WAO says that councils will need to improve strategic financial planning in order to effect transformation and protect their financial resilience. For more information see [The Financial Resilience of Councils in Wales report](#).

## **Financial sustainability of police**

The NAO has also published [Financial Sustainability of Police Forces in England and Wales](#), a report which concludes that police forces have successfully reduced costs since 2011, but do not have a clear understanding of the demands placed upon them or of the factors that affect their costs. In addition the Home Office needs to be better informed to discharge its responsibilities.

## **Data handling by police forces**

The Information Commissioner's Office (ICO) has published [Findings from ICO Audits and Follow up Reviews of Police Forces, a report](#) highlighting the effectiveness of personal data handling of police forces, based on 40 ICO audits and 30 follow-up audits. It is intended to help forces and others in the criminal justice sector see where they can make improvements in how they handle personal data.

## **An Introductory Guide to Local Government Finance (CIPFA, 2015)**

This introductory CIPFA guide is aimed at helping local councillors, those working with and for local councils, and anybody with an interest in the sector to understand the complexity of local government finance. The guide covers revenue and capital financing, accounting, governance and auditing as well as giving an overview of some of the key services provided by local councils.

For further details see the [CIPFA website](#).

### **Benchmarking analysis: Internal Audit in Local Government (CIPFA, 2015)**

The guide outlines trends in the provision of internal audit services, analyses the cost, scope and staffing of the internal audit function and explores the key challenges for auditors now and in the future. It allows organisations to understand not just how their internal audit functions are performing, but also how well they are doing in comparison with their peers.

For further details see the [CIPFA website](#).

### **Look out for**

The Better Governance Forum and CIPFA Counter Fraud Centre will shortly be publishing a new assessment tool to enable organisations to evaluate their performance against the [Code of Practice on Managing the Risk of Fraud and Corruption](#) (2014). This will be an invaluable tool to underpin disclosures in annual governance reports on the robustness of counter fraud arrangements and the resilience of the organisation to fraud.

The tool includes reporting facilities and will be free to subscribers of the Better Governance Forum or the CIPFA Counter Fraud Centre. An optional benchmarking service will also be provided to allow comparisons with similar organisations.

CIPFA encourages audit committees to have oversight of the counter fraud arrangements in their organisation, including the counter fraud strategy and their performance against the counter fraud code.

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