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INCLUSION OF CITIZEN MEMBERSHIP ON AUDIT COMMITTEE

This matter having been deferred by Regional Council on September 18, 2008, the Audit Committee recommends that the following report, May 22, 2008 from the Director, Audit Services, be received.

1. RECOMMENDATION

It is recommended that:

1. Audit Committee provide direction on the issue of citizen membership on Audit Committee.

2. PURPOSE

This report is to provide information and analysis on having citizen members on Audit Committee.

3. BACKGROUND

Request for Report

At the November 1, 2007 meeting of Audit Committee it was requested that a report be prepared on the prospective inclusion of citizen members on the Audit Committee.

Emerging Roles of Audit Committees

In the aftermath of widely publicized accounting scandals, the governance roles of boards of directors and audit committees have been the focus of significant attention in the media.

Generally speaking, the overall purpose of audit committees is to provide governing boards with oversight of their organization's operations. Municipal governments are entrusted with providing services within approved budget amounts in an environment of transparency, accountability, and responsibility rather than being held accountable for profits as is the case with private sector companies. Given this difference, the issue is what benefits if any, can be derived from having citizen membership on audit committee.

Recent governance studies are putting great emphasis on the critical role of the audit committee in a corporation's risk management and financial control system. Legislation has been put in place in the U.S. and Canada for publically traded companies to enhance the independence and financial expertise of audit committees.

For the purposes of this report we researched U.S. and Canadian government recommendations on audit committee composition, and conducted an informal survey among Canadian municipalities for which we received 20 responses.

4. ANALYSIS AND OPTIONS

MAINTAIN STATUS QUO

No Change to Current Audit Committee Composition

- Current composition has worked well to date.
- Audit Committee already has citizen members who are "independent" in that it is made up of elected officials who represent the citizens of York Region.
- Citizen members often struggle with procedural aspects of formal meetings and the reliance on staff reports to initiate discussions, so there may be a learning curve (City of Calgary).
- May be difficult to recruit suitable candidates who are available for daytime meetings in Newmarket.
- Only 35% of respondents to our survey of audit offices across Canada indicated that they had members of the public on their audit committees which suggests that this trend is not yet a common practice.
- Much of the legislation addressing audit committee composition pertains to the private sector and was put in place to protect investors which is not relevant for a municipality.
- Municipal financial reporting is legislated by the Province (Ministry of Municipal Affairs and Housing) and is subject to mandatory independent annual audits.

CHANGE AUDIT COMMITTEE COMPOSITION

Include Citizen Members on the Audit Committee

- Could provide Council with added financial expertise on assurance, risk management, control and governance.
- Financially literate external members could have the background to add insightful comments and review of financial statements and the external audit report.
- The U.S. government has recently enacted legislation (the Sarbanes-Oxley Act) which requires all members of the Audit Committee in publically traded private sector companies be "independent", and "financially literate". In Canada private sector Bill 198 requires that each member be independent and financially literate. The legislation was to assist in protecting investors of publically traded companies by ensuring that audit committees were financially knowledgeable and independent.

- In Canada, as a result of the passing of the *Federal Accountability Act*, audit committees (within federal government) require a majority of members from outside of federal public administration. The Canadian Federal Government (The Treasury Board Secretariat's Policy on Internal Audit and its Directive on Departmental Audit Committees) indicate that "Audit Committees should include members from outside the public service with extensive experience who can offer independent oversight, ongoing objective assessments and professional advice for the . . .senior management team." Prior to this directive, audit committees were comprised of senior management. Their directive advises that by April 1, 2009 all audit committees must have a majority of external members.
- Our survey received 20 responses from internal audit departments across Canada (B.C., Alberta, Ontario, Quebec, Newfoundland and the Yukon). Seven respondents had citizen members on their audit committee. Positive comments included that citizen members "are really insightful into the review of the financial statements and the external audit report as they have the background to ask tough questions and they often have experience on other Boards/Audit Committees. They are independent from Council and therefore bring a fresh perspective to many debates" (City of Calgary).
- Citizen members would need to take the Oath of Office and agree to be bound by the rules of the Municipal Conflict of Interest Act.
- Due to the potentially sensitive nature of the material covered at the Audit Committee, any citizen members would need to be bound by the confidentiality rules of Council.

5. FINANCIAL IMPLICATIONS

If Council was to consider adding qualified citizen members to Audit Committee, a review of current practices suggest that members will serve with no remuneration but will be compensated by the Region for any approved travel expenses related to carrying out their duties as Audit Committee members.

6. LOCAL MUNICIPAL IMPACT

The Audit Committee deals with matters relating to York Region which may directly affect municipalities.

7. CONCLUSION

The main advantage of inclusion of citizen members on Audit Committee would be enhanced financial expertise of the committee, however recruitment of suitable candidates may be difficult. Further direction from Audit Committee is respectfully requested.

For more information on this report, please contact Paul Duggan, Director - Audit Services Ext 1205.