

Audit Committee Handbook

March 2007



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FOREWORD

The constitution and role of Audit Committees in central government has developed significantly in recent years. There has also been an ongoing initiative to embed effective risk management at all levels of the management of government organisations, which increases the need for explicit assurance about risk, control and governance in the organisation. Consequently the value that Accounting Officers and Boards place on the work of Audit Committees has increased.

This edition of the Audit Committee Handbook provides updated good practice guidance which:

- supports Audit Committees (and in turn, their Boards) in achieving the principles and provisions of “**Corporate governance in central government departments: Code of Good Practice**”;
- reflects the increasing availability of good practice experience for Audit Committees in central government; and
- reflects the increasing significance of risk management, and associated assurance needs, in the governance of government organisations.

The guidance in this handbook sets out five fundamental principles, with explanatory good practice notes. It should help with review of the appropriateness and fitness for purpose of the constitution, membership and activity of any particular Audit Committee.

The content of the Handbook has been developed with the help and support of a wide range of stakeholders. HM Treasury is indebted to those who have helped with this revision, and confident that their assistance has helped provide a Handbook that promotes challenging but achievable good practice which will support the continuing quest to improve risk management, internal control and governance in government.



Mary Keegan

Head of Government Finance Profession
HM Treasury

INTRODUCTION

1.1 The Treasury guidance “**Corporate governance in central government departments: Code of good practice**” (hereafter referred to as “**the code**”) provides that:

“**Principle 5:** The board should ensure that effective arrangements are in place to provide assurance on risk management, governance and internal control. In this respect, the board should be independently advised by:

- an audit committee chaired by an independent non-executive member;
- an internal audit service operating in accordance with Government Internal Audit Standards.”

1.2 On Audit Committees, this principle is supported by two provisions :

“**Provision 5.2:** The board should establish an audit committee, of at least three members. The chairman of the committee should be an independent non-executive member of the board and at least one of the committee members should have recent and relevant financial experience. The audit committee should be established and function in accordance with the Audit Committee Handbook.

Provision 5.3: The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available publicly. The department should report annually on the work of the committee in discharging those responsibilities.”

1.3 The code proposes, in **paragraph v** of its introduction:

“The principles and techniques outlined in the code will also prove useful for other parts of central government, other central government bodies and lower tiers of control and management, and in executive agencies. In these cases the code should be applied with adjustments to suit their scale, responsibilities and accountability chains.”

In the context of central government Audit Committees, this should be interpreted to mean that Audit Committees should be established in all departments, Executive Agencies and other Arms Length Bodies including executive Non-Departmental Public Bodies.

1.4 Sponsoring departments and their arms length bodies should ensure that the inter-relationship (including cross-attendance arrangements, if any) of their respective Audit Committees is agreed and appropriately documented (the inter-relationship of Accounting Officer responsibilities is an important factor in the inter-relationship of Audit Committees). Attention should be given to the processes by which information and assurance is communicated between Audit Committees, in particular assurance necessary to support the departmental Statement on Internal Control.

1.5 Some Audit Committees may also have wider responsibilities assigned to them. This can be valuable but care should be taken to ensure that the wider responsibilities do not provide a conflict with the guidance in this handbook. For example, an Audit Committee that is asked to also act as a Risk Committee needs to take particular care to avoid taking up the executive risk management function and to maintain its independence.

1.6 The variety of governance models found in government organisations means that a degree of flexibility will be needed in applying the guidance in this handbook to particular organisations. The basic governance model assumed by this handbook is that of an organisation headed by an Accounting Officer who is supported by a Board, which he or she chairs. In the case of organisations where the Accounting Officer does not chair, or is not a member of, the Board, (particularly NDPBs) the need for both the Board and the Accounting Officer to be supported by the Audit Committee will have to be appropriately accommodated – but the principles remain equally applicable. The **purpose** of the Audit Committee is not materially affected by the Board or governance structure which they support, although size of organisation and specific governance arrangements may well impact on the **way** in which the Audit Committee functions.

1.7 The Code requires that the Audit Committee should publicly report annually on its work and how it has discharged its responsibilities. As the Code also requires that the Audit Committee should be established in accordance with the Audit Committee handbook, the report should explain any non-compliance with the five principles of this Handbook, taking account of the supporting good practice guidance.

2

GOOD PRACTICE PRINCIPLES FOR AUDIT COMMITTEES

This Handbook sets out five good practice principles for Audit Committees in central government. These are summarised below and each principle is then further explained in chapters 3 to 7.

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.

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.

In addition, the role of the Chair and provision of appropriate secretariat support are important elements in achieving Audit Committee effectiveness. Good practice guidance on these roles is provided in **Annexes A and B**:

- the role of the chair: the Chair of the Audit Committee has particular responsibility for ensuring that the work of the Audit Committee is effective, that the Committee is appropriately resourced, and is maintaining effective communication with stakeholders; and

- Committee support: the Audit Committee should be provided with appropriate Secretariat support to enable it to be effective. This is more than a minute taking function - it involves providing pro-active support for the work of the Committee and helping its members to be effective in their role.

3

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.”

SUPPORTING THE BOARD

3.1 Boards have many issues competing for their attention. One of the challenges they and their members face is knowing whether they are giving their attention to the right issues. Assurance is key to addressing this. “**Management of Risk – Principles and Concepts**”¹ (the “**Orange Book**”) defines assurance as “an evaluated opinion, based on evidence gained from review, on the organisation’s governance, risk management and internal control framework”.

3.2 Assurance therefore draws attention to the aspects of risk management, governance and internal control that are functioning effectively and, just as importantly, the aspects which need to be given attention to improve them. Assurance helps a Board to judge whether or not its agenda is focussing on the issues that are most significant in relation to achieving the organisation’s objectives and whether best use is being made of resources. The Audit Committee can help the Board to formulate its assurance need, and then advise on how well assurance received actually meets the assurance need.

3.3 Formulation of the assurance need is key to determining the resource that needs to be dedicated to delivery of assurance in the organisation. Key elements of the assurance need include:

- the extent to which the Board wants to put in place periodic management assurance (e.g. stewardship reports to support year end accountability and reporting);
- the extent to which the Board wants to put in place ongoing management assurance (e.g. inspection or compliance teams which provide ongoing review of specific and defined areas of control); and
- the level of confidence required in assurances, including the extent to which the range of assurance providers can be relied on by Internal Audit in delivering its overall opinion on risk, control and governance in accordance with the **Government Internal Audit Standards**.

3.4 The provision of assurances to the Board should be reviewed by the Audit Committee. The Audit Committee is more than a processing centre for the range of assurances available in the organisation; rather the Audit Committee should constructively challenge:

- assurance providers as to whether the scope of their activity meets the Board and Accounting Officer’s assurance need; and

¹ Management of Risk – Principles and Concepts: HM Treasury, October 2004

- the actual assurances to test that they are founded on sufficient reliable evidence and that the conclusions are reasonable in the context of the evidence.

This adds to the value and usefulness of assurances by enhancing confidence in their reliability. The Audit Committee should also be proactive in commissioning assurance work from appropriate sources if it identifies any significant risk, governance and control issues which are not being subjected to sufficient review, and in seeking assurance that weaknesses identified by reviews that have been conducted are actually remedied.

3.5 The exact role of the Audit Committee will depend on the particular circumstances of the organisation. Examples of issues affecting the exact role of the Audit Committee include the strategic risk management arrangements that the Board and Accounting Officer have established, whether or not there is a separate Risk Committee, and the whistle-blowing arrangements which have been put in place as part of the anti fraud and corruption arrangements. An Audit Committee should not have any executive responsibilities or be charged with making or endorsing any decisions, although it may draw attention to strengths and weaknesses in control and make suggestions for how weaknesses might be dealt with. The overarching purpose of the Audit Committee is to advise the Board; it is then the Board that makes the relevant decisions.

3.6 To fulfil its role, an Audit Committee will need to meet at least four times a year. A model “core programme” of work for an Audit Committee meeting four times a year is provided at [Annex E](#).

TERMS OF REFERENCE

3.7 The Audit Committee should be given formal Terms of Reference by the Board. These should be reviewed regularly and in turn should require the Audit Committee to regularly review its own effectiveness. Model Terms of reference for an Audit Committee are suggested at [Annex D](#).

3.8 The Audit Committee should have appropriate authority to require any member of the organisation either to:

- attend an Audit Committee meeting; or
- provide written report(s) to the Audit Committee for the purpose of providing information to assist the Audit Committee in fulfilling its role of advising the Board.

3.9 The Audit Committee will require access to funding to cover the costs incurred in fulfilling its role. The funding should be sufficient to:

- adequately meet the remuneration and working expenses of its members;
- adequately meet the relevant training needs of its members;
- provide specialist (external) advice or opinions when required; and
- (if agreed as appropriate in the organisation) provide external review of the effectiveness of the Audit Committee.

4

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.”

INDEPENDENCE

4.1 An effective Audit Committee must have members who are both independent and objective. It is good practice, so far as possible, for audit committee members to be independent non-executive Board members.

4.2 However, many organisations will not have sufficient independent non-executive Board members who are also willing to serve as Audit Committee members to provide sufficient numbers or skills for the Audit Committee. To help build a Board capable of providing sufficient qualified members, it is worth remembering that willingness to serve on the Audit Committee could be considered as a factor in making non-executive Board appointments.

4.3 When there are insufficient non-executive Board members to form the Audit Committee, independent external members will need to be appointed. These members are appointed to the Audit Committee but not to the Board and Cabinet Office guidance on the recruitment, appointment and development of non-executive members of Civil Service Boards should still be applied. They will often be chosen because of particular skills or experience that they hold which will be beneficial to the Audit Committee. They may be remunerated at appropriate rate for the time and effort they are expected to contribute. As Audit Committee membership will be the only contact they have with the organisation, such members will have to make particular efforts to obtain and maintain appropriate understanding of the organisation, which is vital if they are to make a meaningful contribution to the Audit Committee’s considerations. In this respect, appropriate induction training is critical, as is an ongoing programme of activity to ensure the member maintains sufficient appropriate contact with the organisation.

RELATIONSHIP WITH THE EXECUTIVE

4.4 Executive members of the organisation should not be appointed to the Audit Committee. The role of the Executive is to attend, to provide information, and to participate in discussions, either for the whole duration of a meeting or for particular agenda items.

4.5 The Accounting Officer and the Finance Director should routinely attend the Audit Committee. It is also normal for the Head of Internal Audit and a representative of the External Auditor to attend. However, the Terms of Reference should also provide for the Audit Committee to sit privately without any non-members present for all or part of a meeting if they so decide.

OTHER PARTICIPANTS

4.6 It is also common for representatives of sponsoring or sponsored bodies to attend Audit Committee meetings (for example, a member of a department may attend the Audit Committee of one of its Executive Agencies). However, such representatives should not be appointed as members of the Audit Committee.

CONFLICTS OF INTEREST

4.7 Normally the process for recording declarations of conflicts of interests in the Audit Committee should mirror the processes used at Board level. Each member of the Committee should take personal responsibility to pro-actively declare any potential conflict of interest arising out of business arising on the Committee's agenda or from changes in the member's personal circumstances. The Chair of the Committee should then determine an appropriate course of action with the member. For example, the member might simply be asked to leave while a particular item of business is taken; or in more extreme cases the member could be asked to leave the Committee. If it is the Chair who has a conflict of interest, the Board should ask another member of the Committee to lead in determining the appropriate course of action. A key factor in determining the course of action will be the likely duration of the conflict of interest: a conflict likely to endure for a long time is more likely to suggest that the member should leave.

TERMS OF APPOINTMENT

4.8 All members of Audit Committees should have a clear understanding of:

- what is expected of them in their role, including time commitments;
- how their individual performance will be appraised, including a clear understanding of what would be regarded as unsatisfactory performance and the criteria which would indicate the termination of Audit Committee membership should be considered; and
- the duration of their appointment and how often it may be renewed.

4.9 The terms of appointment of an Audit Committee member should be clearly set out at the time of appointment. A model letter of Appointment is set out at **Annex C**. The letter should also specify what other activities the individual may or may not undertake in relation to the organisation. The impact on independence of further remuneration from other activities should be given careful consideration. More detailed guidance on the making of appointments can be found in "**Making and Managing Public Appointments**"¹, published by the Public Appointments Unit.

¹ http://www.publicappointments.gov.uk/upload/assets/www.publicappointments.gov.uk/public_appt_guide.pdf

5

SKILLS

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

RANGE OF SKILLS

5.1 The Audit Committee is charged with ensuring that the Board and Accounting Officer of the organisation gain the assurance they need on risk management, governance and internal control. So, it needs a range of skills and experience relevant to various aspects of risk, governance and control.

5.2 Because of the importance of financial management and financial reporting to every organisation, at least one member of the Committee should have recent and relevant financial experience. This experience should be sufficient to allow them to competently engage with financial management and reporting in the organisation, and associated assurances.

5.3 The Audit Committee should identify, and agree with the Board, the other skills required for Committee effectiveness. These identified skills should inform the choice of members of the Committee. The required skills set should be periodically reviewed.

ADDITIONAL SKILLS

5.4 The Audit Committee should be empowered to either:

- co-opt members for a period of time (not exceeding a year, and with the approval of the Board) to provide specialist skills, knowledge and experience which the Committee needs at a particular time; or
- procure specialist advice at the expense of the organisation on an ad-hoc basis to support them in relation to particular pieces of Committee business. Budgets for such procurement should be approved by the Board.

TRAINING AND DEVELOPMENT

5.5 All Audit Committee members, whatever their status or background, will have training and development needs. Those who have recently joined the Audit Committee will need induction training, either to help them understand their role¹; or if they have audit committee experience elsewhere, to help them understand the organisation. In particular those joining a public sector Audit Committee for the first time with no experience of government will need training to help them understand public sector standards, especially those relating to governance and accountability.

¹ Induction training courses for Audit Committee members are run by the National School of Government on a regular basis - <http://www.nationalschool.gov.uk/>

6

SCOPE OF WORK

“The scope of the Audit Committee’s work should be defined in its Terms of Reference and should 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”.

OVERALL ASSURANCE

6.1 In most organisations there are a number of sources of assurance, both internal and external, sometimes primarily intended for the benefit of the organisation and sometimes primarily intended for the benefit of another stakeholder. The Board and Accounting Officer’s assurance needs are largely met by evaluating the various sources of assurance (or gaps in sources of assurance), testing and determining their reliability, and then forming an overall view on the state of risk management, governance and internal control (which is especially important in supporting the Statement of Internal Control).

6.2 Overall assurance of this kind is unlikely to be capable of expression in a single phrase, sentence or indicator because it is highly unlikely that all risk will be equally managed. Rather, the overall view may draw attention to areas where:

- risk is being appropriately managed (no action needed);
- risk is inadequately controlled (action needed to improve control);
- risk is over controlled (resource being wasted which could be diverted to other use);
- there is lack of evidence to support a conclusion - and if this concerns areas material to the operations of the organisation more audit and/or assurance work will need to be done.

INTERNAL AND EXTERNAL AUDIT

6.3 In any government organisation there will be two significant sources of assurance that the Audit Committee can be certain will be present: Internal Audit and External Audit. In central government, the National Audit Office under the Comptroller and Auditor General is responsible for external audit. The work of Internal Audit is carried out primarily for the benefit of the Board and Accounting Officer of the organisation. Although the work of External Audit is normally primarily conducted for the benefit of Parliament, it is still of significant benefit to the organisation as well.

6.4 The work of Internal Audit is likely to be the single most significant resource used by the Audit Committee in discharging its responsibilities. This is because the Head of Internal Audit, in accordance with the Government Internal Audit Standards, has a responsibility to offer an annual opinion on the overall adequacy and effectiveness of the organisation’s risk management, control and governance processes (see **Government Internal Audit Standards, Standard 9, Reporting**). There is consequently a major synergy between the purpose of the Head of Internal Audit and the role of the Audit Committee.

6.5 The role of the Audit Committee in relation to Internal Audit should include advising the Board and Accounting Officer on:

- the Audit Strategy and periodic Audit Plans, forming a view on how well they support the Head of Internal Audit's responsibility to provide an annual opinion on the overall adequacy and effectiveness of the organisation's risk management, control and governance processes.
- the results of Internal Audit work, and management response to issues raised by that work.
- the resourcing of Internal Audit.
- the Terms of Reference (or equivalent) for Internal Audit.

6.6 Whilst the work of the External Auditor is not primarily conducted for the benefit of the organisation or its Audit Committee, the Audit Committee should nevertheless engage with the activity of the external auditor. As well as considering the results of external audit work, they should enquire about and consider the external auditor's planned approach and the way in which the external auditor is co-operating with Internal Audit to maximise overall audit efficiency, capture opportunities to derive a greater level of assurance and minimise unnecessary duplication of work.

FINANCIAL REPORTING

6.7 The Audit Committee will not itself be able to review the accounts in detail in order to advise the Accounting Officer whether they are true and fair. In reaching a view on the accounts, the Audit Committee should consider:

- key accounting policies and disclosures
- assurances about the financial systems which provide the figures for the accounts;
- the quality of the control arrangements over the preparation of the accounts by the Finance Director;
- key judgements made in preparing the accounts;
- any disputes arising between those responsible for preparing the accounts and the auditors.

7

COMMUNICATION

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

CO-ORDINATION BETWEEN THE COMMITTEE AND THE BOARD

7.1 The work of the Audit Committee needs to be effectively communicated if it is to be effective. After each meeting of the Audit Committee a report should be prepared for the Board and Accounting Officer to:

- summarise the business taken by the Committee, explaining if necessary why that business was regarded as important; and
- offer the views of, and advice from, the Committee on issues which they consider the Board or Accounting Officer should be taking action.

If the minutes of the Audit Committee meeting are used as the report, care should be taken in their presentation to highlight the advice being provided. These reports should normally be copied to the Head of Internal Audit and the External Auditor (especially if the report contains advice about or to the auditors).

ANNUAL REPORTS

7.2 The Audit Committee should also provide an Annual Report, timed to support preparation of the Statement on Internal Control. This internal report needs to be open and honest in presenting the Audit Committee’s views if it is to be of real benefit to the Board and Accounting Officer. This report is likely to also offer the basis for preparing a further report suitable for publication in fulfilment of the reporting requirements of **the Code**.

7.3 The Annual Report should summarise the Audit Committee’s work for the year past, and present the Audit Committee’s opinion about:

- the comprehensiveness of assurances in meeting the Board and Accounting Officer’s needs;
- the reliability and integrity of these assurances;
- whether the assurance available is sufficient to support the Board and Accounting Officer in their decision taking and their accountability obligations;
- the implication of these assurances for the overall management of risk;
- any issues the Audit Committee considers pertinent to the Statement on Internal Control and any long term issues the Committee thinks the Board and/or Accounting Officer should give attention to;
- financial reporting for the year;

- the quality of both Internal and External Audit and their approach to their responsibilities; and
- the Audit Committee's view of its own effectiveness, including advice on ways in which it considers it needs to be strengthened or developed.

BILATERAL COMMUNICATIONS

7.4 There should be mutual rights of access among each of the Chair of the Audit Committee, the Accounting Officer, the Head of Internal Audit, and the External Auditor (and, in NDPBs, the Chair of the Board). Whether or not that right of access is exercised, there should be an annual bilateral meeting between the Chair of the Audit Committee and each of these parties to ensure that there is clear understanding of expectations and mutual understanding of current issues.

A

THE ROLE OF THE CHAIR: GOOD PRACTICE

A.1 The role of the Chair of the Audit Committee goes a good deal beyond chairing meetings. Indeed it is key to achieving Committee effectiveness. The additional workload should be taken into account in appointment of the Chair.

A.2 Exactly how a particular Chair manages the Audit Committee will vary depending on the character of the individual and the needs of the specific organisation. Key activities beyond Committee meetings should include the following.

1. Agenda setting

Before each meeting the Chair and the Committee Secretary should meet to discuss and agree the business for the meeting. The Chair should take ownership of, and have final say in, the decisions about what business will be pursued at any particular meeting.

2. Communication

- The Chair should ensure that after each meeting appropriate reports are prepared from the Audit Committee to the Board and the Accounting Officer.
- The Chair should ensure that the Audit Committee provides a suitable Annual Report to the Board.
- The Chair should have bilateral meetings at least annually with the Accounting Officer, the Head of Internal Audit and the External Auditor, and in NDPBs, with the Chair of the Board. In addition, the Chair should meet any people newly appointed to these positions as soon as practicable after their appointment.
- The Chair should also ensure that all Committee members have an appropriate programme of interface with the organisation and its activities to help them understand the organisation, its objectives, business needs and priorities.

3. Monitoring actions:

The Chair should ensure that there is an appropriate process between meetings for action points arising from Committee business to be appropriately pursued. The Chair should also ensure that members who have missed a meeting are appropriately briefed on the business conducted in their absence. Chairs may choose to rely on the Secretariat to take these actions.

4. Appraisal:

- The Chair should take the lead in ensuring that Committee members are provided with appropriate appraisal of their performance as a Committee member and that training needs are identified and addressed. The Chair should themselves seek appraisal of their performance from the Accounting Officer (or Chair of the Board, as appropriate).

- The Chair should ensure that there is a periodic review of the overall effectiveness of the Audit Committee and of its Terms of Reference.

5. **Appointments:**

The Chair should be involved in the appointment of new Committee members, including providing advice on the skills and experience being sought by the Committee when a new member is appointed.

B

COMMITTEE SUPPORT: GOOD PRACTICE

B.1 A good secretariat function is more than a secretarial function. The secretariat should be able to support the Chair of the Committee in identifying business to be taken, and the relevant priorities of the business. For this reason, and as the Audit Committee is a committee of the Board, the Audit Committee Secretariat function should be supervised by the Board secretariat. The Chair of the Committee and the secretariat should agree procedures for commissioning briefing to accompany business items on the Committee's agenda and timetables for the issue of meeting notices, agendas, and minutes. The Chair of the Committee should always review and approve minutes of meetings before they are circulated.

B.2 The specific responsibilities of the Audit Committee Secretariat should include:

- meeting with the Chair of the Committee to prepare agendas for meetings;
- commissioning papers as necessary to support agenda items;
- circulating meeting documents in good time before each meeting;
- arranging for executives to be available as necessary to discuss specific agenda items with the Committee during meetings;
- keeping a record of meetings and providing draft minutes for the Chair's approval;
- ensuring action points are being taken forward between meetings;
- support the Chair in the preparation of Audit Committee reports to the Board;
- arranging the Chair's bilateral meetings with the Accounting Officer, the Head of Internal Audit and the External Auditor, and, in NDPBs, with the Chair of the Board;
- keeping the Chair and members in touch with developments and relevant background information about developments in the organisation;
- maintaining a record of when members' terms of appointment are due for renewal or termination;
- ensuring that appropriate appointment processes are initiated when required;
- ensuring that new members receive appropriate induction training, and that all members are supported in identifying and participating in ongoing training;
- managing budgets allocated to the Audit Committee.

B.3 Careful consideration should be given to ensuring that the Secretariat function is not biased. If the function is provided by Internal Audit there may be a risk of bias towards Internal Audit interests. On the other hand there is merit in ensuring the secretariat is independent of pressure from senior management, as could happen if the Board Secretariat also supports the Audit Committee.

B.4 When the Audit Committee decides to meet privately, the Chair should decide whether the secretariat members should also withdraw. If so, the Chair should ensure that an adequate note of proceedings is kept to support the Committee's conclusions and advice.

MODEL LETTER OF APPOINTMENT OF AN AUDIT COMMITTEE MEMBER

It is recommended that the following issues be included in the Letter of Appointment of an Audit Committee member:

APPOINTMENT AND PURPOSE

You are hereby appointed by the Board / Accounting Officer (delete as appropriate) as a member of the Audit Committee of (organisation). As a member of the Audit Committee you are accountable to the Board / Accounting Officer (*delete as appropriate*) through the Chair of the Committee. Your appointment is for (*number*) years from (*date*). This appointment may be renewed (*number*) times (by mutual agreement) after the duration of this appointment.

The Audit Committee is a Committee of the Board of (*organisation*) and the purpose of the Audit Committee is to:

- review the comprehensiveness of assurances in meeting the Board and Accounting Officer's assurance needs;
- review the reliability and integrity of these assurances;
- advise the Board and Accounting Officer about how well assurances consequently support them in decision taking and in discharging their accountability obligations.

A copy of the Audit Committee's Terms of Reference is enclosed.

The Committee is chaired by (name) and the other members are (names). [It is recommended that the new member be provided with a list of their contact details]

SUPPORT AND TRAINING

The Secretary of the Audit Committee is (name / contact details) and they will shortly be in touch with you to discuss and arrange appropriate induction training.

(Note – the “Audit Committee Induction Course”, provided by National School of Government and supported by HM Treasury, is particularly recommended).

To help you understand the governance arrangements and the role of Audit Committees in government, copies of “**Corporate governance in central government departments: Code of good practice**” and the Treasury “**Audit Committee Handbook**” are also enclosed with this letter of appointment.

COMMITMENT AND REMUNERATION

Your duties as an Audit Committee member are expected to typically take *(number)* days per annum, including time to read papers in preparation for meetings and a programme of activity to keep you in touch with the organisation's activities and priorities. The Audit Committee normally meets *(number)* times each year, but additional meetings may be required from time to time. Your remuneration will be *(include details of amount and means by which it will be paid)*.

CONFLICTS OF INTEREST

If during your period of appointment to the Audit Committee your personal circumstances change in any way that may provide a conflict of interest for you in your Audit Committee role, you are to declare the circumstances to the Chair of the Audit Committee.

APPRAISAL

As a member of the Audit Committee you will be subject to appraisal by the Audit Committee Chair *(include brief details of the appraisal process)*.

CONDUCT

Although your appointment does not make you a Civil Servant, you are expected to conduct yourself in your role in government in accordance with the principles of the *Civil Service Code*. A copy is enclosed.

TERMINATION

If you choose to resign from this appointment you will be expected to give *(number)* months notice, unless your circumstances have changed in a way that make it appropriate for you to resign immediately. If your performance as an Audit Committee member is decided to be unacceptable (see appraisal) or if your conduct (including conflicts of interests) is unacceptable your appointment may be terminated by the Board / Accounting Officer *(delete as appropriate)*.

D

MODEL TERMS OF REFERENCE FOR AN AUDIT COMMITTEE

The Board has established an Audit Committee as a Committee of the Board to support them in their responsibilities for issues of risk control and governance 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.

MEMBERSHIP

- The members of the Audit Committee are:
 - non-executive Board members: *List those who are appointed to the Audit Committee;*
 - independent External members: *List those who are appointed to the Audit Committee; (in all cases indicate the date of appointment and when the appointment is due to end / become eligible for renewal).*
- The Audit Committee will be Chaired by
- The Audit Committee will be provided with a secretariat function by.....

REPORTING

- The Audit Committee will formally report in writing to the Board and Accounting Officer after each meeting;
- the Audit Committee will provide the Board and Accounting Officer with an Annual Report, timed to support finalisation of the accounts and the Statement on Internal Control, summarising its conclusions from the work it has done during the year.

RESPONSIBILITIES

The Audit Committee will advise the Board and Accounting Officer on:

- the strategic processes for risk, control and governance and the Statement on Internal Control;
- the accounting policies, the accounts, and the annual report of the organisation, including the process for review of the accounts prior to submission for audit, levels of error identified, and management's letter of representation to the external auditors;
- the planned activity and results of both internal and external audit;
- adequacy of management response to issues identified by audit activity, including external audit's management letter;
- assurances relating to the corporate governance requirements for the organisation;

- (where appropriate) proposals for tendering for either Internal or External Audit services or for purchase of non-audit services from contractors who provide audit services;
- anti-fraud policies, whistle-blowing processes, and arrangements for special investigations;
- The Audit Committee will also periodically review its own effectiveness and report the results of that review to the Board.

RIGHTS

The Audit Committee may:

- co-opt additional members for a period not exceeding a year to provide specialist skills, knowledge and experience;
- procure specialist ad-hoc advice at the expense of the organisation, subject to budgets agreed by the Board.

ACCESS

- The Head of Internal Audit and the representative of External Audit will have free and confidential access to the Chair of the Audit Committee.

MEETINGS

- The Audit Committee will meet at least four times a year. The Chair of the Audit Committee may convene additional meetings, as they deem necessary;
- a minimum of ... members of the Audit Committee will be present for the meeting to be deemed quorate;
- Audit Committee meetings will normally be attended by the Accounting Officer, the Finance Director, the Head of Internal Audit, and a representative of External Audit (*add any others who may routinely attend such as representatives of sponsoring / sponsored bodies*);
- the Audit Committee may ask any other officials of the organisation to attend to assist it with its discussions on any particular matter;
- the Audit Committee may ask any or all of those who normally attend but who are not members to withdraw to facilitate open and frank discussion of particular matters;
- the Board or the Accounting Officer may ask the Audit Committee to convene further meetings to discuss particular issues on which they want the Committee's advice.

INFORMATION REQUIREMENTS

For each meeting the Audit Committee will be provided with:

- a report summarising any significant changes to the organisation's Risk Register;
- a progress report from the Head of Internal Audit summarising:
 - work performed (and a comparison with work planned);
 - key issues emerging from Internal Audit work;
 - management response to audit recommendations;
 - changes to the Periodic Plan;
 - any resourcing issues affecting the delivery of Internal Audit objectives;
- a progress report from the External Audit representative summarising work done and emerging findings.

As and when appropriate the Committee will also be provided with:

- proposals for the Terms of Reference of Internal Audit;
- the Internal Audit Strategy;
- the Head of Internal Audit's Annual Opinion and Report;
- quality Assurance reports on the Internal Audit function;
- the draft accounts of the organisation;
- the draft Statement on Internal Control;
- a report on any changes to accounting policies;
- external Audit's management letter;
- a report on any proposals to tender for audit functions;
- a report on co-operation between Internal and External Audit.

The above list suggests minimum requirements for the inputs which should be provided to the Audit Committee. In some cases more may be provided. For instance, it might be agreed that Audit Committee members should be provided with a copy of every Internal Audit assignment report, or with copies of management Stewardship Reports if these are used in the organisation.

E

EXAMPLE CORE WORK PROGRAMME FOR AN AUDIT COMMITTEE MEETING FOUR TIMES A YEAR

SPRING MEETING

- Comment on the accounts for the year just finished prior to their finalisation and submission for audit;
- advise on the content of the Statement on Internal Control for the year just finished, to be presented alongside the finalised accounts;
- review Internal Audit's finalised periodic work plan for the financial year just begun.
- agree the Audit Committee's annual report to the Board and Accounting Officer.

SUMMER / PRE-RECESS MEETING

- Review and consider the accounts;
- consider (emerging) External Audit opinion for the financial year just finished and advise the Accounting Officer on signing the accounts and Statement on Internal Control (SIC);
- consider Internal Audit opinion for the financial year just finished;
- discuss the implications of the result of the Accounting Officer's review of effectiveness of the system of internal control in relation to the SIC;
- (some Audit Committees choose to have an additional meeting timed to deal with no business other than the pre-recess finalisation of the accounts.)

AUTUMN MEETING

- Consider mid year report on emerging findings from Internal Audit;
- consider the External Audit management letter for the previous year, any emerging findings from the current interim / in-year work of External Audit, and External Audit's approach to their work;
- consider the External Audit strategy proposed in respect of the current year's accounts;
- consider any residual actions arising from the previous year's work of both internal and external audit.

WINTER MEETING

- Advise on the Internal Audit strategy and the periodic work plan for the beginning of the new financial year;
- consider areas in which the Committee will particularly promote co-operation between auditors and other review bodies in the coming year;
- re-visit emerging findings from auditors and review actions in response to the External Audit management letter;
- consider the Committee's own effectiveness in its work.

F

KEY QUESTIONS FOR AN AUDIT COMMITTEE TO ASK

This list of questions is not intended to be exhaustive or restrictive nor should it be treated as a tick list substituting for detailed consideration of the issues it raises. Rather it is intended to act as a “prompt” to help an Audit Committee ensure that their work is comprehensive.

On the strategic processes for risk, control and governance, how do we know:

- that the risk management culture is appropriate?
- that there is a comprehensive process for identifying and evaluating risk, and for deciding what levels of risk are tolerable?
- that the Risk Register is an appropriate reflection of the risks facing the organisation?
- that appropriate ownership of risk in place?
- that management has an appropriate view of how effective internal control is?
- that risk management is carried out in a way that really benefits the organisation or is it treated as a box ticking exercise?
- that the organisation as a whole is aware of the importance of risk management and of the organisation’s risk priorities?
- that the system of internal control will provide indicators of things going wrong?
- that the AO’s annual ‘Statement on Internal Control’ is meaningful, and what evidence underpins it?
- that the SIC appropriately discloses action to deal with material problems
- that the Board is appropriately considering the results of the effectiveness review underpinning the SIC?

On risk management processes, how do we know:

(A more detailed tool for evaluation of risk management is the “Risk Management Assessment Framework” produced by HM Treasury)

- how senior management and Ministers support and promote risk management?
- how well people are equipped and supported to manage risk well
- that there is a clear risk strategy and policies?
- that there are effective arrangements for managing risks with partners?

- that the organisation's processes incorporate effective risk management?
- if risks are handled well?
- if risk management contributes to achieving outcomes?

On the planned activity and results of both internal and external audit, how do we know:

(A more detailed tool for evaluation of the quality of the Internal Audit service is the "Internal Audit Quality Assessment Framework" produced by HM Treasury)

- that the Internal Audit strategy is appropriate for delivery of a positive reasonable assurance on the whole of risk, control and governance?
- that the periodic audit plan will achieve the objectives of the Internal Audit strategy, and in particular is it adequate to facilitate a positive, reasonable assurance?
- that Internal Audit has appropriate resources, including skills, to deliver its objectives?
- that Internal Audit recommendations that have been agreed by management are actually implemented?
- that any issues arising from line management not accepting Internal Audit recommendations are appropriately escalated for consideration?
- that the quality of Internal Audit work is adequate? / what does application of the Internal Audit Quality Assessment Framework tell us about the quality of the Internal Audit service?
- that there is appropriate co-operation between the internal and external auditors?

On the accounting policies, the accounts, and the annual report of the organisation, how do we know:

- that the accounting policies in place comply with relevant requirements, particularly the Financial Reporting Manual?
- there has been due process in preparing the accounts and annual report and is that process robust?
- that the accounts and annual report have been subjected to sufficient review by management and by the Accounting Officer and / or Board?
- that when new or novel accounting issues arise, appropriate advice on accounting treatment gained?
- that there is an appropriate anti-fraud policy in place and are losses suitably recorded?
- that suitable processes are in place to ensure accurate financial records are kept?

- that suitable processes are in place to ensure fraud is guarded against and regularity and propriety is achieved?
- that financial control, including the structure of delegations, enables the organisation to achieve its objectives with good value for money?
- if there are any issues likely to lead to qualification of the accounts?
- if the accounts have been qualified, that appropriate action is being taken to deal with the reason for qualification?
- that issues raised by the External Auditors are given appropriate attention?

On the adequacy of management response to issues identified by audit activity, how do we know:

- that the implementation of recommendations is monitored and followed up?
- that there are suitable resolution procedures in place for cases when management reject audit recommendations which the auditors stand by as being important?

On assurances relating to the corporate governance requirements for the organisation, how do we know:

- that the range of assurances available is sufficient to facilitate the drafting of a meaningful Statement on Internal Control?
- that those producing the assurances understand fully the scope of the assurance they are being asked to provide, and the purpose to which it will be put?
- what mechanisms are in place to ensure that assurances are reliable?
- that assurances are 'positively' stated (ie – premised on sufficient relevant evidence to support them)?
- that the assurances draw appropriate attention to material weaknesses or losses which should be addressed?
- that the Statement on Internal Control realistically reflects the assurances on which it is premised?

On the work of the Audit Committee itself, how do we know:

- that we are being effective in achieving our terms of reference and adding value to corporate governance and control systems of the organisation?
- that we have the appropriate skills mix?
- that we have an appropriate level of understanding of the purpose and work of the organisation?
- that we have sufficient time to give proper consideration to our business?
- that our individual members are avoiding any conflict of interest?
- what impact we are having on an organisation?



AUDIT COMMITTEE COMPETENCY FRAMEWORK

All members of the Audit Committee should have, or acquire as soon as possible after appointment:

- understanding of the objectives of the organisation and current significant issues for the organisation;
- understanding of the organisation's structure, including key relationships such as that with a sponsoring department or a major partner;
- understanding of the organisation's culture;
- understanding of any relevant legislation or other rules governing the organisation;
- broad understanding of the government environment, particularly accountability structures and current major initiatives.

The Audit Committee should corporately possess:

- knowledge / skills / experience (as appropriate and required) in:
 - accounting;
 - risk management;
 - audit ;
 - technical or specialist issues pertinent to the organisation's business.
- experience of managing similar sized organisations;
- understanding of the wider relevant environments in which the organisation operates; and
- detailed understanding of the government environment and accountability structures.

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