



Helping the Audit Committee to add value

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Agenda

- Governance context
- The Audit Committee principles
- An annual work programme

Non-Executive Directors and the management of risk

Key issues

- many NEDs fail to probe risks and significant minority lack necessary independence
 - 32% of HIAs said NED scrutiny of risk inadequate
 - 17% of HIAs said NEDs didn't operate independently enough of management
- NEDs' analysis of risk may be too narrow
 - 28% of Boards had no formal process to decide how much risk they prepared to take
- many Boards leave review of risk to too narrow a group
 - 63% of companies leave it to the Audit Committee

Barriers to better understanding?

- 28% of HIAs reported NEDs' only had average or poor understanding of operational risks

survey of 141 private sector HIAs
Chartered Institute of Internal Audit, September 2011

Corporate Governance Code of Good Practice

HM Treasury, July 2011

Principles

- 5.1 The Board should ensure that there are effective arrangements for **governance**, **risk management** and **internal control** ... Advice about and scrutiny of key risks is a matter for the Board, not a committee. The Board should be supported by:
- an Audit & Risk Assurance Committee, chaired by a suitably experienced non-executive board member
 - an Internal Audit Service operating to Government Internal Audit Standards.

Government policy

- 5.3 The Board's regular agenda should include scrutinising and advising on risk management.
- 5.4 The key responsibilities of non-executive Board members include forming an Audit & Risk Assurance Committee.

Corporate Governance Code of Good Practice

HM Treasury, July 2011

Supporting provisions

5.5 The Head of Internal Audit should periodically be invited to attend board meetings, where key issues are discussed relating to governance, risk management or control [*across the body*]

5.6 The Board should assure itself of the effectiveness of the risk management system and procedures and its internal controls. The Board should give a clear steer on the desired risk appetite [*for the body*] and ensure that:

- there is a proper framework of prudent and effective controls, so that risks can be assessed, managed and taken prudently;
- there is clear accountability for managing risks;
- officials are equipped with the relevant skills and guidance to perform their assigned roles effectively and efficiently.

Corporate Governance Code of Good Practice

HM Treasury, July 2011

Supporting provisions *continued*

- 5.9 The Board and Accounting Officer should be supported by an Audit & Risk Assurance Committee, comprising at least three members. The Chair should be a non-executive of the Board with relevant experience. There should be at least one other non-executive of the Board on the Committee; the Committee may also choose to seek further non-executive membership from non-members of the Board in order to ensure an appropriate level of skills and experience. At least one, but preferably more, of these Committee members should have recent and relevant financial experience.
- 5.10 Advising on key risks is a role for the Board. The Audit & Risk Assurance Committee should support the Board in this role.
- 5.11 An Audit & Risk Assurance Committee should not have any executive responsibilities or be charged with making or endorsing any decisions. It should take care to maintain its independence. The Committee should be established and function in accordance with the [Audit Committee Handbook](#).

Corporate Governance Code of Good Practice

HM Treasury, July 2011

Supporting provisions *continued*

- 5.12 The Board should ensure that there is adequate support for the Audit & Risk Assurance Committee, including a secretariat function.
- 5.13 The annual *[Statement on Internal Control]* is published with the *[financial statements]* each year. In preparing it, the Board should assess the risks facing the *[body]* and ensure that the *[body's]* risk management and internal control systems are effective. The Audit & Risk Assurance Committee should normally lead this assessment for the Board.
- 5.14 The terms of reference of the Audit & Risk Assurance Committee, including its role and the authority delegated to it by the Board, should be made available publicly. The *[body]* should report annually on the work of the Committee in discharging those responsibilities.

Audit Committee Handbook

HM Treasury, March 2007

Principle 1: The role of the Audit Committee

- The Audit Committee should support the Board and Accounting Officer by reviewing the comprehensiveness of assurances in meeting the Board and Accounting Officer's assurance needs, and reviewing the reliability and integrity of these assurances.

Principle 2: Membership, independence, objectivity and understanding

- The Audit Committee should be independent and objective; in addition each member should have a good understanding of the objectives and priorities of the organisation and of their role as an Audit Committee member.

Principle 3: Skills

- The Audit Committee should corporately own an appropriate skills mix to allow it to carry out its overall function.

Audit Committee Handbook

HM Treasury, March 2007

Principle 4: Scope of work

- The scope of the Audit Committee's work should be defined in its Terms of Reference, and encompass all the assurance needs of the Board and Accounting Officer. Within this, the Audit Committee should have particular engagement with the work of Internal Audit, the work of the External Auditor, and Financial Reporting issues.

Principle 5: Communication

- The Audit Committee should ensure it has effective communication with the Board, the Head of Internal Audit, the External Auditor, and other stakeholders.

Principle 1: The role of the Audit Committee

Assurance

- an evaluated opinion, based on evidence gained from review, on the organisation's governance, risk management and internal control framework

Supporting the Board

- how do Board members know they are giving their attention to the right things?
 - which aspects of governance, risk management and control are functioning effectively?
 - which aspects need to be given attention to improve them?
- assurance helps the Board decide whether or not its agenda is focussing on the issues that are most significant in relation to achieving the body's objectives and whether best use is being made of resources
- the Audit Committee can help the Board to formulate its assurance need, and advise on how well the assurance received actually meets the assurance need

Principle 1: The role of the Audit Committee

Formulating the assurance need

- assurance about what?
- level of confidence required (*informal, limit of liability*)?
- frequency of assurance (*continuous, periodic, annual*)?
- sources of assurance (*management or independent*)?
- resources to be dedicated to providing assurance?

Advising on how well assurance received meets the need

- constructively challenging assurance providers:
 - does their scope meets the assurance need?
 - are the actual assurances based on sufficient reliable evidence?
 - are the conclusions reasonable?
- proactively commissioning additional assurance if significant issues not being reviewed
- seeking assurance that any weaknesses identified are remedied.

Principle 2: Membership, independence, objectivity and understanding of the Audit Committee

Independence

- independent non-executives who are willing to serve
- may consider external members with particular skills or experience (but needs care)

Relationship with Executive

- Executive are not members; their role is to provide information
- the Accounting Officer and Finance Director should routinely attend
- but members may sit privately without any non-members present

Conflicts of interest

- personal responsibility to declare and Chair to determine appropriate action

Terms of appointment

- clear understanding of expected roles, time commitment and duration of appointment
- individual performance appraised

Principle 3: Skills of the Audit Committee

An appropriate skills mix to carry out its function

- the Audit Committee needs a range of skills and experience relevant to governance, risk and control
- at least one member should have recent and relevant financial management and financial reporting experience
- other skills required for Committee effectiveness should be identified, and agreed with the Board
- the Committee should be empowered to co-opt members or procure specialist advice (*at the body's expense with Board approved budgets*)
- all members have training and development needs.

Principle 4: Scope of the Audit Committee's work

Encompassing all the assurance needs of the Board and Accounting Officer

- determining the assurance needs

planning

- evaluating sources of assurance (or gaps)
- testing and determining their reliability

receiving

- forming overall view on state of governance, risk management and control
- drawing attention to areas where:
 - risk being appropriately managed
 - risk being inadequately controlled
 - risk is over controlled
 - lack of evidence to draw a conclusion
- advising on the accounting policies, the accounts, and the annual report

reporting

Principle 4: Scope of the Audit Committee's work

Sources of assurance

- management
- internal audit
- external audit
- other sources

Committee's role re assurance providers

- commissioning & appointment
- approve strategy, plans, terms of reference etc
- review results of work (the **assurance**) and management's response
- quality assurance (performance of assurance provider etc)
- advise the Board

Principle 5: Communication

Co-ordination between the Committee and the Board

- after each meeting inform the Board and Accounting Officer of:
 - business regarded as important
 - issues on which they should be taking action
- Committee's Annual Report (timed to support Statement of Internal Control):
 - comprehensiveness of assurances received and their reliability and integrity
 - implications of assurances for overall management of risk
 - issues impacting on SIC
 - financial reporting issues
 - performance of assurance providers
 - view of Committee's own effectiveness
- regular bilateral communications (*AC Chair, Board Chair, AO, HIA, external auditor*)

Suggested Audit & Risk Committee work programme

Determining the assurance needs

- risk management update - what's changing (*risks and Board's appetite*)?
- progress on addressing previous control issues (*action tracking, follow up*)?
- how does that impact on the assurance needs (*changes to provider plans*)?
- internal audit and external audit strategies and plans

Discussion of current arrangements

- are we clear on the Board's and the AO's assurance requirements?
- do we understand the risk management arrangements and do they alert us to what is changing?
- how do we know that previous issues are being dealt with?
- do we know what sources of assurance are available to us?
- how do we use our knowledge to ensure the assurance we commission remains relevant?

Suggested Audit & Risk Committee work programme

Receiving assurance

- review assurance reports received
- constructively challenge assurance providers (*appropriate scope, sufficient reliable evidence, reasonable conclusions?*)
- adequacy of management responses (*will weaknesses identified be remedied, any additional assurance required?*)

Discussion of current arrangements

- do we receive all the assurance we've commissioned when it is due?
- do we challenge providers on their scope, evidence and conclusions?
- do we understand management's responses?
 - how will they change the risk?
 - when will they change the risk?
- how do we know annual report & accounts comply with relevant policies and due processes were followed?
- do we consider appropriateness of anti-fraud arrangements?

Suggested Audit & Risk Committee work programme

Operational matters

- terms of reference and membership
- performance of assurance providers
- member training
- view of Committee's own effectiveness

Discussion of current arrangements

- do we ensure that our assurance providers are adequately resourced and performing as we require?
- how do we know we are suitably equipped to discharge our role?
- do we consider our own impact?

Suggested Audit & Risk Committee work programme

Reporting to Board & Accounting Officer

- emerging risks and their current state of mitigation (i.e are risk management and control systems effective to manage those risks?)
- financial reporting matters (accounting policies, accounts, organisation's annual report)

Discussion of current arrangements

- do we have a regular **dialogue** with the Board and the AO?
- do we brief both of them routinely on risk matters and financial reporting matters?
- how do we decide the content of our briefings?
- do our assurances draw appropriate attention to material weaknesses or losses to be addressed?

Example cycle of business

theme	Q1	Q2	Q3	Q4
Determining assurance needs	<ul style="list-style-type: none"> Review changes to risk profile Review progress on previous actions 	<ul style="list-style-type: none"> Review changes to risk profile Review progress on previous actions 	<ul style="list-style-type: none"> Review changes to risk profile Review progress on previous actions Approve next year's EA strategy 	<ul style="list-style-type: none"> Review changes to risk profile Review progress on previous actions Approve next year's IA plan
Receiving assurance	<ul style="list-style-type: none"> Receive IA annual report & opinion Review accounts and external audit results 	<ul style="list-style-type: none"> Receive IA reports Receive assurance from other sources 	<ul style="list-style-type: none"> Receive IA reports Receive assurance from other sources 	<ul style="list-style-type: none"> Receive IA reports Receive assurance from other sources
Operational matters	<ul style="list-style-type: none"> Appoint Chair Review ToR Review IA performance 	<ul style="list-style-type: none"> Review EA performance 	<ul style="list-style-type: none"> Committee training 	<ul style="list-style-type: none"> Review Committee's own effectiveness
Reporting to Board and AO	<ul style="list-style-type: none"> Advise on SIC content Agree Committee's annual report Advise AO on signing accounts and SIC 	<ul style="list-style-type: none"> Advise on changing risks and state of mitigation 	<ul style="list-style-type: none"> Advise on changing risks and state of mitigation 	<ul style="list-style-type: none"> Advise on changing risks and state of mitigation

Further reading

- Corporate Governance in Central Government Departments: Code of Good Practice 2011 *HM Treasury (July 2011)*
- Audit Committee Handbook *HM Treasury (March 2007)*
- Helping the Audit Committee to add value *National Audit Office (June 2011)*
- Management of risk - principles and concepts [*'Orange Book'*] *HM Treasury (October 2004)*