



# HILLINGDON

LONDON

## CORPORATE SERVICES AND PARTNERSHIPS POLICY OVERVIEW COMMITTEE

2006/7

### FINAL REPORT

### MEMBERS' ROLE IN AUDIT: TERMS OF REFERENCE FOR THE AUDIT COMMITTEE

#### *Members of the Committee*

Cllr Richard Lewis (Chairman)  
Cllr Brian Crowe (Vice Chairman)  
Cllr John Hensley  
Cllr John Major  
Cllr Michael Markham  
Cllr Brian Stead  
Cllr Anthony Way



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## **CHAIRMAN'S FOREWORD**

Sound financial controls are essential to giving residents the services they deserve, and elected Members have a key role in ensuring Councils spend money wisely. Those Councils that have excellent finances are also able to offer excellent services.

The way a Council spends its residents' money says a lot about the respect a Council shows those who pay its bills. So it is good that Hillingdon has started to improve its performance in recent years, but there is still much that needs to be done before we rank amongst the best.

For the last few years I have been Chairman of the committee charged with supervising a key part of the financial control and risk management process. But we have not been able to give them the level of attention they need because of the range of other duties our committee have.

I was therefore pleased in May 2006 that Council agreed in principle to set up a separate Audit Committee that will allow elected Members to focus more on this vital area and that our Policy Overview Committee was invited to look at what its role and scope should be. This report sets out our proposals.

I would like to thank the witnesses who gave evidence and the officers who supported us during this review.

A handwritten signature in blue ink that reads "Richard Lewis". The signature is written in a cursive style and is underlined with a single horizontal line.



## SUMMARY

1. On 18<sup>th</sup> May 2006 the Annual Council Meeting agreed to establish an Audit Committee and to invite this Committee to report on what the Committee's role and scope should be. Once Cabinet and Council have had the chance to consider our report appointments will be made to the Committee.
2. Our working methods for this review are summarised in the Scoping Report at Appendix 1. Our main sources of evidence for the review were
  - guidance produced by professional bodies such as the Chartered Institute for Public Finance & Accountancy (CIPFA), CIPFA Scotland and the Financial Reporting Council (the 'Smith Guidance')
  - witnesses who attended our meetings from the private and public sectors (see Appendices 2 and 3)
  - four 'excellent'-rated Councils who all responded to a questionnaire we sent them on their arrangements for Members' role in audit (see Appendix 4).
3. Our key concerns were
  - to find the best way for Members to give Audit, Risk Management and Corporate Governance issues the priority they require
  - to ensure that arrangements to be put in place for the Audit Committee are fit for purpose and relevant to Hillingdon's circumstances
  - that the creation of the new Committee adds value
  - that the Audit Committee has the independence and powers it needs to operate effectively and to do so in a transparent way.
4. As well as general principles our conclusions and recommendations include detailed proposals for the Audit Committee's terms of reference, as requested by Council. However we believe that the Audit Committee themselves will also wish to keep their working methods under review as they establish themselves.
5. Our Committee is currently responsible for Member involvement in Audit matters. These duties will pass on to the new Committee once it is established. Under our proposals it will be possible for the Audit Committee to have their first meeting before the end of the current financial year.

## BACKGROUND AND IMPORTANCE

6. In its latest annual letter the Audit Commission commented that the Council should invest the role of 'those charged with governance' in a more manageable forum than full Council because the receipt of their SAS610 report and the audit plan were not in keeping with the normal business of the council. To achieve level 4 for internal control in the relevant Comprehensive Performance Assessment Key Line of Enquiry an Audit Committee must be established that is '*independent of the executive function, with terms of reference that are consistent with CIPFA's guidance*'.
7. Audit is a non-Executive function. It is therefore appropriate that a non-executive committee – in this case the Corporate Services and Partnerships Policy Overview Committee – working on a cross-party basis consider and recommend appropriate terms of reference for the new Audit Committee.
8. This is an evidence-based review. Our recommendations are based on practical experience gained elsewhere as well as formal guidance.

## MAIN ISSUES

9. In drawing up our Scoping Report we identified the following key issues which we believe our recommendations address:
  1. How do Members currently receive the reports it is now proposed to deal with in an Audit Committee?
  2. How will an Audit Committee improve Member engagement in the areas of providing
    - effective challenge across the council;
    - independent assurance on the risk management framework and associated internal control environment; and
    - effective leadership on governance, financial reporting and audit issues?
  3. How can an audit committee demonstrate the impact of its work?
  4. What are the legal rights of Members to information?
  5. What information do Members need from the various officers who will provide reports?

6. How will Members obtain assurance that appropriate action has been taken to address risk and control issues and to respond to issues raised by external audit?
10. We also wish to comment in particular on the following points.

**Independence and transparency**

11. We think it essential the Audit Committee should be chaired by an independent person – i.e. someone who is neither a Member nor an officer. This will demonstrate the independence of the Audit Committee itself and ensure the transparency and impartiality of its working. The Council will also benefit from the relevant skills and experience such a person will bring. This approach has worked well for the Standards Committee.
12. In proposing the appointment of an independent Chairman we recognise that one of our witnesses from an ‘excellent’-rated Council expressed doubt about the value of involving independents. However, we believe that situation at Hillingdon is different. Unlike Hillingdon, the council concerned already has ‘excellent’-rated status and appears to have no shortage of suitably experienced Members.
13. We believe that the independent Chairman should be appointed in a similar way to the Chairman of the Standards Committee. Essentially, this will mean the Audit Committee being responsible for the decision to appoint on advice from officers. It will also involve the Audit Committee holding their initial meetings with an elected Member acting as Chairman until the independent Chairman is appointed.

**‘Teeth’**

14. We are concerned that the Audit Committee should have ‘teeth’. The Borough Solicitor advised us that the Audit Committee would be a ‘committee of full Council’. Under the current rules of procedure the Audit Committee would not have the powers we have as a Policy Overview Committee to require Cabinet Members and officers to attend meetings or to place reports on the agendas of Cabinet and Council meetings,
15. We believe that it is important that the Audit Committee does have such powers. The Borough Solicitor has advised that it will be possible to do this through an amendment to the Constitution giving the Audit Committee the same powers in this respect as Policy Overview and Scrutiny committees. In this way there will be no reduction in Members’ powers in relation to Audit matters when the new Audit Committee takes over these responsibilities from us.
16. A copy of the Borough Solicitor’s advice is at Appendix 5.

## CONCLUSIONS

17. On the basis of the evidence presented to us we have reached the following conclusions:
  1. We believe that Members have a key role to play in the Council's audit arrangements. Councils with a separate Audit Committee derive clear advantages from the greater priority and focus that result. The Audit Committee will allow Members to oversee financial and operational control and the management of risk management issues.
  2. We also believe that the benefits in terms of corporate governance outweigh the costs associated with the additional meetings.
  3. Successful and effective Audit Committees are those that operate independently of the Executive, whether in the private or public sectors.
  4. We believe the appointment of an independent person (i.e. neither Member, nor officer) to be Chairman of Hillingdon's Audit Committee will strengthen its independence. An appropriate Non-Disclosure Agreement can overcome any problem regarding access to confidential 'Part 2' information.
  5. We accept the CIPFA advice that an Audit Committee should be independent of Scrutiny as well as of the Executive. We also accept the Borough Solicitor's advice that it will be a committee of full Council subject to the rules of procedure in Part 4, Schedule B of the Constitution.
  6. We are concerned, however, that Hillingdon's Audit Committee should have 'teeth'. In particular, it should have no less power to deal with Audit matters than our Policy Overview Committee does in dealing with them at present.
  7. We believe the Chairman of the Audit Committee needs relevant financial expertise. However, the rest do not. It is, perhaps, sometimes easier for people without relevant professional expertise to ask basic questions the public want answered.
  8. We agree with the evidence we have received that the Council must offer suitable training to Members serving on the Audit Committee. Furthermore, it should be a requirement of committee membership that Members receive adequate training.



9. We believe that the Committee should be small in number and that there should be a fixed limit to the period the elected Members serve.
10. We believe that the independent Chairman should be appointed in a similar way to the Chairman of the Standards Committee on a remunerated contract subject to periodic review.

## **RECOMMENDATIONS**

18. We recommend specifically:
  1. That Council goes ahead with creating an Audit Committee for Hillingdon.
  2. That the role and scope of the Audit Committee – its terms of reference – be as set out in Chart 1 at the end of this report.
  3. That the Audit Committee comprise an independent Chairman with relevant financial expertise and four elected Councillors and that the Vice-Chairman comes from the majority group.
  4. That no Cabinet Member or Member of the Executive Scrutiny Committee serve concurrently on the Audit Committee.
  5. That no elected Member serve for more than four years on the Audit Committee.
  6. That Part 4, Schedule B of the Constitution be amended to give the Audit Committee powers to require Cabinet Members and officers to attend to answer questions and to have its reports and recommendations placed on the agenda of Cabinet and/or Council meetings, as appropriate, in the same way as Policy Overview and Scrutiny committees.
  7. That the Chairman be appointed and remunerated along similar lines to the Chairman of the Standards Committee Chairman with a contract subject to periodic review.
  8. That resources be provided to provide training for Members serving on the Audit Committee and that agreeing to receive such training is made a condition of membership of the Committee.
  9. That the Council's External Auditor can attend the Audit Committee and that the Head of Internal Audit may have private access to the Chairman of the Audit Committee.

10. That the Audit Committee meet at least quarterly and that the quorum of the Audit Committee be three, of whom at least one must be the Chairman or Vice-Chairman.
11. That Council also appoint two substitute Members who will be eligible to receive training.

## **ACKNOWLEDGEMENTS**

19. Thanks are due to many people for their contributions to this detailed investigation including:
  - Raj Alagh, Borough Solicitor
  - Christopher Neale, Corporate Director of Finance
  - Helen Taylor, Head of Internal Audit:
  - Tim Copnell, KPMG
  - Michael Bradley, Chief Internal Auditor, London Borough of Barnet
  - Clive Palfreyman, Assistant Head of Finance – Governance and Internal Audit, Buckinghamshire County Council
  - the officers at Bucks. CC, Herts. CC, Kent CC and the London Borough of Wandsworth who replied to our questionnaire
  - Guy Fiegehen and Charles Francis in Democratic Services.

## **REFERENCES**

20. References for this work included:
  1. Briefing note on Audit Committees prepared by Helen Taylor, Head of Internal Audit, including information on terms of reference for Audit Committees at Barnet & Hackney and the Audit Commission's Key Line of Enquiry for Internal Control
  2. Appendix 3 to CIPFA Practical Guidance Note for Local Authorities
  3. CIPFA in Scotland: Audit Committee Principles in Local Authorities in Scotland – A Guidance Note
  4. Financial Reporting Council: Guidance on Audit Committees ('The Smith Guidance') January 2003
  5. Briefing note prepared by Raj Alagh, the Borough Solicitor on Wednesbury Reasonableness
  6. Survey of Audit Committee arrangements at four 'excellent rated Council's' – information supplied by Buckinghamshire, Hertfordshire and Kent County Councils and the London Borough of Wandsworth

## **CHART 1: OUR PROPOSED TERMS OF REFERENCE FOR HILLINGDON'S AUDIT COMMITTEE**

### **Statement of Purpose**

The purpose of Audit Committee is to

- provide independent assurance of the adequacy of the Council's risk management framework and the associated control environment
- 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
- oversee the financial reporting process.

### **Audit Activity**

The Audit Committee will:

1. Approve but not direct Internal Audit's strategy and plans, ensuring that work is planned with due regard to risk, materiality and coverage.
2. Review the Head of Internal Audit's Annual Report and Opinion and Summary of Internal Audit Activity (actual and proposed) and the level of assurance this can give over the Council's corporate governance arrangements.
3. Review summaries of Internal Audit reports and the main recommendations arising.
4. Review a report from Internal Audit on agreed recommendations not implemented within a reasonable timescale.
5. Consider reports dealing with the management and performance of the providers of internal audit services.
6. Receive and consider the External Auditor's annual letter, relevant reports and the report to those charged with governance.
7. Monitor management action in response to issues raised by External Audit.

8. Receive and consider specific reports as agreed with the External Auditor.
9. Comment on the scope and depth of External Audit work and ensure that it gives value for money.
10. Liaise with the Audit Commission over the appointment of the Council's External Auditor.
11. Commission work from Internal and External Audit.
12. Ensure that there are effective arrangements for ensuring liaison between Internal and External audit.

### **Regulatory Framework**

The Audit Committee will:

1. Maintain an overview of the Council's Constitution in respect of contract procedure rules, financial regulations and codes of conduct and behaviour. And, where necessary, bring proposals to the Cabinet and/or Council for their development.
2. Review any issue referred to it by the Chief Executive or a Director, or any Council body.
3. Approve and regularly review the authority's risk management arrangements, including regularly reviewing the corporate risk register and seeking assurances that action is being taken on risk related issues.
4. Review and monitor Council policies on 'Raising Concerns at Work' and anti-fraud and anti-corruption strategy and the Council's complaints process.
5. Oversee the production of the authority's Statement of Internal Control and recommend its adoption.
6. Review the Council's arrangements for corporate governance and agree necessary actions to ensure compliance with best practice.
7. Consider the Council's compliance with its own and other published standards and controls.

## **Accounts**

The Audit Committee will:

1. Review and approve the annual statement of accounts. Specifically, to consider whether appropriate accounting policies have been followed and whether there are concerns arising from financial statements or from the auditor that need to be brought to the attention of the Council.
2. Consider the External Auditor's report to those charged with governance on issues arising from the audit of the accounts.

*London Borough of Hillingdon*

**CORPORATE SERVICES AND PARTNERSHIPS  
POLICY OVERVIEW COMMITTEE**

**2006/7**

**SCOPING REPORT**

**MEMBERS' ROLE IN AUDIT:  
TERMS OF REFERENCE FOR THE AUDIT COMMITTEE**

**Aim of review**

1. To recommend terms of reference for the Audit Committee that will ensure the Committee's work adds value to the Council's arrangements for risk and performance management.

**Terms of Reference**

2. The proposed terms of reference are as follows:
  1. To review terms of reference of Audit Committees in other Councils and gather evidence on their effectiveness.
  2. To examine available guidance e.g. from ODPM, LGA, ALG, I&DeA, Audit Commission, CIPFA and Financial Reporting Council (FRC).
  3. To consider the proposed composition of the Audit Committee, including the selection of the Chairman.
  4. To examine the types of information/report the Audit Committee will receive.
  5. To make recommendations to Council on this and any related matters.

**Background and importance**

3. On 18<sup>th</sup> May 2006 Annual Council agreed to establish an Audit Committee and to appoint Members in Autumn 2006.
4. In its Annual letter, the Audit Commission commented that the council should invest the role of 'those charged with governance' in a more manageable forum than full council because the receipt of the SAS610

report and the audit plan were not in keeping with the normal business of the council. To achieve level 4 for internal control in the relevant Comprehensive Performance Assessment Key Line of Enquiry an Audit Committee must be established: '*independent of the executive function, with terms of reference that are consistent with CIPFA's guidance.*'

5. The Chartered Institute of Public Finance and Accountancy (CIPFA) has recently issued a practical guide for local authorities on the establishment of Audit Committees. There is also considerable private sector guidance available on Audit Committees.

### **Reasons for the Review**

6. This a new Committee. It requires terms of reference.
7. Audit is a non-Executive function. It is therefore appropriate that a non-executive committee – in this case the Corporate Services and Partnerships Policy Overview Committee – working on a cross-party basis consider and recommend appropriate terms of reference.
8. An evidence-based review will allow the Committee's recommendations to be based on practical experience gained elsewhere.

### **Key issues**

9. The review will cover the following issues:
  1. How do Members currently receive the reports it is now proposed to deal with in an Audit Committee?
  2. How will an Audit Committee improve Member engagement in the areas of providing
    - effective challenge across the council;
    - Independent assurance on the risk management framework and associated internal control environment; and
    - effective leadership on governance, financial reporting and audit issues.
  3. How can an audit committee demonstrate the impact of its work?
  4. What are the legal rights of Members to information?
  5. What information do Members need from the various officers who will provide reports?
  6. How will members obtain assurance that appropriate action has been taken to address risk and control issues and to respond to issues raised by external audit?

## **Methodology**

10. The review will be conducted as follows.

### ***Documents***

11. The Committee will investigate good practice guidance and experience available outside of the Council (both public and private sector) on how best to manage audit committees.
12. The Committee will need to familiarise themselves with the range of information audit committees may examine. The main items are:
- Financial statements;
  - External auditor's opinion and report to members
  - Financial reports;
  - Internal audit quarterly reports, strategy, annual plan and annual report
  - Inspection agency reports,
  - Anti fraud and corruption strategy
  - The Statement on Internal Control (SIC)
  - Risk management reports.

However, the Audit Committee will consider the format and frequency they wish to adopt for receiving such information once the committee has been established.

### ***Witnesses***

13. The Committee have requested evidence from the following witnesses:
- a) the Director of Finance, Christopher Neale, on the financial information currently given to Members
  - b) the Risk and Insurance Manager, Simone Batchelor, on risk management information
  - c) a public sector best practice expert e.g. Jane Bloodworth, DEFRA
  - d) a private sector best practice expert e.g. Tim Copnell, Institute of Audit Committees
  - e) one or two best practice Councils e.g. Kent.

### **Stakeholders and consultation plan**

14. Indirectly service users and their representative organisations are key stakeholders, as an improved ability to examine decisions and influence decision-taking should ultimately benefit service users.

### **Connected work (recently completed, planned or ongoing)**



15. Work on the organisational structure of the Council to be presented to the Cabinet in August may be relevant if reporting structures and processes are changed.

**Outcome**

16. The Committee will agree a report on their findings and recommendations that will be ready to go to Council on 23<sup>rd</sup> November. Officers will consult with the Council Leader about the need for a reference to Cabinet.

**Proposed timeframe & milestones**

Meeting		Action	Milestone
1	26.07.06	1. Consider Scoping Report 2. Note initial briefing paper	1. Agree Scoping Report 2. Familiarise with background to this topic
2	21.09.06	<b>1. First Witness Session</b> - Director of Finance, Christopher Neale and Risk and Insurance Manager, Simone Batchelor - Public sector best practice expert e.g. Jane Bloodworth, DEFRA - Private sector best practice expert e.g. Tim Copnell, Institute of Audit Committees 2. Consider briefing note from Borough Solicitor on application of the Wednesbury reasonable principle 3. Initial discussion of emerging findings	1. Questions on current policy, best practice in public and private sectors 2. Understand Wednesbury reasonableness 3. First thoughts on conclusions and eventual recommendations
3	17.10.06	1. Second Witness Session - One or two best practice Councils e.g. Kent 2. Consider first draft/outline of Final Report	1. Confirm effectiveness of arrangements elsewhere 2. Consider possible recommendations
4	09.11.06	Consider Final Report	Agree recommendations

**Risk assessment**

17. No high risk factors have been identified that might hinder the success of this review.

**SUGGESTED QUESTIONS FOR WITNESSES**

1. What is Audit? Please describe its purpose, scope and function.
2. What are the key linkages between Audit and other business disciplines and processes such as accounting, financial management, business planning, risk management and performance management?
3. What is the role of Members in Audit?
4. What are the advantages for Hillingdon of creating a new, separate Audit Committee? Can the benefits be quantified and compared with the additional cost?
5. What should be the scope of Hillingdon's Audit Committee? Would it matter if different Member processes dealt with Risk Management and with Performance Management?
6. What powers should Hillingdon's Audit Committee have in relation to (a) Council, Cabinet and other Member-level committees and (b) officers?
7. How many Members do Audit Committees usually have and when should they meet?
8. What advantages are there in independent members, who are neither Councillors, nor officers, serving on the Audit Committee? Could the Chairman be an independent member? Are there any disadvantages?
9. Should the Chairman be qualified in Audit in some way? Should the Chairman be remunerated?
10. What level of qualification and/or experience do other Members require and what on-going training do they need?

**Witnesses were also invited to comment on the 'Key Issues' in the Scoping Report (see paragraph 9).**

**FIRST WITNESS SESSION: 21<sup>ST</sup> SEPTEMBER 2006**

***Raj Alagh, Borough Solicitor: The Wednesbury reasonableness principle***

1. Raj Alagh said he had been asked to comment on the the Wednesbury reasonableness principle in the context of the proposed Audit Committee. He also wished to give a preliminary view on the probable constitutional position the Audit Committee would have.

*The Wednesbury reasonableness principle*

2. The Borough Solicitor began by referring to the Protocol agreed in 2002 setting out the rights of Members to information. He had told the Executive Scrutiny Committee earlier in the week that he was in the process of updating the Protocol and that it would be circulated to all Members.
3. The Wednesbury case had concerned the request for a cinema licence considered by Wednesbury Council in 1948. An appeal to the High Court established a key legal principle, namely that Councils have to consider all relevant information in coming to a decision and disregard all information that is not relevant.
4. The Borough Solicitor quoted two recent decisions at Hillingdon that illustrated the two aspects of this principle – the acquisition of the Old Barn in Harmondsworth and the proposed closure of Bourne Lodge.
5. He emphasized that it was for Members to decide whether they had sufficient information to make a decision. His advice was that, if Members think they do not have sufficient information, then they should defer the decision concerned.
6. In law Members' rights to information come from two main sources – statutory rights contained in the Freedom of Information Act and the precedents established through Common Law. But Members' right to information is not a 'roving commission', and they cannot demand to know something simply on the basis of curiosity. The Birmingham case had shown that Members needed to demonstrate a need to know.
7. Members' rights to information are set out in Article 13 of the Constitution. Paragraph 13.02 in particular deals with the principles of decision-making. Democratic Services were reviewing the format for Cabinet reports in particular to ensure they continue to meet those principles and capable of being open to the necessary scrutiny.

### *Constitutional position of the Audit Committee*

8. The Borough Solicitor said he had only had a brief chance to look at the CIPFA guidance on Audit Committees. His preliminary view was that such an Audit Committee would be a committee of full Council that would be similar, for example, to the Planning or Pensions Committees. As such, the Audit Committee would be proportional to party size, and Executive Members would be not precluded from membership. In legal terms the independence of a committee – on which the CIPFA guidance placed great emphasis in the case of Audit Committees – is not affected if its members also serve on other Council bodies.
9. If Executive Members were excluded from membership of the Audit Committee, that would place it in the same category as the Council's Policy Overview and Scrutiny Committees, from which Executive Members are also precluded.
10. The Borough Solicitor said he would arrange to circulate for the next meeting
  - a revised version of the Protocol on the Rights of Members to Information (if available by then)
  - a note on the independence of the proposed Audit Committee and its probable status within the Constitution as a Committee of full Council.

### ***Christopher Neale, Director Finance & Helen Taylor, Head of Internal Audit:***

#### ***Current policy and best practice***

#### ***Tim Copnell, KPMG: Private sector view***

#### ***Michael Bradley, Chief Internal Auditor, London Borough of Barnet: View from another Council***

11. The **Chairman** invited the four witnesses to sit as a panel and reply in turn to the suggested questions they had been sent. He also invited the District Auditor, Mr Les Kidner, to comment when he arrived for the following item.

**Q1:** *What is Audit? Please describe its purpose, scope and function*

**Q2:** *What are the key linkages between Audit and other business disciplines and processes such as accounting, financial management, business planning, risk management and performance management?*

12. **Tim Copnell** distinguished between Internal and External Audit.
- **External Audit** involves the independent examination of an organisation's accounts and is what the private sector usually means by Audit
  - **Internal Audit** is, in contrast, part of the organisation itself and involves assurance that an organisation's systems are fit for purpose and working as intended. It is found in both the private and public sectors.
13. In the private sector an audit committee is usually a sub-committee of the Main Board, though independent of it, and comprises some or all of the non-executive directors. Private sector audit committees do not include executive directors because they would have a conflict of interest e.g. in presenting a favourable picture in the accounts. It is the shareholders who need reassurance that the accounts give a fair reflection of the company's worth. The audit committee's role is to provide the necessary oversight.
14. Mr Copnell confirmed in reply to the **Chairman** that it is the shareholders who usually appoint the auditors on the recommendation of the audit committee (via the board). Again, there would be a conflict of interest if, for example, the Finance Director were to do so.
15. Mr Copnell said private sector companies see Internal Audit as an integral part of their organisation with its independence usually protected through a management line to the Chief Executive Officer and a general reporting line to the Chair of the Audit Committee who have oversight of its work programme.
16. **Michael Bradley** confirmed that audit has a wider role in the public sector where it also covers corporate governance, risk management and internal control. He said these functions need to be supported by an adequately resourced Internal Audit Unit.
17. Mr Bradley also thought that Internal Audit is more focussed on looking forward than External Audit. Internal Audit is concerned with how the objectives of an organisation will be met.
18. **Helen Taylor** added that the role of the Finance Director differs between the private and public sectors. For example, in the case of local authorities the Director of Finance has a 'whistle blowing' duty. This had happened at Hillingdon a few years ago when the then Borough Treasurer had issued a section 114 notice.
19. **Christopher Neale** said Internal Audit is key to improving the Council's performance. An Audit Committee would provide more focus at Member level than the current arrangements and have teeth. Many

Councils with top CPA ratings have Audit Committees; those with lower ratings tend not to.

20. **Michael Bradley** confirmed in reply to a question from **Cllr Hensley** that local authority audit is involved with non-financial matters e.g. risk management. **Tim Copnell** said that, in contrast, that would be a responsibility of the board as a whole in the private sector.

Q3: *What is the role of Members in Audit?*

21. **Michael Bradley** said that at Barnet the Audit Committee's job is to
- ensure that the Audit Plan covers the key strategic risks,
  - ensure that every audit recommendation is followed up
  - invite the Head of Service to explain any failures.
22. The **Chairman** said that in Hillingdon the Corporate Services and Partnerships Policy Overview Committee already fulfilled those functions and asked what would be gained through a separate Audit Committee. **Mr Bradley** replied that he thought it was more difficult for Members to carry out those functions without a separate Audit Committee. **Helen Taylor** said that, as an example, at present audit reports sometimes went through as 'for information' items and didn't get proper Member scrutiny or challenge.
23. **Tim Copnell** said there were some similarities in that respect between public sector Internal Audit and External Audit in both sectors. Audit committees need to reassure themselves about key accountancy policy judgements and whether 'big ticket' items were soundly controlled as well ensure that the whole risk management system is robust and effective. But too much involvement in detail can be counter-productive and cause unhealthy friction with the executive. An audit committee needs a strong relationship with the executive part of the organisation, maintain dialogue with the Finance Director and to give her/him support when necessary.
24. **Mr Copnell** added that robust challenge is the single most important function of an audit committee, challenge that is without fear of reprisal.
25. The **Chairman** asked how challenge and a strong relationship can be combined and balanced. **Cllr Markham** suggested this should be seen in part as a mentoring role for the executive. **Mr Copnell** agreed mentoring can be an effective approach and said the relationship should not be adversarial.

Q4: *What are the advantages for Hillingdon of creating a new, separate Audit Committee? Can the benefits be quantified and compared with the additional cost?*

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Corporate Services & Partnerships Policy Overview Committee  
Terms of Reference for the Audit Committee

26. The **Chairman** said the first part of this question had been covered in earlier answers. He asked the Finance Department to provide a note on the quantifiable costs and benefits of introducing an Audit Committee.

Q5: *What should be the scope of Hillingdon's Audit Committee? Would it matter if different Member processes dealt with Risk Management and with Performance Management?*

27. In relation to the first part of the question **Christopher Neale** referred Members to the CIPFA Scotland guidance that had been circulated and to a note he tabled of how Member oversight of these and related functions are currently organised in Hillingdon.

28. **Cllr Markham** asked if the Scottish model was effective. **Helen Taylor** said CIPFA England had copied it. **Tim Copnell** added that he thought the model adopted was less important than the effectiveness of the people who serve on it.

29. **Les Kidner**, the District Auditor, said the Health Services had a longer experience of audit committees than local councils. Those had been based on the private sector model. They varied a good deal in their effectiveness. He agreed the audit committee's role was to challenge rather than be adversarial.

30. The **Chairman** asked if effectiveness depended on audit committee members having some professional qualification [an issue also covered in suggested questions Q9 and Q10 below]. **Mr Kidner** said this wasn't necessary but that effectiveness was definitely helped if a committee's membership included one or more people with some financial background. In his view Members' role is to ask sensible questions and to expect sensible answers. He added that an audit committee needs to have an open relationship with the Executive and with officers.

31. The **Chairman** noted that the second part of the question, referring to the need for any Member-level links between Risk Management and Performance Management, did not appear to be a concern in the minds of the witnesses.

Q6: *What powers should Hillingdon's Audit Committee have in relation to (a) Council, Cabinet and other Member-level committees and (b) officers?*

32. The **Chairman** asked by way of introduction to this question how councils coped with the risk of their audit committees becoming too close to the Executive and officers. **Michael Bradley** said that Barnet

have a rule that the Chairman of their Audit Committee can only serve for a maximum of four years and is drawn from an Opposition party in the same way as the House of Commons Public Accounts Committee. The majority of Barnet's Audit Committee Members come from the majority party, but none are in the Cabinet.

33. **Cllr Garg** asked where recommendations went in Barnet. **Mr Bradley** said that they weren't sent to the Council or Cabinet but to officers.

34. **Cllr Garg** asked if Barnet's Audit Committee could mandate any action. **Mr Bradley** said the Committee could only invite further consideration. It did not get into detail. He confirmed again that the Committee has no powers at all but could have influence through drawing attention to matters.

35. **Tim Copnell** said private sector audit committees also have no decision-making powers. It is the Board who make recommendations to shareholders. He noted however that private sector audit committees do have full access to the company's information. He was sure if that would apply to a Council Audit Committee.

Q7: *How many Members do Audit Committees usually have and when should they meet?*

36. **Tim Copnell** said audit committees in the private sector typically meet four times a year in line with the financial reporting cycle. **Michael Bradley** said Barnet's Audit Committee met up to six times a year. This greater frequency reflected the committee's wider scope which went beyond just financial matters. **Helen Taylor** said Oxfordshire had a double committee system to cover this.

37. The **Chairman** noted the need to obtain further information about the usual size of the committees.

Q8: *What advantages are there in independent members, who are neither Councillors, nor officers, serving on the Audit Committee? Could the Chairman be an independent members? Are there any disadvantages?*

38. **Tim Copnell** said that in the private sector all audit committee members are non-executives. Experts may be co-opted onto a committee but not to chair it. He pointed out that there could be difficulties with an independent, non-councillor Chairman in having access to all the necessary information. This would depend on legislation and a council's rules. He was also uncertain about the insurance position for a non-councillor e.g. could they be covered by the Council's insurance arrangements?



Q9: *Should the Chairman be qualified in Audit in some way? Should the Chairman be remunerated?*

Q10: *What level of qualification and/or experience do other Members require and what on-going training do they need?*

*[NB: paragraph 30 above also refers to this issue.]*

39. **Michael Bradley** said that at Barnet there is no requirement for Audit Committee Members to be professionally qualified, but some are.
40. **Tim Copnell** said at least one Audit Committee member needed financial expertise. However not every member of the audit committee need be a financial expert – sometimes the best questions are the simple questions and it is often easier for people without relevant expertise to ask such questions.
41. **Christopher Neale** told Members that paragraph 3.9 on page 12 of the CIPFA Scotland guidance refers to types of training available for Members.
42. The Chairman asked if an Audit Committee needed to be clerked by someone with an audit background. **Mr Bradley** said he did not think this is necessary. The **Chairman** expressed concern if this meant neither the Chairman nor the Secretary of the Audit Committee would have relevant expertise. **Mr Neale** said he thought the role of advising the Audit Committee on audit matters would be for the Head of Internal Audit.
43. The **Chairman** reiterated his concern about the need to be careful that such relationships do not become too cosy. **Tim Copnell** said audit committees needed to take advice from several sources, internal and external.
44. On remuneration, **Tim Copnell** said a typical non-executive sitting on an audit committee would be paid about £30-35,000pa (for their role as a non-executive director – not just the audit committee duties). The Chairman would receive more.

**SECOND WITNESS SESSION: 17<sup>TH</sup> OCTOBER 2006**

***Clive Palfreyman, Assistant Head of Finance – Governance and Internal Audit, Buckinghamshire County Council: Evidence from an ‘Excellent’ Council***

Q1: *What is Audit? Please describe its purpose, scope and function*

1. **Clive Palfreyman** said the role of audit in local government is to provide Members with an independent end-of-year opinion, or ‘assurance’, whether or not the authority has effective control frameworks for its financial and operational systems, projects, programmes and other initiatives and on the risk profile of the organisation. This should support the Authority’s Statement of Internal Control. The Audit Commission provides a further layer of external re-assurance to the Council. Dealing with detailed performance issues is a matter for other committees.

Q2: *What are the key linkages between Audit and other business disciplines and processes such as accounting, financial management, business planning, risk management and performance management?*

2. **Clive Palfreyman** said Internal Audit is a statutory financial role. It is obliged to direct its resources to core financial systems. It conducts risk-based reviews. Risk is not all financial.
3. **Cllr Hensley** asked, if concerns arise, how is the report handled and what feedback should an Audit Committee get?
4. Mr Palfreyman said every assignment resulted in a report. Although opinions are subjective at the end of the day, they are based on professional judgements informed by the profession’s manual and guidance. Essentially these opinions answer the question: are risks being managed or not? Positive or negative.
5. Buckinghamshire’s Audit Committee receives quarterly progress reports. Each negative audit report has its executive summary and management response to any specific recommendations provided to Members. Negative reports are followed up every six or twelve months.
6. Raising awareness of audit issues is only half the story. Follow up is essential. Management can be called to attend if necessary.

7. Cllr Hensley asked if the timescale was shorter for follow-up reports on very high-risk items.
8. Mr Palfreyman said each recommendation had an agreed timetable for reports, but not all recommendations are agreed with management. Audit has a reporting line to the Chief Executive officer, the Chair of the Audit Committee and the Council Leader.
9. **Cllr Major** asked whether having an Audit Committee would have helped the local Primary care Trust avoid its huge deficit?
10. Mr Palfreyman said up to a point. Bucks CC spends £2million a day. It isn't possible to provide assurance about every penny. He also said it is not the responsibility of the Audit Committee to own problems and put them right. Ownership of issues has to be with managers who are held accountable.

Q3: *What is the role of Members in Audit?*

11. **Clive Palfreyman** said Members have three key roles

*(i) Monitoring the output and quality of the Audit Service itself*  
Mr Palfreyman thought Members are often weak at doing this. The Committee had to challenge the auditors about the robustness and sustainability of their work.

*(ii) Assist in monitoring the governance arrangements of the organisation*

This is mainly done through the Statement of Internal Control and extends to anti-fraud policy and Members' and officers' codes of conduct.

*(iii) Risk management*

Members need to ensure risks are identified and managed. As well as an officer 'Risk Management Champion' there needs to be a lead Member too.

**Christopher Neale** said that in Hillingdon, respectively, Simone Batchelor and Cllr Bianco hold these roles. He suggested that these arrangements would need to be refreshed once the Audit Committee had been set up.

1. **Cllr Crowe** said it is important the Member champion ensures the risks are managed rather than handle them himself.
2. **Cllr Way** said the Audit Committee would need to clarify their role *vis a vis* that of the Risk Management Champion if he were not be a member of the Audit Committee.

Q4: *What are the advantages for Hillingdon of creating a new, separate Audit Committee? Can the benefits be quantified and compared with the additional cost?*

3. **Clive Palfreyman** said one consideration is that it will help the Council comply with CIPFA guidance and aid the CPA rating. It could also add value in its own right. He had been surprised when he arrived in Bucks CC at the level of challenge and ownership in different service areas. People tended to work in silos. Bucks had lacked a corporate compliance process.
4. He thought two key advantages of a separate Audit Committee are to give Members a better level of assurance and help raise Audit work in the Council's priorities. For example, there should be a 'golden thread' running from the Audit Plan to the Risk Management strategy through to the Council's corporate priorities.
5. **Cllr Hensley** asked if it could help raise the Council's effectiveness and efficiency, too. Mr Palfreyman said there is a clear effect. An Audit Committee gives Audit a voice in the organisation. There will also be opportunities to bring together all the Council's assurance activity – including, for example, OFSTED and SSI – to provide a more consistent approach.
6. **The Chairman** said the priority should be to maintain and improve the level of challenge in the Council.

Q5: *What should be the scope of Hillingdon's Audit Committee? Would it matter if different Member processes dealt with Risk Management and with Performance Management?*

7. **Clive Palfreyman** said it is more appropriate for Performance Management to be handled through line management, Cabinet and Overview and Scrutiny arrangements. In relation to the first part of the question **Christopher Neale** referred Members to the CIPFA Scotland guidance that had been circulated and to a note he tabled of how Member oversight of these and related functions are currently organised in Hillingdon.

Q6: *What powers should Hillingdon's Audit Committee have in relation to (a) Council, Cabinet and other Member-level committees and (b) officers?*

8. **Clive Palfreyman** said, in relation to officers, the role is to provide effective challenge to individual officers. On (a) he said the Audit Committee should have the right to report to Cabinet or to Council on

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its assurance activity as appropriate. The responsibility will be on the Audit Committee itself to escalate issues if the need arises. In some other London Boroughs the Audit Committee has the right to direct the work of other committees, but he did not agree with that approach himself.

9. In response to a question about the need for ‘teeth’ – a phrase the Director of Finance had used at the previous meeting – Mr Palfreyman said he saw dangers in the Audit Committee directing the work of other Member bodies. The Audit Committee should not become a ‘political toy’. It should be the least political part of the Council. The risk is, though, that it might become the most political. It is not, for example, the Audit Committee’s role to performance manage a service department.
10. **Cllr Crowe** said he had concerns about the statement that it might become counter-productive for the Audit Committee to try to direct the work of other committees. What would be the position if the Audit Committee flags up an issue, but it is not addressed elsewhere. Might not the Audit at least need teeth to place a report on the agenda of Cabinet, Council or a committee?
11. **Helen Taylor** said an organisation where that happened would be seriously dysfunctional. The **Chairman** and **Cllr Way** expressed their concerns that some power would need to be written into the Constitution to ensure reports to other Member bodies were placed on their agenda as is the case with Policy Overview and Scrutiny committees having the right to do so in relation to Cabinet and Council.

Q7: *How many Members do Audit Committees usually have and when should they meet?*

12. **Clive Palfreyman** said there are usually up to ten. He thought they are usually cross party and reflect the balance of the Council. The quorum is usually about four or five.

Q8: *What advantages are there in independent members, who are neither Councillors, nor officers, serving on the Audit Committee? Could the Chairman be an independent member? Are there any disadvantages?*

13. **Clive Palfreyman** said there are no independent members on Bucks CC’s Audit Committee. His experience elsewhere was that independent members do not add much value. He would only recommend appointing an independent person if the Council genuinely could not find any Member with some financial background. Only one Member of the Audit Committee needs to have that.

14. **Cllr Markham** asked if the Chairman of the Audit Committee should have financial expertise. Mr Palfreyman said that should be provided by the Head of Internal Audit. Although CIPFA stresses the need for Audit Committees to be independent of the rest of the Council, that does not require the appointment of independent people to serve on it.

15. **Cllr Way** said he thought an independent person serving as Chairman would be much less likely to 'kowtow' to the Cabinet than say a Member from the ruling Group. He also noted the value the Council had derived from having independent people serve as Chairman and Vice-Chairman of the Council's Standards Committee.

16. **Cllr Crowe** said he thought the role of the Standards Committee was not an exact analogy. He thought that bringing in independent people in this way was still relatively new and that to do so would require careful judgement.

*Q9: Should the Chairman be qualified in Audit in some way? Should the Chairman be remunerated?*

*Q10: What level of qualification and/or experience do other Members require and what on-going training do they need?*

17. **Clive Palfreyman** said he thought no formal qualification is necessary. The ability to ask straightforward questions is more important. He also did not believe that there should be special remuneration for the Chairman of the Audit Committee. He did though agree with the need for the Council to provide relevant training.

**APPENDIX 4**

**SURVEY OF AUDIT COMMITTEE ARRANGEMENTS AT FOUR 'EXCELLENT' RATED COUNCILS**

Four questionnaires were sent in October 2006 to the senior audit officer at each Council. All replied.

	<b>Question</b>	<b>Herts. CC</b>	<b>Bucks. CC</b>	<b>LB Wandsworth</b>	<b>Kent CC</b>
1.	Do you currently have an audit committee?	Yes. We have an audit panel, was a committee previously	Yes. We have changed the role of our existing regulatory committee to include audit committee responsibilities. The old regulatory functions are now virtually obsolete as the audit & risk issues predominantly comprise the agenda.	Yes	Yes - called 'Governance & Audit Committee'
2.	If so, when was the committee established?	Panel from September 2004 but audit committee for as long as anyone can remember	Yes. First meeting was July 2005	Mid 2005	Established in 2001 as the Audit Committee, and renamed in April 2005.  We reported to an audit sub-committee from about mid 1990s
3.	If you do not have an	N/a	All within audit	N/a	N/a

	<b>Question</b>	<b>Herts. CC</b>	<b>Bucks. CC</b>	<b>LB Wandsworth</b>	<b>Kent CC</b>
	audit committee, which committee(s) takes responsibility for financial and risk matters?		committee		
4.	Does your audit committee follow the political balance of the authority?	Yes: 6 Cons/2 Lab/2LD Full membership 46 Cons/16 Lab/ 14 LD/1 Green	Yes - Bucks is dominated by one party. There is one representative of the opposition on the committee.	Yes, but Cabinet Members and Chairmen of Overview and Scrutiny Committees are prohibited from being members of the Audit Committee.	Yes
5.	How many members are on your committee and what is the quorum?	10 - Quorum 3	7 members, 3 is quorum.	There are 7 members, and the quorum is 3.	13 Cons/9 Labour/3 LD: 1. Quorum for all committees is a third
6.	Who chairs your audit committee? E.g. are they from the majority party, or an opposition party and an 'independent' person (i.e. not a councillor)	Majority party but not cabinet member	From the majority party.	A member of the Majority Party	Member from the majority party, with no other responsibilities
7.	Do you have any independent non-members on your	No	No - All members of the committee are Members of the Council	No	No

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	<b>Question</b>	<b>Herts. CC</b>	<b>Bucks. CC</b>	<b>LB Wandsworth</b>	<b>Kent CC</b>
	committee?				
8.	If you have such members what are their backgrounds, e.g. chamber of commerce, academic?	-	-	-	-
9	Are 'independent' members remunerated in any way?  If so can you disclose the level of remuneration?	-	-	-	-
10.	Are Members remunerated in addition to the allowance they receive as councillors?  If so can you disclose the level?	No	No	No	In addition to the basic allowance, the chairman receives a Special Responsibility Allowance, which for 2005/06 was £7,662
11.	Does at least one of the members of you committee have a financial or risk	Yes - Not a constitutional requirement, but at least two have financial	Yes - Some Members have been selected on the basis of their background	Yes - The Chairman of the Committee works in the risk management industry. The previous	Yes

	<b>Question</b>	<b>Herts. CC</b>	<b>Bucks. CC</b>	<b>LB Wandsworth</b>	<b>Kent CC</b>
	management background?	backgrounds		chairman was a CCAB qualified accountant.	
12.	How often does your committee meet?	Quarterly	Quarterly – around the external accounts audit timetable	Twice per year, with written updates on internal control environment issues provided to all Members of the Committee between the two meetings. However if there are items of a material nature that the Head of Audit considers should be discussed at a full meeting of the Committee then he can agree with the Chairman to arrange such a meeting.	Quarterly
13.	What powers does your committee have e.g. in calling officers to account or referring matters to other committees or	Can call officers to account. The Executive (Cabinet + Leader) is required to have regard to any advice given by the Committee.	Can call officers. Can request that other committees undertake work but not impose.	The Head of Audit requests via the Directors' Board that Chief Officers/Directors from all departments attend the meetings.	Powers are described in the Terms of Reference. Members frequently request officers to attend committee meetings to explain the findings of

	<b>Question</b>	<b>Herts. CC</b>	<b>Bucks. CC</b>	<b>LB Wandsworth</b>	<b>Kent CC</b>
	cabinet?			Officers are 'called to account' and the Audit Committee is very much part of the Internal Audit escalation process. The Committee can and has drawn matters to the attention of Overview and Scrutiny Committees and the Head of Audit attends those meetings.	audit reports, and have also been known to refer matters to other committees.
14.	How does your committee demonstrate its independence and ability to challenge the executive?	By setting its own agenda – although in its latest guise, it has only just had its first meeting, so has not yet built up any record as a Committee.	Follows the CIPFA Audit committee guide.	Via its terms of reference, its membership rules, having reports submitted to it in an open style that promote questions, pre-briefing meetings between key officers and members, and the importance afforded to Internal Audit and the prominence of the Internal Audit Service within the Authority.	Independence is demonstrated by it being a stand-alone Committee. Minutes are presented to the next meeting of full council, for debate.  The main responsibility for 'calling to account' belongs to our Cabinet and Policy Overview Committees.

	<b>Question</b>	<b>Herts. CC</b>	<b>Bucks. CC</b>	<b>LB Wandsworth</b>	<b>Kent CC</b>
15	Is your audit committee also independent of your overview and scrutiny committees?	Yes	Yes	Yes	Yes

**ADVICE FROM RAJ ALAGH, BOROUGH SOLICITOR**

- 1. Does the Audit Committee have the power firstly, to require Cabinet Members and Officers to attend its meetings?**
- 2. Secondly, does it have the ability to place reports on the agendas of other bodies such as Cabinet or full Council?**

1. In short, my view is that it does have this power. However, it is important that I set out my advice, and the rationale for it in full, so that there is a proper audit trail in existence in the event that the Audit Committee's powers are ever challenged at any stage in the future.
2. The starting point is Section 106 of the Local Government Act 1972 which provides that Standing Orders may be made as respects any Committee of a local authority by that authority with respect to the quorum, proceedings and place of meeting of the Committee. On my reading of this section, there is no express restriction as to what may be contained within the Standing Orders provided that they relate to these three specific matters.
3. Section 20 of the Local Government and Housing Act 1989 empowers the Secretary of State by regulation to require local authorities to incorporate into their Standing Orders such provisions as the regulations may prescribe for regulating their proceedings and business.
4. The Secretary of State has made the Local Authorities [Standing Orders] [England] Regulations 2001. I have had a look at these and I am satisfied that they do not have any bearing on the issues upon which my advice is being sought.
5. (As I have indicated in my previous e-mail), Parliament has given Overview and Scrutiny Committees the express power to require the attendance of members, officers' etc. to their meetings [Section 21 of the Local Government and Housing Act 2000]. I believe that the rationale for giving this power to these Committees was to enable them to properly carry out their scrutiny function in particular.
6. In my view, just because Overview and Scrutiny Committees have been given the above statutory power, it does not follow that other Committees, such as the Audit Committee [which is a Council Committee], are precluded in law from having the ability to require the attendance of members, officers etc. to their meetings.

7. Although Audit Committees should be independent of the scrutiny function [as set out in Section 21 of the 2000 Act], nevertheless they will be performing a similar function in practice and therefore the ability to require the attendance of witnesses to their meetings will in my view be a necessary prerequisite to enable them to properly perform this role.
8. Section 106 of the Local Government Act 1972 was in existence long before the concept of Overview and Scrutiny Committees was introduced. The section does allow an authority considerable freedom in terms of how it conducts the proceedings of its appointed Committees.
9. The only prohibition on this freedom, which I can find, is Section 20 of the 1989 Act and the Standing Orders Regulations referred to above. However, as I have indicated above, they are not relevant for the purpose of this advice.
10. My view appears to be backed up by the CIPFA Guidance on Audit Committees, which states that " The Committee should have the right to call any other officers or agencies of the Council as required ". I am aware that this statement does not appear to have any statutory basis but nevertheless, it does endorse my advice.
11. The CIPFA Guidance is silent on the issue of whether Audit Committees can place reports on the agendas of Cabinet and Council meetings but my advice, as set out above, applies equally to this issue as it does to the right to require the attendance of witnesses.
12. In order to give the Audit Committee the " teeth ", which Members feel it should have, an amendment to the Constitution is required. There is little point in devising a new set of Standing Orders just for the Audit Committee. On the basis that it is a Committee of the Council, the Committee Standing Orders [Part Four, Schedule B of the Constitution] would simply need to be added to.
13. I would suggest that rather than incorporating additional rules, which would apply to all Council Committees, it would be preferable to have an additional paragraph/set of paragraphs, which apply to Audit Committees only. [You can lift the appropriate wording from the Overview and Scrutiny Procedure Rules and I am happy to look at it for you once you have drafted the relevant paragraph[s].]
14. There is a prescribed procedure in place for the amendment of the Constitution, which requires the ultimate approval of full Council.

8<sup>th</sup> November 2006