

Better Governance Forum briefing paper

Audit Committee Update

-helping audit committees to be effective

Issue 2 – Reviewing the Annual Governance Statement or
Statement on Internal Control

May 2010

Introduction

Dear Audit Committee Member,

This is the second edition of the new series of briefing papers for audit committee members in public sector bodies.

Produced by the CIPFA Better Governance Forum it is free to our subscribing organisations. We aim to provide members of audit committees with direct access to relevant and topical information that will support them in their role. This issue includes an article to help you review your Annual Governance Statement or Statement on Internal Control and pointers to other information and guidance relevant to your role. If you missed the first edition, which covered the review of the audit plan, then you can download a copy from the Better Governance Forum website http://www.cipfanetworks.net/governance/library/default_view.asp?content_ref=9685

The CIPFA Better Governance Forum is part of the Chartered Institute of Public Finance and Accountancy which is the leading body for setting standards of governance and recommended practice for audit committees in local government and other parts of the public sector. The Forum is a subscription network covering all aspects of governance providing guidance, briefings and workshops.

We hope you will find these updates helpful. We have had some very positive feedback both from audit committee members and from those who support the committee. Please continue to send through your comments together with suggestions for future topics.

We aim to produce briefings three times a year. It will be emailed to the key contact in your organisation who will be able to email it to you or print it if you prefer. If you want to make sure you receive your copy directly please provide us with your details using the link on page 3.

Best wishes

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Future editions of this briefing:

The next edition is planned for September and will feature risk management and how the audit committee can help make the management of risk more effective in the organisation.

We are also starting to plan the editions for 2011. Possible topics for future editions are:

- Value for money
- International Financial Reporting Standards
- Counter-fraud arrangements
- Scrutiny of treasury management
- Effectiveness of internal audit.

Let us know which topics are most important to you and any other suggestions.

Workshops and training for audit committee members in 2010

Advanced Audit Committees

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

17 November 2010 – York

<http://www.cipfanetworks.net/governance/events/>

Effective Audit Committees

17 June 2010 – Glasgow

14 July 2010 - London

<http://www.cipfanetworks.net/training/>

Reviewing the Annual Governance Statement and Statement of Accounts

8 June 2010 – Birmingham

<http://www.cipfanetworks.net/governance/events/>

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

<http://www.cipfanetworks.net/training/>

If you have an organisational email address (for example jsmith@mycouncil.gov.uk) then you will also be able to register on our website. This will give you access to governance material and guidance documents. If you would like to request that these

Receive our briefings directly:

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

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Sign up today at www.cipfanetworks.net/governance.

Reviewing the Annual Governance Statement or Statement on Internal Control

What is an Annual Governance Statement (AGS), Statement on Internal Control (SIC) or Statement on Internal Financial Control (SIFC)?

The AGS, SIC or SIFC is a public statement, normally included with your statement of accounts, which explains how your organisation manages its governance and control arrangements. They are produced by both public and private sector organisations.

What does my organisation need to have?

Confusingly not all public bodies have the same requirement! While CIPFA recommends that all local government bodies in the UK have an Annual Governance Statement, this is only a statutory requirement in England and Northern Ireland. Welsh authorities have a Statement on Internal Control although an AGS is likely to be required from 2010/11 as the Welsh Assembly Government have consulted on this. In Scotland authorities are required to have a Statement on Internal Financial Control.

Central government bodies and health authorities are all required to have a Statement on Internal Control.

What's included in these statements?

Although the names are different, there are many similarities between these statements as they all evolved out of the Statement on Internal Financial Control. And there are common features in all good statements. A good statement is open and honest, stating what works well and where improvements are needed. It includes a plan, showing who is responsible for taking action and when they will take action by. It also outlines progress against previous action plans. Whilst the focus of an SIFC is on financial controls, the other statements cover the full range of internal controls and the AGS covers wider governance matters such as ethics and leadership too.

The statement summarises the key processes for delivering good systems of control and governance and indicates who is responsible for what. Processes are likely to include internal audit activity, risk management, performance management and other types of review and challenge. Responsibility lies with management, especially senior management, and the audit committee has an important role to play in providing challenge and oversight.

What does the Audit Committee do?

The audit committee has an on-going role in delivering good governance. Every time it reviews an audit report (internal or external) or holds an officer to account for his or her action (or inaction), it is helping to deliver good governance. In relation to the statement itself, the audit committee should take a robust and challenging approach, ensuring that:

- The statement reflects the organisation and is an honest self-assessment. Members should review evidence and challenge it where they believe it to be inaccurate or incomplete.
- They have sufficient assurance from enough separate parts of the organisation (this is known as 'triangulation' in audit circles) to be confident that, where controls and governance are deemed to be good, they are good and, where weaknesses are identified, the statement contains an accurate assessment of those weaknesses.
- The statement itself is well written and would be understood by someone with no knowledge of your organisation. In other words, it should be in plain English, with no jargon and it should include sufficient explanations.
- The action plan addresses all identified problem areas, including those identified in previous years where actions remain incomplete. Actions should be SMART (specific, meaningful, allocated, realistic and timely).

What makes for good governance?

Good practice approaches include:

- Creating and regularly reviewing a vision and direction for your organisation so that everyone understands what they are there to deliver.
- Indicating the level of service to be delivered – you can't be excellent at everything so what will you concentrate on and what can be good enough?
- Board / Member and officer roles are clearly defined, with schemes of delegation and codes of practice/conduct, so that everyone understands what they should and should not be doing.
- Having standing orders, financial regulations and guidance notes so that everyone knows what procedures are to be followed.
- A robust, challenging and supporting audit committee to provide oversight and review.
- Arrangements to ensure that you comply with laws and regulations and identify and act on changes promptly.
- Appropriate and flexible whistle-blowing arrangements.
- Methods to identify and act on officer and member development needs.
- Excellent and open communication with your community.
- Ways to ensure good governance in all your partnerships.
- Promotion of the values of good governance and ethical standards.

How do you draw up a good statement?

- Review and map your assurance framework to make sure that it covers all areas, including the hard to reach ones such as partnerships, and that you do not have any duplication in assurance.
- Obtain wide engagement – not just the head of audit or governance doing everything, but getting mini-governance or assurance statements from directors and heads of service that contribute to the overarching statement and/or setting up a working group to develop the statement.
- Be open and honest – it's about improvement and adding value, not about looking good.
- Be prepared to challenge yourself and look for areas for improvement, perhaps by benchmarking or comparing yourself with other organisations.
- Compare the assurances received to the strategic risk register. Are there any high risk areas that have not been adequately covered?
- Look for any inconsistencies or discrepancies. For example, has assurance been provided that there are no significant problems in an area but you have conflicting evidence from elsewhere (audit, risk, performance, complaints, fraud, etc)?
- Check progress against action plans during the year so problems can be dealt with quickly and governance becomes part of the way we do things round here, not just a once-a-year activity.
- Ensure that the action plan is widely known and understood in the organisation and beyond so that those charged with action are held to account and delivery is more likely.

Key questions to ask:

1. What process has the organisation gone through to gather evidence to support the AGS/SIC/SIFC? Has it involved staff from across the organisation?
2. Have assurance statements already gone through a process of challenge and review prior to presentation to the audit committee? What did this show?
3. Does the action plan flow out of the statement and identify the major issues we need to address as an organisation?
4. Does the action plan include actions outstanding from previous years, prioritised as necessary?
5. How will the action plan be communicated to staff, stakeholders and the public?

Other sources of information

There are lots of sources of information and guidance on governance that are general or sector specific. Ask your internal auditors or governance staff for copies of the guidance that relates to your organisation. The Better Governance Forum website contains the following documents:

The Statement on Internal Control: A guide for Audit Committees, National Audit Office
A Good Practice Guide to the Statement on Internal Control, National Audit Office
Delivering Good Governance in Local Government, Framework and Guidance Note, CIPFA & SOLACE
Rough Guide to the Annual Governance Statement, CIPFA

Elizabeth Humphrey
Senior Associate, CIPFA Better Governance Forum

Recent developments you may need to know about:

Application Note to Delivering Good Governance in Local Government: a Framework – CIPFA/SOLACE

In 2009 CIPFA published its Statement on the Role of the Chief Financial Officer in public service organisations. This was followed by the Statement on the Role of the CFO in Local Government. The statement has introduced the principle of 'comply or explain' for organisations when undertaking their annual governance reviews. The [Application Note to Delivering Good Governance in Local Government: a Framework](#) advises on the application of the Statement on the Role of the Chief Financial Officer in Local Government under the CIPFA/SOLACE Framework: Delivering Good Governance in Local Government. It shows how the annual governance statement can reflect compliance with the Statement for reporting purposes.

Statement on the Role of the Chief Financial Officer in public service organisations

Audit Committees outside local government may also like to consider the CIPFA Statement on the Role of the Chief Financial Officer in public service organisations when reviewing their governance arrangements. http://www.cipfa.org.uk/panels/finance_director/index.cfm

Update on the consultation on the role of Head of Internal Audit

The draft CIPFA Statement on the role of the Head of Internal Audit was launched at the CIPFA Audit Conference on 19th May 2010. The document and consultation material is available on the CIPFA website. <http://www.cipfa.org.uk/pt/consultations.cfm>

The CIPFA Statement has five principles which apply across all public service organisations:

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, commenting on responses to emerging risks and proposed developments; and
2. giving an objective 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.

Launch of the Effective Internal Audit guide

The guide provides guidance on assurance frameworks and the role of internal audit, how internal audit teams can improve and demonstrate their effectiveness. It includes case studies, improvement tools and links to other resources.

Audit committee members can use this guide to help understand how internal audit should support the achievement of the organisation's objectives and provide leadership within the organisation. In addition it also highlights how crucial the audit committee is in supporting internal audit. It will be available free to Better Governance Forum subscribing organisations on the website.

Severance Agreements for Chief Executives

The Audit Commission recently published a report examining severance payments to Chief Executives in local government. The report, *By Mutual Agreement*, includes recommendations to the Government, Councils and the Local Government Association. The report found that three in every ten departing council chief executives receive compensation for the early termination of their contract and the costs of severance payments for councils can be high. Making a severance payment may be in the best interests of councils and the taxpayer, but the formal processes are not working well. [By Mutual Agreement](#) Last year the Better Governance Forum published guidance on negotiating staff severance agreements. It is available from our website.

Counter fraud checklist for those responsible for governance

This new checklist is now available free to Better Governance Forum subscribing organisations on the website. http://www.cipfanetworks.net/governance/library/default_view.asp?content_ref=10290 It can be used by those responsible for governance (audit committees or equivalent) to assess their contribution to the fraud defences of their organisation and determine what action is needed. This is appropriate to use in any organisation.

Fraud risk evaluation diagnostic (FRED)

FRED enables practitioners such as risk managers, internal auditors, finance managers, and counter fraud specialists, to gain an understanding of the susceptibility to fraud and corruption of their organisation. The first part will be available soon.

It has been designed to:

- quickly gain an overview of the susceptibility of the organisation to fraud and to identify the high risk areas
- maintain an understanding of the level of fraud risk in the organisation over time
- Aid planning of work designed to combat fraud and corruption and as part of the development of a zero-tolerance culture.

FRED will also inform the Annual Governance Statement / Statement of Internal Control and help provide information for assessment of internal control by both internal audit and external audit.

The Audit Committee Cycle

Accounts

As well as reviewing the Annual Governance Statement or Statement on Internal Control, audit committees will also be reviewing the statement of accounts. If you are not experienced in this area it can be daunting to receive long complex documents and undertake a meaningful review. The accounts show the financial health of your organisation and its ability to manage its resources and they are important documents that are publicly available. Efforts should be made to present financial information clearly and in 'plain English' to non-experts and this is one of the areas where audit committee members can add value.

Audit Committee self-assessment

A periodic self-assessment of how you are performing can be a useful improvement step and can also support your Annual Governance Statement or Statement on Internal Control. There are a number of checklists you can use and copies can be found on our website:

A Toolkit for Local Authority Audit Committees, CIPFA Better Governance Forum
The Audit Committee Self-Assessment Checklist, National Audit Office

Annual Report on the Audit Committee

Does your audit committee produce an annual report on its work? Those that do have found it a useful way to demonstrate the range and impact of their work to the rest of the organisation, the public and other stakeholders.

Suggestions for what you should include:

- How you have fulfilled your terms of reference.
- Major areas reviewed during the year and recommendations made.
- Governance developments or changes that the committee has promoted.
- Development activities such as training undertaken.

Reflecting back over the year and the issues raised will also support your review of the Annual Governance Statement, Statement on Internal Control or Statement on Internal Financial Control and help to shape your work programme for 2010/2011.

If you would like to see examples of similar reports then you can find these on the Better Governance Forum website.



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