



The Governance  
Institute

Student answer to question 5

# Health Service Governance

June 2017

## Important notice

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## 5a)

Advisory Note to the Board

Re: Audit Committee Composition and Auditor Independence

Date: 8<sup>th</sup> June 2017

It is acknowledged that due to the resignation of NED colleagues recently that quoracy has become an issue, particularly for the Audit Committee, a key statutory committee of the Board. That said; the proposal being put forward is against good governance practice and that recommended by both the UK Code of Corporate Governance and the HFMA Audit Committee Handbook. The key role of the Committee is to provide assurance back to the Board on the effectiveness of the risk management and internal control systems. It is therefore right and appropriate that this is completed by independent scrutiny and challenge by non-executive directors as opposed to executive officers who are responsible for the day-to-day running of the organisation, or representatives from Audit – who would be effectively marking their own homework!

The composition is therefore as follows: at least three NEDs, one of whom must be financially experienced or qualified, the majority of whom should be independent, the term of which shall be determined by the Board, but which is normally 3 years. The Chair of the Board may not be the Chair of the Audit Committee to ensure separation of reporting and scrutiny. The Audit

Committee Chair, should however, be remunerated for their role in acknowledgement of the key role the Committee plays. Members must also be appropriately inducted; often by the company secretary. NEDs are the only members of the committees but with invites often going to trust officers, including the CEO, Director of Finance, Officers from Internal Audit, External Audit and Counter Fraud Services. The Audit committee, being solely NED led is reliant on management information and as such, should routinely meet at least once a year in private with external and internal audit colleagues. The Committee should meet 4 times a year – normally to coincide with key reporting requirements, eg annual accounts, annual report and quality account drafting and presentation prior to Board approval. Powers given to the Audit Committee will be described in the matters reserved for Board and scheme of delegation and outlined in the Committee's terms of reference, which also summarises its duties as follows:

- To provide scrutiny and test the effectiveness of the risk management system and internal control system.
- To test the integrity and quality of data relating to publicly disclosed information.
- To satisfy themselves of the integrity of the trust's financial statements – seeking assurances from the External Auditors who give an opinion on the true and fair view of the financial statement, an opinion as to whether they are prepared in accordance with requirements and an opinion of value for money. The Committee will receive the Letter of Engagement, fees and Annual Auditor Report, prior to Board (an independent panel now appoints External Auditors in accordance with the Local Audit and Accountability Act 2014).
- Receive assurances and reports from Internal Audit, including Head of Internal Audit Opinion, will monitor the KPIs of the Internal Auditor and agree the audit plan and fees.
- Seek assurances from Counter Fraud colleagues re robustness of Counter Fraud measures – receive their annual report and agree forward plan.
- Seek assurance and test effectiveness of whistleblowing and now Freedom to Speak Up procedures and their application.
- Receive the Annual Governance Statement, Annual Report, Annual Accounts prior to Board approval; unless approval has been delegated.
- Receive the Quality Account.
- Seek assurance on clinical audit effectiveness (HFMA recommend the Committee considers clinical audit with the same regard as financial).
- Receive management reports as to whether there have been any breaches of SFIs or standing orders, or any Single Tender Waivers or ex-gratia payments given.

## 5b)

The role of the External Audit is to provide independent professional opinion as to whether the financial accounts are true and fair and in accordance with regulation (International Reporting Requirements and DoH group Accounts Manual etc). Their opinion is critical in letting the public know that the Board are operating appropriately (and in the case of the corporate world whether investors should be investing money). It is therefore essential that they are impartial and independent. Threats, however, exist including whether auditors are directly appointed/reporting to a trust officer (eg direct of finance); whether they are a previous employee and therefore have 'insider knowledge' which might affect their judgement or are 'connected' by family etc, to the trust – the Audit Committee should therefore seek assurances there is not threat.

Other threats include:

- Self-interest – where it's not in their interest to raise issues as they fear they might lose the contract.

- Self-review – in the case of Arthur Andersen and Enron, where External Auditors didn't check their non-audit work.
- Advisory/advocate – where they've given advice/acted on behalf of the trust
- Intimidation – where they are intimidated by trust officers and take information at face value without making further enquiries.
- Familiarity – where they know the organisation too well and therefore don't investigate/check thoroughly.

Remedies include:

- Limiting or barring non-audit work. The Committee would need to set this policy and thresholds.
- Rotate the audit firm – which has advantages and disadvantages including; loss of familiarity and relationships, added cost, but would mean incoming firm could audit previous firm's work.
- Rotate audit partner – again having advantages and disadvantages. Ultimately the Audit Committee would need to seek assurance from its external auditors and conduct checks itself to ensure independence isn't compromised.

The FRC recent guidance highlighted additional responsibilities of the Audit Committee in relation to External Auditors – including conducting an annual appraisal – of which independence should be an element.

**Total marks: 24/25 marks**