

CIPFA Better Governance Forum

# Audit Committee Update

- helping audit committees to be effective

Issue 4

Strategic Risk Management

Governance risks in 2011

Role of the Head of Internal Audit

January 2011

# Introduction

Dear Audit Committee Member,

This is the fourth issue of Audit Committee Update and it is now a year since the first issue. I hope you have found them useful.

This issue focuses on strategic risk management. In a period of rapid change where far-reaching decisions have to be made, it is vital that risk management is at the heart of that process. In some organisations risk management is considered to be a rather bureaucratic exercise and is not always used successfully. Used effectively risk management will help the organisation achieve its objectives and improve decision making. The audit committee has a key role to play in supporting the application of good governance principles in decision making and risk management has much to offer.

Also in this issue we have drawn together a 'Top 10' list of potential risk areas your organisation might be facing in 2011. This handy checklist provides the audit committee with 10 key issues, together with suggested follow up actions for the audit committee. We hope you find it useful. Please let us know if you would like this to be an annual feature of these briefings.

CIPFA has just published its statement of the role of the head of internal audit in the public services. We feature an article from Clive Darracott, who was secretary to the steering group that drew up the statement, explaining what the statement is all about and how audit committees can use it.

2011 promises to be a challenging year across the public services and audit committee agendas will be challenging too. We aim to support you in meeting that challenge.

Best wishes

Diana Melville  
CIPFA Better Governance Forum

## Future issues of this briefing:

The next issue is planned for May and will focus on International Financial Reporting Standards.

We are also starting to plan future issues. Possible topics include:

- Value for money
- Scrutiny of treasury management
- Evaluating the effectiveness of internal audit
- Partnerships & shared service arrangements
- Information governance risks

We welcome feedback and suggestions for future issues. Please let us know what you would like to see.

## Workshops and training for audit committee members in 2011 from CIPFA

### **Advanced Audit Committees**

Have you cracked the basics? Then how about your role in relation to value for money, countering fraud and treasury management?

1<sup>st</sup> March 2011 – London

Further details on the website <http://www.cipfanetworks.net/governance/events/>

### **Effective Audit Committees**

23<sup>rd</sup> March 2011 – Edinburgh

7<sup>th</sup> June 2011 – Glasgow

### **CIPFA Audit Conference**

11<sup>th</sup> May - Brighton

Day 1 of the audit conference focuses on the strategic issues of governance and financial challenge for public service organisations. It will be of benefit to audit committee members as well as auditors.

### **International Financial Reporting Standards – issues for audit committees**

7<sup>th</sup> June - Webinar

### **Managing the external audit contract – the audit committee role**

Addressing the key issues audit committees will need to address to evaluate the appointment of external auditors and to monitor their performance.

10<sup>th</sup> November – Birmingham

16<sup>th</sup> November – London

17<sup>th</sup> November - York

### **In house training**

In house training tailored to your needs is available. For further details contact Claire Simmons on 0208 6678542 or [Claire.Simmons@cipfa.org.uk](mailto:Claire.Simmons@cipfa.org.uk) or visit the website <http://www.cipfanetworks.net/training/portfolio/>

## Receive our briefings directly:

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

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

[http://www.ipf.com/ipfvalidation/login/register\\_visitor.asp?dest=www.cipfanetworks.net](http://www.ipf.com/ipfvalidation/login/register_visitor.asp?dest=www.cipfanetworks.net) .

# The role of the audit committee in strategic risk management

This article will outline the key role an audit committee should play in supporting and reviewing risk management in their organisation. The role of the audit committee is important but it can be difficult sometimes to determine what the discrete role is. The article will outline first of all what risk management is all about and then consider the audit committee role. It will end with some key questions that audit committees might like to consider.

## **What is risk management and why is it important to the organisation?**

The British Standard ISO 31000:2009 (1) defines risk management as 'coordinated activities to direct and control an organisation with regard to risk'. Risk is simply defined as the 'effect of uncertainty on objectives'.

Effective risk management has a number of benefits to an organisation and is now seen as a key tool across public and private sectors. Management of risk enables an organisation to:

- Increase the likelihood of achieving objectives;
- Improve governance;
- Comply with legal and regulatory requirements;
- Support better decision making;
- Improve operational effectiveness and efficiency.

These benefits demonstrate that risk management isn't just about dealing with problems better; it is also an aid to improvement.

## **How does risk management link to internal control and governance?**

The importance of risk management in supporting good governance is clearly set out in the principles of the Good Governance Standard for Public Services (2). One of the six principles is 'Good governance means taking informed, transparent decisions and managing risk.' In the local government Good Governance Framework (3) this principle has been adapted to the local government context to be 'Taking informed and transparent decisions which are subject to effective scrutiny and managing risk.' The framework emphasises the importance of risk management for the successful delivery of services.

The internal controls of an organisation should be influenced by the risks. An effective control will manage an identified risk, perhaps by reducing the likelihood of the risk happening, or minimising the impact if it did. When controls are reviewed their success in managing those risks should be considered. Sometimes controls are put in place to manage risks but continue to operate even though the risk has changed or other controls now address the risk. This can lead to inefficiency.

## **What is the typical role for the Audit Committee?**

The precise roles and responsibilities towards risk management will vary according to the terms of reference. CIPFA's position statement on audit committees in local government (4) identifies the following core functions:

- Consider the effectiveness of the authority's risk management arrangements.
- Seek assurances that action is being taken on risk related issues identified by auditors and inspectors.
- Be satisfied that the authority's assurance statements... properly reflect the risk environment.

The way that an audit committee fulfils these functions are likely to include:

- Oversight of the risk management function & its effectiveness, for example whether there are senior management and member risk management champions, reviewing improvement plans, results of benchmarking etc.
- Reviewing risk management annual plans, annual reports and the assessment of risk maturity of the organisation.
- Commenting on changes to the risk management policies of the organisation.
- Understanding the key risks facing the organisation, by reviewing risk registers or receiving briefings on key risk areas. Knowledge of the key risks helps the committee discharge their other responsibilities such as reviewing the internal audit plan or reviewing the annual governance statement.

### **How can the Audit Committee support and encourage the effectiveness of the risk management function?**

This is a valuable role for the organisation. Good understanding amongst audit committee members of what risk management can and should be doing, will help to raise the profile of risk management across the organisation. By monitoring the performance of risk management and any obstacles to improvement, the audit committee can help to ensure the adoption of good practice across the organisation.

When the audit committee reviews the organisation's key risks it may want to seek assurance that the actions being undertaken are having an effect. If there are concerns about critical risks then questions from the audit committee can help to ensure that the appropriate action is taken.

Understanding the organisation's key risks and the overall risk profile can help the audit committee take a more coordinated approach to its assurance statements. This can help those working in risk management too. For example the committee can consider what assurance it receives about the major risk areas.

The following case studies provide some examples of how an audit committee can support their organisations to manage risk better.

#### **Case Study 1**

A local authority was planning a major refurbishment of the building where the IT data centre was located. This was highlighted as 'high risk' on the risk register because of the IT director's concerns about damage and service interruption. The audit committee requested a briefing from the property team responsible for the refurbishment to ensure that adequate protection and contingency arrangements would be in place.

#### **Case Study 2**

In one central Government Department, the Chairman of the Audit Committee plays an active role in the corporate governance exercise for preparing the Statement on Internal Control. The Chairman meets with each Director General to discuss the assertion statement and return they have provided on the effectiveness of the risk and internal control environment operating in their Group. This helps the Chairman understand how the Groups are managing their risks as well as identifying some common risk and control themes across the Department. The Chairman then discusses these themes with the Accounting Officer which are fed into the draft Statement on Internal Control. This approach enables the Chairman to be able to attest to the rest of the Audit Committee that an appropriate evidence base exists for the disclosures made in the draft Statement on Internal Control and facilitates the Committee's recommendation to the Accounting Officer that he or she sign the Statement on Internal Control.

#### **Case Study 3**

At the London Borough of Enfield, in addition to considering corporate risks and

opportunities every six months and departmental risk registers on a rolling programme, Members of the Audit Committee decided to track the management of risk relating to safeguarding vulnerable adults and children. A review of procedures against risk of abuse to the vulnerable had been included on the Corporate Risk Register; however Audit Committee Members wanted to seek additional assurance following recent nationally publicised tragedies at neighbouring authorities. Members questioned and challenged reports presented on safeguarding services to vulnerable children, to vulnerable adults, and about ensuring safeguarding within the recruitment process. They gained assurance, despite the inherent risks associated with this high profile area of Council responsibility, that every reasonable measure is being taken to minimise and manage relevant risks.

These case studies demonstrate how strategic risk management provides the audit committee with the opportunity to influence and support good governance in the organisation. Familiarity with this role will enable the audit committee to identify new risks to good governance and also support the audit committee to be more effective across the full range of its responsibilities.

### Key Questions to ask:

1. How consistently is the risk management policy applied across the organisation? What is being done to address any weak areas?
2. Has the risk maturity of our organisation been assessed? In what areas have we improved in the last year and what still needs to be done?
3. What are the major risks facing the organisation?
4. How effectively are risks being managed in a particular area? For example, a major project, change programme or key strategic service.
5. How do we get our assurance about the management of risks and how does this link to the annual governance statement (statement on internal control, statement on internal financial control as appropriate)?

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Acknowledgements: thanks to members of the Risk Advisory Group for commenting on and contributing to this article.

### References

1. Risk Management – Principles and Guidelines, British Standard ISO 31000:2009
2. Good Governance Standard for Public Services, OPM & CIPFA 2004
3. Delivering Good Governance in Local Government Framework, CIPFA & SOLACE 2007
4. Position statement on audit committees in local government, CIPFA

# 10 governance risks for 2011

The audit committee is well placed to understand the risks to good governance the organisation faces. Such risks might arise from external factors, for example legislative changes. Or they could arise from changes or initiatives within the organisation.

The Better Governance Forum has put together a 'Top 10' of governance issues the audit committee might want to review during 2011.

	Potential Risk Area	What the audit committee can do
1	<p><b>Service reduction plans</b></p> <p>Has the approach to identifying budget savings involved 'good governance' principles? For example have the full range of risks been identified? Will new risks be created by the proposals?</p> <p>There is no 'easy' way to implement a significant programme of savings but the goal should be to maintain a viable organisation. This means looking at longer term issues as well as short term impacts.</p>	<p>Ask about the process to identify proposed budget savings or service reductions.</p> <p>Seek assurance that the proposals are supported by:</p> <ul style="list-style-type: none"> <li>• Good quality data.</li> <li>• Comprehensive risk identification</li> <li>• Evidence of consultation</li> <li>• Impact assessments, for example equalities or environmental</li> </ul> <p>Use the Better Governance Forum risk tool to assess governance risks.</p>
2	<p><b>Major organisational change programmes</b></p> <p>Is your organisation pursuing a major change programme, for example significant outsourcing or shared services arrangements?</p> <p>Such programmes are likely to have significant legal, financial, service continuity and people risks that need to be carefully managed.</p> <p>Assurance and accountability arrangements also need to be considered, both for the project itself and for the new arrangements.</p>	<p>Seek assurance over the effective management of project risks.</p> <p>Ask about the plans for assurance and accountability. For example:</p> <ul style="list-style-type: none"> <li>• Will internal audit have access to the new body?</li> <li>• What financial risks are there and how will these be monitored?</li> <li>• Will the annual governance statement need to cover the new body?</li> </ul>
3	<p><b>Partnerships and the 'Big Society'</b></p> <p>Your organisation's goals and objectives for its partnerships might have changed, and so might those of your partners. As well as internal factors such as reduced funding, new initiatives such as the Big Society may change things.</p> <p>The consequence could be that you or a partner needs to change a partnership agreement or withdraw from the partnership. New forms of partnership might be proposed with new partners.</p> <p>Are there any financial, legal or reputation risks as a result? What are the consequences for service delivery?</p>	<p>Ask for the latest partnership risk assessments.</p> <p>Where there are significant strategic risks the audit committee might want to ask for assurance about how these risks are being managed.</p> <p>Consider whether there is scope to work with the audit committees of your partners.</p>

4	<p><b>Fraud Risks</b></p> <p>All of these governance risk areas also potentially increase the risk of fraud.</p> <p>Does the organisation have an up to date fraud risk assessment that reflects current changes?</p> <p>Has the risk of fraud been considered in relation to service reduction planning, IFRS etc?</p>	<p>Ask whether fraud risks have been identified, assessed and appropriate actions taken.</p> <p>Review major fraud risks.</p> <p>Use the checklist for those charged with governance to review your counter fraud arrangements.</p> <p>Ask if there have been briefings or guidance given for example on legislation such as the Bribery Act and to those working in 'at risk' areas such as procurement and contracts.</p>
5	<p><b>Transparency Agenda</b></p> <p>All public bodies are expected to publish details of expenditure by January 2011. Has your organisation complied or will they be able to do so?</p> <p>Have other aspects of decision making been made as transparent and accessible as possible?</p> <p>At the same time have you considered the fraud risks of greater transparency?</p> <p>Has the organisation developed a clear strategy to deal with redaction and commercially sensitive information?</p>	<p>Ask what actions have been taken and whether your organisation is ready.</p> <p>Ask whether the fraud risks have been identified and whether controls have been put in place. For example, staff should not change invoice or supplier details without verification from the supplier.</p>
6	<p><b>Changes to information governance legislation</b></p> <p>The Information Commissioner is now enforcing monetary fines on organisations which fail in their duties to comply with the Data Protection Act 1998. Other enforcement action (Undertakings and Audits) are also available.</p> <p>There is expected to be changes to the Freedom of Information Act to cover private sector organisations which deliver major outsourced public services.</p> <p>Cloud computing is considered as a major source for future efficiencies. Has the audit committee been presented with a business plan?</p>	<p>Ask what your organisation has done to review its compliance arrangements.</p> <p>If the organisation is collaborating with neighbouring authorities, have they set up an Information Sharing Protocol?</p> <p>Does the organisation have a clear policy about data security and encryption and are these policies updated regularly and brought to the attention of staff?</p> <p>Has the organisation developed a strategy of protecting and responding to a cybercrime attack?</p> <p>Do you have clauses in your contracts to manage FOI requests which may go to your private sector partner organisations?</p>

7	<p><b>Forthcoming changes to the standards regime (England)</b></p> <p>How will leadership in ethical government in your organisation be affected by the forthcoming legislation on standards committees?</p> <p>The Localism Bill was published in December 2010 and once enacted English authorities will no longer be required to have a standards committee or a code of conduct for members. The authority will have a duty to promote and maintain high standards of conduct.</p>	<p>Find out if your authority will be keeping its Standards Committee and whether it plans to develop a voluntary code of conduct.</p> <p>If there will be no standards committee, what Member body will provide leadership on ethical governance to ensure the authority can fulfil its duty to promote high standards of conduct?</p>
8	<p><b>Local Accountability</b></p> <p>With the reduction in national accountability such as the CAA, the government has said it wants to see greater local accountability. New plans for local referenda are set out in the recently published Localism Bill, together with measures for pay accountability.</p> <p>How is the audit committee responding to this challenge?</p>	<p>Evaluate how effective the audit committee is in providing local accountability.</p> <p>Existing routes for ensuring accountability are likely to be holding public meetings and publishing an annual report. Consider how effective these are and what more could be done.</p>
9	<p><b>Changes to external audit of local authorities</b></p> <p>In England new arrangements are being developed by Communities and Local Government. Legislation and guidance will come out later in 2011, together with any transition arrangements. There are likely to be implications for the audit committee concerning the appointment of external auditors.</p>	<p>Ensure that you are kept up to date with the latest guidance.</p>
10	<p><b>International Financial Reporting Standards</b></p> <p>For local authorities the 2010/11 accounts will be the first presented under new IFRS regulations. One of the goals of IFRS is to introduce greater transparency and accountability, but any change carries risks that need to be properly managed.</p>	<p>Ask how the IFRS transition is being managed.</p> <p>Ask for a briefing on what the changes mean for the audit committee and their review of the accounts.</p> <p>Review the Audit Commission checklist 'Countdown to IFRS'</p>

# The role of the Head of Internal Audit

More than ever before CIPFA sees a strong internal audit as crucial to all public service organisations. We are committed to supporting Heads of Internal Audit (HIAs) and have recently issued a Statement on the role of the HIA in public service organisations (download at <http://www.cipfa.org.uk/roleoftheHIA/>). This covers the whole of the public services and we are also issuing a version for local government that reflects the specific personal statutory responsibilities of chief financial officers and monitoring (legal) officers.

The Statement aims to clarify the role and raise the profile of the HIA and we are keen that this be widely used, and not just by HIAs. We wanted buy in from key stakeholders and so set up a steering group chaired by Mike More, Chief Executive of Westminster City Council and comprising senior internal audit, finance and governance people from across the public services. Members included the Head of the Government's Internal Audit Profession and the Institute of Internal Audit's Policy Director.

In drafting the Statement we identified five core principles:

## **The Head of Internal Audit in a public service organisation plays a critical role in delivering the organisation's strategic objectives by:**

1. championing best practice in governance and management, objectively assessing the adequacy of governance and management of existing risks, advising on responses to emerging risks and proposed developments; and
2. giving an independent and evidence based opinion on all aspects of governance, risk management and internal control.

## **To perform this role the Head of Internal Audit:**

3. must be a senior manager with regular and open engagement across the organisation, particularly with the Leadership Team and with the Audit Committee;
4. must lead and direct an internal audit service that is resourced to be fit for purpose; and
5. must be professionally qualified and suitably experienced.

and we set out the arrangements needed to support these:



## Using the Statement in your organisation

In launching the Statement Mike More said: *'A strong HIA is needed more than ever and we need to support them to make sure that they are able to give us the objective assurances that we need. All organisations should look at how their HIA arrangements compare with the Statement and make improvements where needed'*.

We see the relationship between the audit committee and the HIA as crucial, with the audit committee providing support for the HIA – by helping to see that they have the resources that they need and that their views and reports are properly considered – and providing challenge – by reviewing how well regarded the HIA and the service is and whether they are looking at the right areas and drawing well founded and measured conclusions. We don't want the Statement to be another 'tick box' to be completed but we do think that Audit Committees could ask some questions such as:

- Does the HIA have good relationships with others including the committee itself and with the Chief Executive, the Chief Financial Officer and the Legal Officer and the Board or Council?
- Does the HIA have enough resources to draw an annual opinion that is soundly based?
- Where the HIA has operational responsibilities do they have enough time to do their HIA job and are the audit arrangements for their operational responsibilities independent?
- Does (should) the audit committee have a role in the appointment and performance management of the HIA?
- Does the HIA's plan look at the important areas and does it link in with the organisation's risk register?
- Is the HIA's role (and others) clear in promoting good governance?
- Is the HIA's view sought on major new developments and major policy changes? (If not, why not?)
- Do staff in the organisations see the HIA post as one to aspire to and a good career move? (If not, why not?)

We hope that the Statement will produce some interesting debates and challenges. We will keep the Statement under review and will be very happy to take any comments.

We will also be working closely with CIPFA's Audit Panel and the Better Governance Forum to support HIAs and their staff and audit committees. The Audit Panel comprises HIAs from different sectors and they are our eyes and ears, ensuring that CIPFA is aware of the issues facing internal auditors. See our website for more details

<http://www.cipfa.org.uk/panels/audit/index.cfm> .

If you have any comments on the CIPFA Statement or any general comments on how CIPFA could support audit committee members please contact Keeley Lund, Technical Manager CIPFA, [Keeley.Lund@cipfa.org.uk](mailto:Keeley.Lund@cipfa.org.uk)

Clive Darracott  
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## Developments you may need to know about:

### **CIPFA publishes statement on the role of the head of internal audit.**

The statement is now available on the CIPFA website <http://www.cipfa.org.uk/roleoftheHIA/> For more details on the statement and how it is of interest to audit committee members read the article on page 8 of this issue.

CIPFA is now consulting on a statement specifically for local government. The consultation can be viewed here [http://www.cipfanetworks.net/governance/documentation/default\\_view.asp?library=158&category=1257&content\\_ref=12516](http://www.cipfanetworks.net/governance/documentation/default_view.asp?library=158&category=1257&content_ref=12516) . The deadline for comments is 19<sup>th</sup> January 2011.

### **Audit Committees in Wales**

The Welsh Assembly Government published a proposed measure for consultation in 2010 which would make audit committees compulsory in Wales. The government has now published all the responses received to their consultation, including CIPFA's response and the Stage 1 Committee report. These can be seen on the attached website, together with future progress of the measure. <http://www.assemblywales.org/bus-home/bus-legislation/bus-leg-measures/business-legislation-measures-localgov.htm>

Since the responses were published, CIPFA has been in detailed discussions to ensure that CIPFA's good practice guidance is reflected in the new legislation, particularly with regards to the core responsibilities and membership of the proposed mandated audit committees.

### **Localism Bill**

The bill was published in December 2010. The bill is wide-ranging but audit committee members should be particularly interested in the following areas:

- Changes to the standards regime in England and ethical governance.
- Changes to the forms of governance available to authorities
- Pay accountability
- Local referenda

A briefing on the bill is available from the Better Governance Forum website [http://www.cipfanetworks.net/governance/documentation/default\\_view.asp?library=160&category=1272&content\\_ref=12356](http://www.cipfanetworks.net/governance/documentation/default_view.asp?library=160&category=1272&content_ref=12356)

### **New guidance on reaching the value for money conclusion (local government England)**

From 2010/11 there will be a new, more focused approach to local value for money audit work by external auditors. For local government, including fire & rescue authorities and police authorities, external auditors will give their statutory value for money conclusion based on the following two criteria:

- The organisation has proper arrangements in place for securing financial resilience.
- The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

The work the external auditor will need to do to support their conclusion will depend on risk. When reviewing the external auditor's plans in this area, audit committee members should consider what other assurances they receive relating to value for money.

More details of the new approach can be found in the Audit Commission publication 'A new approach to value for money audit' published in December 2010. <http://www.audit-commission.gov.uk/localgov/audit/auditmethodology/fees/Pages/proposedscalesoffeesfor20112.aspx>

## **Delivering Good Governance in Local Government**

CIPFA and SOLACE are looking to undertake a review of the governance framework in local government during 2011. CIPFA wrote to Chief Executives in November 2010 seeking their initial thoughts on the current arrangements. The results will be publicised shortly.

## **Sustainability Reporting**

CIPFA has just published a new resource '*Sustainability Reporting: A Public Services Perspective*'. The publication sets out optional arrangements for expanding annual reporting to include a range of measures on sustainability. Where the organisation plans to publish performance data on a range of sustainability measures the audit committee may wish to consider the assurance arrangements in place to support the data, prior to publication.

## **Audit Committee Survey**

CIPFA Better Governance Forum will be undertaking a survey of audit committees in local government during 2011. The survey will identify how local authorities currently fulfil their responsibilities and also look ahead to likely developments.

We aim to have initial results available for announcement at the CIPFA Audit Conference on 11<sup>th</sup> and 12<sup>th</sup> May 2011. Further information and the results will be on the Better Governance Forum website later in the year.

# **The Audit Committee Cycle**

## **Audit Planning**

Audit plans are likely to come before the committee for approval in the next few months. Issue 1 of Audit Committee Update focused on audit planning and the issues the committee should consider when reviewing the plan. Copies of this issue and all others are available on the Better Governance Forum website [http://www.cipfanetworks.net/governance/documentation/default\\_view.asp?library=160&category=1272&content\\_ref=11243](http://www.cipfanetworks.net/governance/documentation/default_view.asp?library=160&category=1272&content_ref=11243)

## **Preparing to meet International Financial Reporting Standards**

Prior to reviewing the financial statements many audit committees find it helpful to have a briefing on new developments or changes to accounting policies. This is of particular value this year because of changes to international standards. Your finance team should be able to advise you. In addition watch out for the next issue of Audit Committee Update which will include an article on this topic.



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