

# **NHS AUDIT COMMITTEE HANDBOOK – 2005**

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**NHS AUDIT COMMITTEE HANDBOOK - 2005**

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## **FOREWORD**

Welcome to the new Audit Committee Handbook. This is a complete rewrite of the 2001 edition, but builds on the established principles to reflect the needs of today's NHS.

New in this edition you will find references to the Assurance Framework, designed to provide a template to shape the Committee's risk assessment and risk management activities.

You will see references to Integrated Governance which has been developed to ensure that the strands of governance such as financial, clinical, research and risk are brought together in a coherent way.

Also, since the last edition, the Standards for Better Health have been developed. They bring together and rationalise existing requirements for the service, as well as describing a level of service which is acceptable and which must be universal.

From the above you would be right to conclude that today's Audit Committee will be expected to take a wider responsibility for scrutinising the risks and controls which affect all aspects of the organisation's business. As the senior Board Committee their role is central to the organisation's governance.

However, you should not conclude that these wider responsibilities are balanced by a reduction in the traditional finance role. On the contrary, the need for a sharp and critical financial focus is perhaps even greater than before. The increased public expectation arising from the substantially increased public funding would be reason enough. But this is coupled with rapidly changing dynamics within the system.

Foundation Trusts and Independent Sector Treatment Centres are new providers and, at the time of writing, plans are being developed for an enhanced commissioning function for reconfigured PCTs. Taken alongside Payment by Results, Patient Choice and Practice Based Commissioning, these changes will challenge the control systems and put Audit Committees on their mettle.

The Reference Group have done their best to ensure the Handbook is as helpful as possible. To help you in your role it retains an updated version of the "Self Assessment Checklist", which was found particularly useful in the earlier edition. Additional material describing the Committee's remit together with sample agendas and best practice guidance is included in comprehensive appendices.

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As ever, it has been a challenging balance between length and detail but I hope that you find the new Handbook is useful as you approach your key responsibilities.

***Roger Moore  
Chief Executive  
NHS Appointments Commission***

## **SUMMARY OF KEY DEVELOPMENTS**

The model Terms of Reference in this Handbook guide NHS Boards and Audit Committees to re-consider their approach to the scrutiny of the establishment and maintenance of an effective system of governance, risk management and internal control. This is consistent with the continued development of NHS Boards towards good governance principles, as well as recognising the developments in healthcare management and broader corporate governance. This handbook recognises that the requirement for a Statement on Internal Control, informed by an embedded system of assurance, is now joined by a clear public declaration on the Standards for Better Health, that require Boards and Audit Committees to consider the whole system of internal control. To carry this out effectively :

- Boards and their Audit Committee need to review their relative terms of reference and scheme of delegation to ensure that the most effective ways of working are in place
- Audit Committees need to broaden their traditional remit to include an overview on clinical risks and build their work programme around an embedded assurance framework that is fit for purpose
- Audit Committees need to look at the ways that they work and consider how they can be more effective
- Audit Committees need to maintain a focus on achieving strong financial management that will underpin operational developments

As NHS Trusts move towards NHS Foundation Trust status they should be looking to review the fitness for purpose of their Audit Committees, considering guidance from Monitor and wider developments in the private sector, such as the Smith Committee.

## **SECTION 1: PRINCIPLES**

### **Why do Audit Committees exist in the NHS?**

The Codes of Conduct and Accountability, issued in April 1994, set out the requirement for every NHS Board to establish an Audit Committee. That requirement remains in place today and reflects, not only established best practice in the private and public sectors, but the constant principle that the existence of an independent Audit Committee is a central means by which a Board ensures

effective internal control arrangements are in place. In addition, the Audit Committee provides a form of independent check upon the executive arm of the Board.

### **What does the Audit Committee do?**

Initially, and across all sectors, the main focus of an Audit Committee's work related to internal financial control matters, such as the safeguarding of assets, the maintenance of proper accounting records and the reliability of financial information. The importance of that financial scrutiny has certainly not diminished, but there is now an expectation of a wider focus by the Audit Committee, particularly in the NHS/public sector where there is a need to meet the broad range of stakeholder needs.

Today, as a consequence, the Audit Committee's primary role is to conclude upon the adequacy and effective operation of the organisation's overall internal control system. In performing that role the Committee's work will predominantly focus upon the framework of risks, controls and related assurances that underpin the delivery of the organisation's objectives (the Assurance Framework). As a result, the Committee has a pivotal role to play in reviewing the disclosure statements that flow from the organisation's assurance processes. In particular these cover the Statement on Internal Control, included in the Annual Report and Accounts, and the declarations under the Standards for Better Health required by the Healthcare Commission. Both of these documents should come to the Audit Committee before being submitted for approval to the Board.

It is clearly the job of executive directors and the Accountable Office to establish and maintain processes for governance. The Audit Committee independently monitors, reviews and reports to the Board on the processes of governance and, where appropriate, facilitates and supports, through its independence, the attainment of effective processes.

### **Where should the Audit Committee begin its work?**

The Committee needs to gain a clear understanding of the broad framework of governance in the organisation, particularly with regard to what other committees are doing. The starting point for this is to ensure that the overall process for governance is established and operating. To this end the Committee should use the Assurance Framework as its central tool for planning its work. To rely on this, the Committee needs to spend time ensuring that the Assurance Framework provides a complete coverage of the organisation, at a strategic level, and that the listing out of controls and assurances within it are reasonable.

The Committee can then concentrate on the high risk areas, either where the inherent risk is high and the level of dependency upon the operation of controls is critical, or where the residual risk is high and the situation needs monitoring.

The Committee should then use both management and auditors to give it assurance that the way of managing risks is effective. This will mean gaining assurance, in a number of formats, that the controls are effective and the risk acceptable, or else that action plans are in place and being implemented.

## **Who are the members of the Audit Committee?**

Audit Committees comprise not less than three non-executive directors, with a quorum of two. Neither the Chairman nor the Chief Executive of the organisation can be a member of the Audit Committee, although they should be invited to attend certain meetings either to form a view and understanding of the Committee's operation or to provide assurances and explanations to the Committee on specific issues. The Director of Finance and the Trust Secretary would normally be present, together with representatives from Internal and External Audit. Others may be invited or required to attend, as required.

The distinctiveness of the Audit Committee is that it solely comprises non-executives. This condition of membership provides the basis for the Committee to operate independently of any decision-making processes and to apply an objective approach in the conduct of its business.

Given the importance and complexity of the Committee's work it is unlikely that membership is best suited to non-executives who are new to their role or who do not have a background of operating on equivalent Committees in other organisations. As a minimum one member of the Committee must have recent relevant financial experience, and the other members must ensure that they receive induction and training in their role, including some basic financial literacy and an understanding of internal control. Increasingly, there is value in more than one member of the Committee having a financial background.

The selection of the Chairman is a critical appointment for the organisation. Consideration should be given to excluding the Audit Committee Chairman from all other committee responsibilities, but this may be part of a wider review of the roles and work of non-executive directors and will depend on the particular circumstances.

Rotation of members will be a matter of judgement for the organisation's Chairman and Board, but a balance needs to be struck between bringing in a fresh perspective and maintaining an experienced membership that has established effective relationships with those that attend the Committee. Any conflicts of interest would need to be dealt with in accordance with existing Codes that operate within the organisation.

## **How frequently should the Audit Committee meet?**

The frequency of meetings needs to be driven by the nature and timing of the business to be considered, any complementary work conducted by other committees and any work that can be carried out between meetings. This all needs to be determined at the outset of the financial year so that the Committee is not considering unnecessary issues, reacting to foreseeable events or commenting on matters that can no longer be influenced. Generally, to date, Audit Committees have met 3 to 4 times per year but there is a case, given the Committee's wider remit and the retention of a more focused financial scrutiny role, for this to increase to 5 to 6 times per year. This decision is one for the Board and the Committee to make if it is felt necessary to ensure that the Committee meets its terms of reference. Reducing the commitments of the Committee Chairman, and perhaps the other Committee members, may create additional capacity to ensure more frequent meetings, but this needs to be balanced with their need to understand sufficient of the breadth of the organisation's activities.

## **What authority does the Committee have?**

The Audit Committee must be invested with sufficient authority to act with independence. It should be constituted as a committee of the Board and the terms of reference should be set out in the minutes of the Board. Specimen terms of reference are at Appendix A.

Audit Committee meetings and their minutes should be formal. The minutes should be presented at the following Board meeting.

The Audit Committee should have explicit authority to receive full access to information and the ability to investigate any matters within its terms of reference, including the right to independent professional advice. The Trust Secretary should ensure that the Committee receives the resources that it needs to do so.

Membership of the Committee should be disclosed in the annual report.

## **How do the auditors support the Audit Committee's work?**

It is not the role of the Audit Committee to manage the internal and external audit functions; rather it should use the auditors to assist it in meeting its needs, along with other sources of advice and assurance.

In particular, the Committee should actively review the plans of the auditors, understanding the distinct and separate roles that each plays. Whilst the role of external auditors is set out firmly under the Audit Commission's Code of Audit Practice, there is more scope for the Committee to be pro-

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active in influencing the internal audit strategy and requesting work from internal audit that focuses on the assurance needs of the Audit Committee, and thereby the needs of the Board.

### Internal Audit

An effective Audit Committee is dependent, in many respects, on the existence of an effective internal audit function. Internal Auditors should attend every meeting and the cycle of approving and monitoring the progress of internal audit plans and reports, culminating in the Head of Internal Audit's opinion on the system of internal control, is a key feature of the work of the Committee across the year.

An important principle is that internal audit is an independent and objective appraisal service within an organisation. As such, its role embraces two key areas:

1. The provision of an independent and objective opinion to the Accountable Officer, the Board, and the Audit Committee on the degree to which risk management, control and governance support the achievement of the organisation's agreed objectives
2. The provision of an independent and objective consultancy service specifically to help line management improve the organisation's risk management, control and governance arrangements

Each year's annual plan should set out details of the assignments to be carried out, providing sufficient detail for the Audit Committee and other recipients to understand the purpose and scope of the defined assignments and their level of priority. The relationship between the plan and the Assurance Framework is critical. The Committee should be clear on the risks and controls that internal audit will be addressing and where else the Committee needs to turn to be assured on the risks and controls that are not contained within the internal audit plan. The Assurance Framework should be the mechanism that enables this task to be done.

The Head of Internal Audit should have a right of access to the Chair of the Audit Committee at any time, and it should be clear that management should not be allowed to restrict or censure this access. It is good practice for the Chair to meet informally with the Head of Internal Audit, potentially in advance of each Audit Committee meeting.

The Head of Internal Audit's formal annual report to the Accountable Officer and the Audit Committee should present the opinion of the overall adequacy and effectiveness of the organisation's risk management, control and governance processes. This opinion will encompass the Assurance Framework and requirements in relation to the Standards for Better Health.

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### External Audit

External Auditors are usually invited to attend every meeting, and the cycle of approving and monitoring the progress of external audit plans and reports, culminating in the opinion on the annual report and accounts, is central to the core work of the Committee.

The objectives of the External Auditors fall under two broad headings, to review and report on:

- a. the audited body's financial statements, and on its Statement on Internal Control

*and*

- b. whether the audited body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources

External Auditors are appointed by the Audit Commission, and the appointed auditor, either a District Auditor from the Audit Commission or Partner/Director from a firm, should develop an audit strategy. The strategy should be developed to deliver a safe opinion on the accounts and a safe conclusion on proper arrangements, and will take into account the audit needs of the organisation, as assessed by the appointed auditor, using a risk-based approach. The Audit Committee should approve the strategy.

External Audit should prepare an annual audit plan, designed to implement the audit strategy, for approval by the Audit Committee.

The annual plan should set out details of the work to be carried out, providing sufficient detail for the Audit Committee and other recipients to understand the purpose and scope of the defined work and their level of priority. Some work may be carried out by External Audit that has been prescribed for them by the Healthcare Commission, but will be included within the plan. The Audit Committee should approve the annual plan and the associated fees, although in so doing it needs to recognise the statutory duties of the External Auditor.

The annual audit plan should be kept under review to identify any amendment needed to reflect changing priorities and emerging audit needs. The Audit Committee should approve material changes to the annual audit plan.

The appointed auditor should have a right of access to the Chairman of the Audit Committee at any time.

External Audit will issue a number of reports over the year, some of which are required under the Code of Audit Practice and International Standards on Auditing, whilst others will depend upon the contents of the audit plan.

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The main mandatory reports will be:

- Report to those charged with governance (incorporating the report required under ISA (UK&I) 260) that sets out the main matters arising from the audit of the financial statements and use of resources work
- Statutory report and opinion on the accounts
- Annual audit letter

In addition to these reports, the External Auditor may issue a Public Interest Report or referral to the Secretary of State, if significant issues or breaches occur.

### **How do the Local Counter Fraud Specialists support the Audit Committee's work?**

Every NHS organisation is required to have a Local Counter Fraud Specialist, under Secretary of State directions. The Committee should satisfy itself that adequate arrangements are in place to counter fraud and they will want to consider the results of counter fraud work, in so far as they have a bearing on the wider role of the Committee.

The NHS counter fraud policy is based around seven generic areas :

- Creating an anti-fraud culture
- Prevention
- Sanctions
- Deterrence
- Detection
- Redress
- Investigation

The LCFS' annual plan and reports should come to the Audit Committee. The Committee should assure itself that the plan gives adequate coverage for the seven areas, and formally agree the annual workplan. It should consider the implications of the findings from their pro-active and reactive work, particularly in the light of their wider knowledge of the organisation. At the end of the year the full work of the LCFS should be summarised in an Annual Report that is received by the Committee.

The Counter Fraud and Security Management Service carry out quality inspections of the whole NHS organisation's approach to countering fraud, and any report arising from such a review should be discussed at the Committee.

### **What is the value of private discussions with the auditors?**

Private discussions between the Audit Committee members and each (or either) of the auditors, without management present, is an important part of building up a relationship of trust and supporting the independence of the audit functions. These should be formally scheduled to generally take place before at least one meeting a year and can use a standard set of questions (see Appendix D) or cover specific issues.

The value of these discussions is to allow the Committee members and the auditors' freedom to discuss, without any perceived or actual management influence, a range of matters. They also provide an opportunity for the auditors to feedback to the Audit Committee on its own performance. The Audit Committee should also schedule time for the non-executive members to meet on their own.

### **Should the Audit Committee consider clinical governance issues?**

Some of the largest risks to an NHS organisation lie within its clinical activities, and the Audit Committee is not the place for the contents of these detailed reviews. However, it does have a responsibility to ensure that the clinical governance processes and outcomes can be used to provide assurance on the overall processes of risk management, governance and internal control.

The Committee should therefore ensure that clinical objectives and risks are firmly included in the Assurance Framework and that there is an adequate process in place to give assurance on the management and control of these risks. The Committee should satisfy itself that the same level of scrutiny and independent audit is given to clinical risks as to strategic, financial or operational risks.

The Committee will need to satisfy itself that its work and that of any Clinical Governance Committee, are co-ordinated to avoid duplication or omission. The Audit Committee will particularly wish to concentrate on areas of significant clinical risk, control or assurance.

### **What other assurances should be sought?**

Whilst the Committee is called an "Audit" one, this should not distract from the fact that the majority of assurances to the Committee should come from management, and not just from auditors, although they provide a critical element of independent assurance. In this context robust systems of risk management and application of an Assurance Framework should be at the core of any Committee's review process.

To this end the Audit Committee will need to liaise closely with any Risk Management Committee to avoid any duplication or overlap. The Audit Committee's role is not to manage risks, but rather

to ensure that the overall system is in place and effective, leaving the operational management to any Risk Management or Governance Committee.

Some assurances will be external to the organisation (such as the Healthcare Commission, Royal Colleges or Inland Revenue), and the Committee members should be using the Trust Secretary to make them aware of relevant reports and recommendations. Others will be internal to the organisation (such as Security Manager, Infection Control team, or Risk Manager) and the Committee may wish to understand the nature of their work and the relative appropriateness of their source of assurance.

### **How should the financial focus be maintained?**

The maintenance of sound public accountability, through financial reporting and the maintenance of sound systems of internal financial control, remains a critical element of the Audit Committee's work.

A key role of the Committee is to review, agree and recommend to the Board for approval the Annual Report and Accounts, in some detail. Given the importance of financial management in the NHS, it should also ensure that it is regularly reviewing the risks and controls around financial management, and assuring itself that the most effective means of management are operating to meet the statutory duties, particularly the robustness of monitoring management accounts and Board reports.

In doing this work the Committee will need to consider the integrity, completeness and clarity of financial reporting, taking into consideration the views of External Auditors and considering issues of judgement and estimates that could have a bearing on the accounts. Should concerns arise, the Committee should bring these to the attention of the full Board.

Although the Director of Finance does not have the same reporting framework to the Audit Committee as the respective sets of auditors, he or she is critical to the successful operation of the Committee. The Director of Finance has operational responsibility for establishing and maintaining a sound system of internal financial control, is responsible for the production of the annual accounts, is the key contact for the External Auditors and is increasingly taking on wider risk management responsibilities. Consequently, the Director of Finance will be the key executive contact with the Committee and its Chairman and it is to the Director of Finance that the Committee will turn most often for explanations, clarification and support. Conversely, the Committee can offer the Director of Finance a high profile forum of support when potentially difficult financial control decisions are required.

## **What administrative support should the Committee expect?**

As with any committee, really effective work is best achieved if there is strong administrative support that allows the members of the Committee to concentrate on their role in preparing for, and contributing to, the meeting. What is also important is that all members of the Committee should participate actively, and that the Chair of the Committee is not too dominant.

For an Audit Committee to make effective use of its limited time it needs to have a Secretary. Ideally the Trust Secretary, where that post exists, should be a senior officer of the organisation so that the Audit Committee's influence continues to act between meetings. The Secretary should not be the Director of Finance or the Head of Internal Audit.

The timing of meetings needs to be discussed with all the parties involved, including the Internal Auditor, the External Auditor and the Director of Finance, to ensure that key tasks, such as the approval of accounts, are accommodated. The planning of meetings is likely to be the responsibility of the Secretary to the Audit Committee.

Appendix B provides a self-assessment checklist. Appendix C provides an example Audit Committee timetable tracking key agenda items over the year.

## **Should the Committee produce an annual report?**

The Audit Committee, in line with best practice in other sectors, should prepare a report to the main Board that sets out how the Committee has met its Terms of Reference.

The report should include, as a minimum:

- A specific statement confirming that the draft Statement on Internal Control is consistent with the view of the Committee on the organisation's system of internal control and that it supports the Board's approval of the Statement, subject to any reasonable limitations that the Committee may draw attention to
- That the system of risk management in the organisation is adequate in identifying risks and allowing the Board to understand the appropriate management of those risks
- That the Committee has reviewed and used the Assurance Framework, and believes that it is fit for purpose
- That there are no areas of significant duplication or omission in the systems of governance in the organisation that have come to the Committee's attention and not been adequately resolved

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- o That the current self-assessment by the organisation against the Standards for Better Health is consistent with the Committee's understanding, gained through the Assurance Framework

In addition, the report should highlight to the Board the main areas that the Committee has reviewed and any particular concerns or issues that it has addressed. These could include:

- a. The financial position and financial reporting systems of the organisation
- b. Any major break-down in internal control that has led to a significant loss in one form or another
- c. Any major weakness in the governance systems that has exposed, or continues to expose, the organisation to an unacceptable risk

## **SPECIMEN TERMS OF REFERENCE**

These specimen Terms of Reference build on original work based around the Cadbury Committee and Combined Code and subsequent guidance and best practice in the private and public sector. They reflect the particular nature of Audit Committees in the NHS and the growing role of the Committee in developing integrated governance arrangements and providing assurance that NHS bodies are well managed across the whole range of their activities.

### **Terms of Reference**

#### **Constitution**

The Board hereby resolves to establish a Committee of the Board to be known as the Audit Committee (The Committee). The Committee is a non-executive committee of the Board and has no executive powers, other than those specifically delegated in these Terms of Reference.

#### **Membership**

The Committee shall be appointed by the Board from amongst the Non-Executive directors of the Authority/Trust/PCT and shall consist of not less than three members. A quorum shall be two members. One of the members will be appointed Chair of the Committee by the Board. The Chairman of the organisation shall not be a member of the Committee.

#### **Attendance**

The Director of Finance and appropriate Internal and External Audit representatives shall normally attend meetings. However at least once a year the Committee should meet privately with the External and Internal Auditors.

The Chief Executive and other executive directors should be invited to attend, but particularly when the Committee is discussing areas of risk or operation that are the responsibility of that director.

The Chief Executive should be invited to attend, at least annually, to discuss with the Audit Committee the process for assurance that supports the Statement on Internal Control.

The Trust Secretary, or whoever covers these duties, shall be Secretary to the Committee and shall attend to take minutes of the meeting and provide appropriate support to the Chairman and committee members.

**Frequency**

Meetings shall be held not less than three times a year. The External Auditor or Head of Internal Audit may request a meeting if they consider that one is necessary.

**Authority**

The Committee is authorised by the Board to investigate any activity within its terms of reference. It is authorised to seek any information it requires from any employee and all employees are directed to co-operate with any request made by the Committee. The Committee is authorised by the Board to obtain outside legal or other independent professional advice and to secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

**Duties**

The duties of the Committee can be categorised as follows:

**Governance, Risk Management and Internal Control**

The Committee shall review the establishment and maintenance of an effective system of integrated governance, risk management and internal control, across the whole of the organisation's activities (both clinical and non-clinical), that supports the achievement of the organisation's objectives.

In particular, the Committee will review the adequacy of:

- o all risk and control related disclosure statements (in particular the Statement on Internal Control and declarations of compliance with the Standards for Better Health), together with any accompanying Head of Internal Audit statement, external audit opinion or other appropriate independent assurances, prior to endorsement by the Board
- o the underlying assurance processes that indicate the degree of the achievement of corporate objectives, the effectiveness of the management of principal risks and the appropriateness of the above disclosure statements
- o the policies for ensuring compliance with relevant regulatory, legal and code of conduct requirements
- o the policies and procedures for all work related to fraud and corruption as set out in Secretary of State Directions and as required by the Counter Fraud and Security Management Service

In carrying out this work the Committee will primarily utilise the work of Internal Audit, External Audit and other assurance functions, but will not be limited to these audit functions. It will also seek reports and assurances from directors and managers as appropriate, concentrating on the overarching systems of integrated governance, risk management and internal control, together with indicators of their effectiveness.

This will be evidenced through the Committee's use of an effective Assurance Framework to guide its work and that of the audit and assurance functions that report to it.

#### **Internal Audit**

The Committee shall ensure that there is an effective internal audit function established by management, that meets mandatory NHS Internal Audit Standards and provides appropriate independent assurance to the Audit Committee, Chief Executive and Board. This will be achieved by:

- o consideration of the provision of the Internal Audit service, the cost of the audit and any questions of resignation and dismissal
- o review and approval of the Internal Audit strategy, operational plan and more detailed programme of work, ensuring that this is consistent with the audit needs of the organization as identified in the Assurance Framework
- o consideration of the major findings of internal audit work (and management's response), and ensure co-ordination between the Internal and External Auditors to optimise audit resources
- o ensuring that the Internal Audit function is adequately resourced and has appropriate standing within the organisation
- o annual review of the effectiveness of internal audit

#### **External Audit**

The Committee shall review the work and findings of the External Auditor appointed by the Audit Commission and consider the implications and management's responses to their work. This will be achieved by:

- o consideration of the appointment and performance of the External Auditor, as far as the Audit Commission's rules permit

- discussion and agreement with the External Auditor, before the audit commences, of the nature and scope of the audit as set out in the Annual Plan, and ensure coordination, as appropriate, with other External Auditors in the local health economy
- discussion with the External Auditors of their local evaluation of audit risks and assessment of the Authority/Trust/PCT and associated impact on the audit fee
- review all External Audit reports, including agreement of the annual audit letter before submission to the Board and any work carried outside the annual audit plan, together with the appropriateness of management responses

#### **Other Assurance Functions**

The Audit Committee shall review the findings of other significant assurance functions, both internal and external to the organisation, and consider the implications to the governance of the organisation.

These will include, but will not be limited to, any reviews by Department of Health Arms Length Bodies or Regulators/Inspectors (e.g. Healthcare Commission, NHS Litigation Authority, etc.), professional bodies with responsibility for the performance of staff or functions (e.g. Royal Colleges, accreditation bodies, etc.)

In addition, the Committee will review the work of other committees within the organisation, whose work can provide relevant assurance to the Audit Committee's own scope of work. This will particularly include the Clinical Governance Committee and any Risk Management committees that are established.

In reviewing the work of the Clinical Governance Committee, and issues around clinical risk management, the Audit Committee will wish to satisfy themselves on the assurance that can be gained from the clinical audit function.

#### **Management**

The Committee shall request and review reports and positive assurances from directors and managers on the overall arrangements for governance, risk management and internal control.

They may also request specific reports from individual functions within the organisation (e.g. clinical audit) as they may be appropriate to the overall arrangements.

**Financial Reporting**

The Audit Committee shall review the Annual Report and Financial Statements before submission to the Board, focusing particularly on:

- the wording in the Statement on Internal Control and other disclosures relevant to the Terms of Reference of the Committee
- changes in, and compliance with, accounting policies and practices
- unadjusted mis-statements in the financial statements
- major judgemental areas
- significant adjustments resulting from the audit

The Committee should also ensure that the systems for financial reporting to the Board, including those of budgetary control, are subject to review as to completeness and accuracy of the information provided to the Board.

**Reporting**

The minutes of Audit Committee meetings shall be formally recorded by the Trust Secretary and submitted to the Board. The Chair of the Committee shall draw to the attention of the Board any issues that require disclosure to the full Board, or require executive action.

The Committee will report to the Board annually on its work in support of the Statement on Internal Control, specifically commenting on the fitness for purpose of the Assurance Framework, the completeness and embeddedness of risk management in the organisation, the integration of governance arrangements and the appropriateness of the self-assessment against the Standards for Better Health.

**Other Matters**

The Committee shall be supported administratively by the Trust Secretary, whose duties in this respect will include:

- Agreement of agenda with Chairman and attendees and collation of papers
- Taking the minutes & keeping a record of matters arising and issues to be carried forward
- Advising the Committee on pertinent areas

## AUDIT COMMITTEE: SELF ASSESSMENT CHECKLIST

**Status Key**

- 1 = must do
- 2 = should do
- 3 = could do

STATUS	ISSUE	YES	NO	N/A	COMMENTS/ACTION
<b>COMPOSITION, ESTABLISHMENT AND DUTIES</b>					
1	Does the Audit Committee have written terms of reference that adequately and realistically define the Committee's role in accordance with Department of Health guidance?				
1	Have the terms of reference been adopted by the Board?				
2	Are the terms of reference reviewed annually to take into account governance developments (including integrated governance principles) and the remit of other committees within the organisation?				
2	Has the Committee established a plan for the conduct of its own work across the year?				
1	Has the Committee been provided with sufficient membership, authority and resources to perform its role effectively and independently?				
2	Are changes to the Committee's current and future workload discussed and approved at Board level?				
1	Are Committee members independent of the management team?				
1	Does the Committee report regularly to the Board?				
2	Are members, particularly those new to the Committee, provided with training?				
2	Does the Board ensure that members have sufficient knowledge of the organisation to identify key risk areas and to challenge both line management and the auditors on critical and sensitive matters?				
2	Does at least one Committee member have a financial background?				
2	Does the Committee prepare an annual report on its work and performance in the preceding year for consideration by the Board?				
<b>COMPLIANCE WITH THE LAW AND REGULATIONS GOVERNING THE NHS</b>					
3	Has the Committee formally assessed whether there is a need for the support of a "Company Secretary" role or its equivalent?				

STATUS	ISSUE	YES	NO	N/A	COMMENTS/ACTION
3	Does the Committee have a mechanism to keep it aware of topical, legal and regulatory issues?				
<b>INTERNAL CONTROL AND RISK MANAGEMENT</b>					
2	Has the Committee formally considered how it integrates with other committees that are reviewing risk e.g. risk management and clinical governance?				
2	Has the Committee formally considered how its work integrates with wider performance management and standards compliance?				
2	Has the Committee been briefed on its assurance responsibilities with regard to internal control and risk management, particularly with regard to the Statement on Internal Control, the Assurance Framework, Standards for Better Health and the Head of Internal Audit's opinion?				
2	Has the Committee reviewed whether the reports it receives are timely and have the right format and content to ensure its internal control and risk management responsibilities are discharged?				
2	Is the Committee satisfied that the Board has been advised that assurance reporting is in place to encompass all the organisation's responsibilities?				
2	Is there clarity over the timing and content of the assurance statements received by the Committee from the Head of Internal Audit?				
<b>INTERNAL AUDIT</b>					
1	Do formal terms of reference exist, defining Internal Audit's objectives, responsibilities and reporting lines?				
1	Are the terms of reference approved by the Committee and routinely reviewed?				
2	Do the terms of reference adequately specify the relationship between the Head of Internal Audit and the Audit Committee?				
2	Are the key principles of the terms of reference set out in the Standing Financial Instructions?				
1	Does the Committee review and approve the Internal Audit plan at the beginning of the financial year?				
1	Does the Committee approve any material changes to the plan?				
2	Are audit plans derived from clear processes based on risk assessment with clear links to the Assurance Framework?				
1	Does the Audit Committee receive periodic reports from the Head of Internal Audit?				

STATUS	ISSUE	YES	NO	N/A	COMMENTS/ACTION
3	Has the Committee established a process whereby it reviews any material objection to the plans and associated assignments that cannot be resolved through negotiation?				
2	Does the Committee effectively monitor the implementation of management actions arising from audit reports?				
1	Does the Head of Internal Audit have a direct line of reporting to the Committee and its chairman?				
2	Are any scope restrictions placed on Internal Audit and, if so, what are they and who establishes them?				
2	Is Internal Audit free from any operating responsibilities or conflicts of interest that could impair its objectivity?				
2	Has the Committee determined the appropriate level of detail it wishes to receive from Internal Audit?				
2	Does the Committee hold periodic private discussions with the Head of internal Audit?				
2	Does the Committee review the effectiveness of Internal Audit and the adequacy of staffing and resources within Internal Audit?				
3	Has the Committee agreed a range of Internal Audit performance measures to be reported on a routine basis?				
2	Is there appropriate cooperation with the External Auditors?				
3	Are there any quality assurance procedures to confirm whether the work of the Internal Auditors is properly planned, completed, supervised and reviewed?				
<b>EXTERNAL AUDIT</b>					
1	Do the External Auditors present their audit plans and strategy to the Committee for approval?				
2	Has the Committee satisfied itself that work not relating to the financial statements work is adequate and appropriate?				
2	Does the Committee receive and monitor actions taken in respect of prior years' reviews?				
1	Does the Committee review the External Auditor's annual audit letter?				
2	Does the Committee hold periodic private discussions with the External Auditor?				
2	Does the Committee assess the performance of External Audit?				
<b>ANNUAL ACCOUNTS</b>					
1	Is the Committee's role in the approval of the annual accounts clearly defined?				

STATUS	ISSUE	YES	NO	N/A	COMMENTS/ACTION
2	Is a Committee meeting scheduled to discuss proposed adjustments to the accounts and issues arising from the audit?				
3	Does the Committee annually review the accounting policies of the organisation?				
<b>ADMINISTRATIVE ARRANGEMENTS</b>					
2	Does the Committee have a plan of matters to be dealt with over the coming year?				
2	Are papers circulated in good time and are minutes received as soon as possible after the meetings?				
2	Does the Committee meet the appropriate number of times to deal with planned matters?				
2	Are Committee papers distributed in sufficient time for members to give them due consideration?				
2	Are Committee meetings scheduled prior to important decisions being made?				
2	Is the timing of Committee meetings discussed with all the parties involved?				
<b>OTHER ISSUES</b>					
3	Has the Committee considered the costs that it incurs: and are the costs appropriate to the perceived risks and the benefits?				
2	Does the Committee assess its own effectiveness periodically?				
3	Does the Annual Report and Accounts of the Authority/Trust include a description of the Committee's establishment and activities?				

**Audit Committee Handbook 2005    APPENDIX C EXAMPLE AGENDA TIMETABLE**

AGENDA ITEM/ISSUE	1	2	3	4	5
Review Assurance Framework					
Approval of Internal Audit Plan	x				
Review of Internal Audit Progress Reports	x	x	x	x	X
Review of annual accounts progress	x				
Agreement of External Audit plans and fees	x				x
Agreement of final accounts timetable and plans				x	
Note business of other committees and review inter-relationships	x	x	x	x	x
Receipt of Annual Internal Audit Report and associated opinions	x	x			
Review of audited annual accounts and financial statements		x			
Standards for Better Health process and declaration	x		x		
Review of losses and special payments	x	x	x	x	x
Private discussions with Internal and External Audit			x		
Self assessment of committee's effectiveness				x	
Briefing/Update sessions		x		x	
Review of other reports and policies as appropriate e.g. changes to Standing Orders and Standing Financial Instructions, changes to accounting policies	x	x	x	x	
Produce annual Audit Committee report	x				

### **Best Practice and Issues to Consider: Internal Audit**

- The Audit Committee should expect to see audit plans that are derived from clear processes based on risk assessment and corporate objectives that can be reconciled to the Assurance Framework. However, the level and nature of this will depend upon the risk maturity of the organisation
- Audit Committees should receive quarterly reports from the Head of Internal Audit summarising Internal Audit activity in the quarter. The report should describe the major audit issues and report outcomes (such as agreed actions), rather than inputs against the audit plan
- The Audit Committee should monitor the implementation of agreed actions by a variety of means, including the follow-up of audits to review whether important recommendations have been actioned by management and that either assurance levels have improved or risks reduced
- Some Internal Auditors prepare briefings for the Audit Committee on new legislation, updates on NHS internal control developments etc.
- The Audit Committee may wish the Internal Audit function to prioritise its findings against defined levels of assurance, to indicate the importance of each finding and the urgency of action
- The Audit Committee should ensure that once Internal Audit have agreed their findings and recommendations with management, the resultant agreed actions should identify individuals and timescales for implementation

#### **Review of Internal Audit: questions to consider**

- Do formal terms of reference exist, defining Internal Audit's objectives, responsibilities, authority and reporting lines?
- How is the scope of Internal Audit work decided? What are the relative emphases given to internal control reviews, policy compliance reviews, VFM audits and consultancy assignments?
- Are any scope restrictions placed on Internal Audit and, if so, who establishes them?

- Does Internal Audit report directly to an appropriate level of management that will ensure that audit findings are given due weight and attention?
- Are the Internal Auditors free from any operating responsibilities that could impair their objectivity?
- Is the technical knowledge and experience of the Internal Audit staff sufficient to ensure that duties are performed to an appropriate standard?
- Is there clarity as to reliance on third part assurances?
- Is the work of the Internal Auditors properly planned, completed, supervised and reviewed? Are there any quality assurance procedures?
- Is the Internal Audit plan prepared in collaboration with the External Auditors?

### **Best Practice and Issues to Consider: External Audit**

- The Audit Committee should expect to see audit plans that are based on a clear assessment of audit risk that recognises the business risks of the organisation
- Audit Committees should receive regular reports arising from work planned by External Audit summarising External Audit activity in the period. The report should describe the major audit issues, and report outcomes against the audit plan
- The Audit Committee should ensure follow up audits are carried out to review whether important final report recommendations have been actioned by management
- Some External Auditors prepare briefings for the Audit Committee on new legislation, updates on accounting standards, etc
- Discuss the results of the ALERT process, comparing the External Auditor's assessment with Committee members' own views, and those of executive management
- Look at the work that External Auditors are proposing to address the risks identified and ensure that it is adding value to the organisation. This work should not be used to replace work that is part of the management function, or could be achieved by a better use of other resources (for instance - re-allocation of management duties, coverage by an internal assurance function, etc.)
- In reviewing the results of the ALERT process, discuss and understand the wider position in the health economy and the understanding of that risk by partners/other stakeholders

- The Audit Committee should discuss with the External Auditors the main issues and parameters for audit planning in the meeting before the annual audit plan is due to be approved. This allows the committee members to:
  - a. discuss the organisation's audit needs
  - b. reflect on the previous year's experience
  - c. be updated on likely changes and new issues
  - d. ensure co-ordination with other bodies
- In reviewing the draft plan presented to the Committee, members should be concentrating on the outputs from the plan, and what they will need from the External Auditor, balanced against an understanding of the auditor's statutory functions
- Review of the audit fee is an important role, but the review should be for consistency with the Audit Commission's guidelines and appropriateness in the context of the organisation's needs and the statutory functions of the External Auditor. Driving down the cost of audit services may well produce disproportionate reductions in service and value
- External Audit should be working with both management and other assurance functions, to optimise their level of coverage. Whilst ISA (UK & Ireland) 610 establishes standards and provides guidance to External Auditors in considering the work of Internal Audit, the Committee will want to see, and gain assurance, that duplication is minimised wherever possible
- External Auditors should be asked about their own internal systems of quality assurance and quality control, and be prepared to feedback on the results of this. The Audit Commission has its own quality assurance process for its appointed auditors
- Before reviewing the findings of any report, ensure that the scope of the work is absolutely clear. Committee members should be clear what has, and more importantly what has not, been included within the audit review
- Concentrate on the overall conclusion to start with, since this should indicate the level of issues that the External Auditor wishes to draw to the attention of the Committee
- Prioritise committee time on the major findings and gain assurance that line management are dealing with the other issues. The main question for the Committee should be whether the findings are consistent with their own appreciation of the issues from other information

- received, either in the Committee or as a Board member. If they are inconsistent then it is appropriate to probe and challenge the findings to support the report
- o The response of management to audit findings is vital. The Committee should consider:
    - a. have management taken the audit seriously?
    - b. does the report highlight issues with policies and processes, or with the people implementing them?
    - c. have management agreed a realistic and timely action plan to remedy any problems?
    - d. when will the action plan be followed up by management and the External Auditors?
    - e. what further work is required to complete the audit?
  - o The Chairman of the Audit Committee should have a clear understanding and relationship with the lead from External Audit, at the partner/director/district auditor level, so that any impending Public Interest report should not be a surprise
  - o Once a Public Interest Report is being considered the Committee should receive a briefing from the External Auditor on the statutory background and potential consequences of such a report. This should include the reasons for the consideration and the steps taken to date

The Committee should consider the contents of this briefing and consider in detail the implications and necessary actions needed. In such an instance it would be expected that the issue should immediately be taken for consideration by the whole Board.

Review of External Audit: questions to consider

- o Are any scope restrictions placed on External Audit and, if so, who establishes them?
- o Are External Audit reports and audit recommendations given due weight and attention?
- o Are the External Auditors free from anything that could impair their objectivity?
- o Is the technical knowledge and experience of the External Audit staff sufficient to ensure that duties are performed to an appropriate standard?
- o Is there clarity as to reliance on third part assurances?

- Are External Audit reports issued on a timely basis?

#### **Private discussions with both sets of auditors**

They should not be minuted, unless both the Committee and auditor agree that a note to the Committee's full minutes would be pertinent. The Chairman of the Committee may wish to retain his/her own note of the discussion.

- Do the Internal Auditors have adequate resources to provide the objective assurances required by the Audit Committee?
- Has the External Auditor quoted for enough resources to meet their statutory functions?
- Did the Auditors receive all the co-operation they desired?
- Was any attempt made to restrict the scope of the Auditors work in any way?
- Was the original audit strategy or plan modified due to deficiencies in internal control or accounting records?
- Did the Auditors have any significant disagreements with management (however resolved)?
- How were these resolved?
- Do the Auditors have any concerns about management's control consciousness or operating style?
- What is the Auditors view of their relationship with management?
- Do the Auditors believe they are under any undue pressure?
- Are there any other matters which, in the opinion of the Auditors, should be considered by the Audit Committee?

#### **Best Practice and Issues to Consider: Annual Report of the Committee**

- The report should not be long, 3 or 4 pages should be sufficient, and may be drafted by the Trust Secretary under the direction of the Chair of the Audit Committee
- The Committee Chairman should take overall responsibility for its preparation and share drafts of the report with the non-executive members of the Committee

- o The final draft report should be shared with the Internal and External auditors, to ensure that it is consistent with their understanding, and with any other regular attendees to the Committee, such as the Director of Finance. However the final ownership of the report should be with the committee members
- o The report should go to all members of the Board in advance of the meeting to agree the Annual Report and Accounts
- o If the report includes any significant issues, this should be discussed by the Audit Committee Chair with the Chair of the organisation

### **Best Practice and Issues to Consider: Using the Assurance Framework**

The Assurance Framework is the key source of evidence that links strategic objectives to risks and assurances, and the main tool that the Board should use in discharging its overall responsibility for internal control.

The work of the Audit Committee, with regard to the Assurance Framework, should be to:

- 1 Review the Assurance Framework to ensure that there is an appropriate spread of strategic objectives and that the main inherent/residual risks have been identified, as well as any that are newly arising. This is to ensure that there is no major omission.

*This review should be done once a year.*

- 2 Assure itself that the process that has been undertaken by management to populate the Assurance Framework is appropriate, in that the necessary directors and managers have been involved and take responsibility for their entries, and that there are no major omissions from the list of controls.

***This review could be carried out on the Committee's behalf by the Internal Auditors, although the Committee should specifically agree the Terms of Reference for this piece of work.***

- 3 Monitor the implementation of action plans that have been drawn up to cover gaps in controls, assurances and reports to management.

***This should be through reports from management, but may be supplemented by independent follow-up from auditors.***

- 4 Consider, in particular, the "audit needs" of the organisation in terms of the sources of assurance, both independent and from line management, and ensure that there is a plan for these assurances to be received.

*This should be done at the very start of the audit planning process and involve a detailed review of the current sources of assurance and the prioritisation process.*

- 5 Review the results of assurances, either in whole or specific to a risk or objective, and the implications that these have on the achievement of objectives.

*In looking at the results of assurance work, the Committee should concentrate on assessing whether the overall objective is being met, that the main controls are operating as expected and that agreed actions for improvement are being implemented.*

The work of the Audit Committee is NOT to manage the process of populating the Assurance Framework or getting involved in the operational development of risk management processes, either at an overall level or individual risks. These are operational issues that the Committee should satisfy itself are being carried out by line management.

### **Best Practice and Issues to Consider: Maintaining the Financial Focus**

- o At some stage, before the meeting to review the accounts, all members of the Committee should receive a briefing, either from an independent person, or the Director of Finance and the External Auditor, on how to understand a set of accounts and what should be looked for
- o Any proposed changes in accounting practice, either due to changes in accounting standards or interpretation, should be discussed at an Audit Committee prior to the meeting on approving the accounts, so as not to put undue pressure on a decision close to final accounts submission dates
- o Changes in accounting policies should be accompanied by a document showing the relative impact of each option, particularly on the achievement of statutory financial duties and consider compliance with the NHS Finance Manual
- o The Committee should expect a briefing from the Director of Finance explaining any material variations between the Month 12 budget report and the final accounts. This briefing should explain why these arose
- o The Committee will receive, from the External Auditors, a report on their final accounts work, which should cover any audit adjustments that were required to the draft accounts, and any particular issues that have arisen at the year-end. The report will include details of any uncorrected mis-statements (other than those considered by the auditor to be 'clearly trivial') reported to management, which have not been corrected, with a request to the Committee that the corrections are made. If the Committee decides not to correct the

mis-statements, the auditor will request a written representation from the Committee explaining the reason behind the decision

### **Best Practice and Issues to Consider: Self Assessment**

Appendix B to this Handbook includes a checklist that Audit Committees should use annually to assess their performance.

As with any self-assessment it is important that the Committee members should be constructively critical in their responses, rather than take false assurance that their current interpretation of the requirements is correct.

- Audit Committee members should complete the checklist outside the meeting and the results should be collated by someone independent of the members, such as the Trust Secretary
- The involvement of the auditors, either internal or external, may help in interpretation of the questions or discussion on best practice, given their likely experience with other Audit Committees
- In areas of doubt, the Committee may wish to look at other self-assessment checklists for Audit Committees, or ask for advice on best practice in other parts of the public and private sectors
- The Committee should draw up its own plan for improvement as a result of the self-assessment, either in requesting future training or development for members, or in changes to its processes and procedures

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