

1. WHY AUDIT?

- 1.1 Effective audit is an essential source of information and support for governors. Even where confidence in management is high, all governors will at some time ask themselves: can we have confidence in the information that is provided to us, and the processes providing it? Sound audit provides some of that reassurance, and through independent scrutiny assurance can be obtained that standards of control, management and governance are satisfactory. In practice, it is an essential part of enabling you to be satisfied that your HEI is being properly governed, managed and controlled.
- 1.2 In turn, this means that a governing body can provide assurance to its various funders that the data it provides to them is accurate and can be relied upon. Without such confidence the idea of a governing body being accountable and having "unambiguous and collective responsibility for overseeing the institution's activities"⁵ simply can't exist in practice.
- 1.3 Therefore those who undertake audit for the governing body, are - in a sense - its 'eyes and ears'. They investigate issues in levels of detail way beyond what a board could (and should) do, and - as we will see later - it follows that there needs to be a high level of confidence between a governing body and those it asks to undertake an audit role for it.
- 1.4 What does 'assurance' mean? HM Treasury defines it as "*an evaluated opinion, based on evidence gained from review, on the organisation's governance, risk management and internal control framework*".⁶ Assurance therefore draws attention to how risk management, governance and internal control are functioning and, just as important, the aspects that need to improve. Assurance helps a board to judge whether or not it is focusing on the most significant issues in relation to achieving the institution's objectives and whether best use is being made of resources.

Is audit just about finance?

- 1.5 Historically the answer was, generally, yes, but things are changing. The history of audit is certainly based in the scrutiny of financial records and systems, and this still forms an essential part of any institutional audit programme. The appointment of a firm of professional auditors to report on the institution's accounts each year (referred to as the external auditors), and the structure for their reporting is a key part of the assurance process for governors to understand. It is a mandatory requirement of the financial memorandum with the funding council, as well as of your HEI's governing instruments. (For details of the financial memorandum see the separate material on finance in this series. Make sure you have the current version.)

"Oh, I never read that audit stuff, the board papers are too thick as it is. I just leave all that to those who are interested"

LAY GOVERNOR

"The audit committee? That's just to stop the finance director fiddling the books isn't it?"

STAFF GOVERNOR

⁵ See the CUC Governance Code of Practice, in the CUC Guide for Members of Higher Education Governing Bodies in the UK, revised version 2009. Available from www.shef.ac.uk/cuc

⁶ Audit Committee Handbook: HM Treasury, March 2007. Original quotation from Management of Risk - Principles and Concepts: HM Treasury, October 2004

- 1.6 However, audit now encompasses a much wider brief. The whole structure of governance and management of an HEI is subject to scrutiny, to give assurance that the objectives set by the governing body are being realised in practice, with proper regard to economy, efficiency and effectiveness, and value for money (VfM). For this purpose, institutions are required to have an internal audit service. In addition, all HEIs must have active risk management systems in place, and the audit function will usually review how these systems are working, and whether they are providing the level of confidence required by the governing body.
- 1.7 That is not all. In recent years, audit of the academic function has grown into a substantial activity. How this has been done is summarised in Chapter 8, but it has been driven by government interest, concerns about standards, and the need to demonstrate suitable academic performance to the public. The assessment of academic activity may be a different form of audit and more to do with external accountability, but it is no less valuable in giving assurance to governors about the fundamental activities of an HEI.

SUGGESTED TASK

Before reading any further identify the main elements of an audit structure that exists in your HEI. How well do they work in practice?

"I was surprised to find that the audit committee didn't ask many questions of the auditors. Only later did I realise that we all needed training - we hadn't got the necessary knowledge."

NEW AUDIT COMMITTEE MEMBER

The structure of audit

- 1.8 There are a few basic requirements in the structure of audit that need to be briefly set out at the start of this material. First, an essential part of the audit structure is the audit committee. This provides a clear focus to the governance of the assurance process. Your HEI must have an audit committee of independent governors, perhaps with other people coopted because they have relevant experience. The committee's job is to oversee the audit process and tell the governing body what they find.
- 1.9 The role of the audit committee is considered in Chapter 3, but it is more than just a processing centre for the range of assurances available to the board. Its job includes checking whether those assurances are sufficient, as well as testing the evidence on which they are based and the reliability of the conclusions drawn from that evidence.
- 1.10 There are two specific audit appointments - external and internal - which exist to help provide that assurance. Having an HEI's annual accounts (nowadays usually called financial statements) examined by a professional auditor has been a requirement for many years, and giving a professional opinion on the annual financial statements is the role of the external auditor.
- 1.11 The development of internal audit can be seen as a response to the increased complexity of the sector and the large amounts of public money invested in it. Its role is focused on management and control, right from asking whether an HEI's strategies are being realised, to examining the petty cash. Done well, it can be a very useful service to all governors. It may be carried out by a professional firm under contract, a team of staff employed by the HEI, or a consortium arrangement, where several institutions form a joint audit team. The merits of each are discussed later.
- 1.12 The four funding councils have mandatory requirements for audit which are set out in Chapter 2. At this stage, you need to know that:
 - Your HEI must have an effective audit committee with an independent governor as its chair, and three or four independent members who do not have executive authority and preferably who are not members of the finance committee or its equivalent.

- Your HEI must have professional external auditors and you must regularly review their appointment.
- Your HEI must have an internal audit service (though what form it takes is optional) and its rights of inquiry must not be restricted. The governing body should regularly review the internal audit arrangements.
- Your HEI must report promptly to the funding council any serious control failures or accounting breakdowns highlighted by the audit process.

Can you leave audit to the audit committee?

- 1.13 This is a very important question. As a new governor, you may wonder whether you need to know much about audit, beyond its existence or otherwise, or take a close interest in the work of the auditors and audit committee. Most governors will not be members of the audit committee and - frankly - may not be very interested in the detail of its work. So what is expected of the other governors? Can audit be left to the audit committee?
- 1.14 The straightforward answer to that final question is 'no'. Governors are responsible for their HEI, and although a systematic audit process can be a great help, fulfilling that duty remains with you and the whole board. All members need to make their own assessment of what assurance can be derived from the work of the auditors and the audit committee.
- 1.15 It's also very unwise to allow the perception to grow that a board is not really interested in audit generally or the work of the audit committee, which needs to know that it has the strong support of the governing body. This can be demonstrated, for example, by allocating sufficient time in board meetings for the audit committee chair to report on significant findings and have them debated. Simply taking the audit committee's report 'as read' - or pressing the audit chair to be brief - has the opposite effect. It is critical that those appearing before the audit committee, or who are subject to its scrutiny, know that the governors will take a close interest in the outcome.
- 1.16 Moreover, there will inevitably come a time when the audit committee will have to probe unsatisfactory situations and seek information which someone would rather not divulge. Weakness at this stage may lead eventually to serious damage to the reputation of the institution and may even threaten its survival. Therefore the governing body has to take the lead in ensuring that audit is taken seriously.
- 1.17 As a governor, you need to know what goes on in the audit process so that you can judge what degree of assurance you personally can draw from what you see. Your interest adds to the audit committee's own perception of its value. That's why it's worth your time reading this material in full, even if you're not a member of the audit committee. The committee's role is to help you discharge your duties, not absolve you from them.

"It's vital to engage the interest of the board in the work of the audit committee. It's about engaging in accountability, with the audit committee as the conscience of the board"

**AUDIT COMMITTEE CHAIR,
OFGEM, QUOTED IN IMPROVING
THE EFFECTIVENESS OF AUDIT
COMMITTEES, HOUSING
CORPORATION 2004**

"I have seen audit committee members selected because the individuals are known to be weak – or were not at the meeting when nominations were agreed!"

EXTERNAL AUDIT PARTNER

Where to look for help

- 1.18 The CUC has published a Handbook for Members of Audit Committees in HEIs⁷. It's a comprehensive guide which is useful for those closely involved, but too detailed for a new governor. However, it has provided much of the background for this volume. The Chartered Institute of Public Finance and Accountancy (Cipfa) has also published a (shorter) Handbook for Audit Committee Members in further and higher education⁸.
- 1.19 Internally there are four key sources of support and advice you can turn to: the chair of the audit committee as a fellow governor and colleague; the finance director; the clerk or secretary to the governing body; and - indirectly - the internal auditors themselves. The first three can be approached directly to answer any questions you have. The internal auditors can be approached through the clerk, and may (for example) be available to run a short seminar or awayday on current issues or aspects of best practice.

What next?

- 1.20 Collecting a few key documents will be useful, and these should probably include: the terms of reference for the audit committee; the most recent financial statements; the most recent annual report of the audit committee; and the external auditors' management letter about those statements. You might also want to look at the National Audit Office website (and in Wales the Wales Audit Office website) for more useful publications⁹.

Self-challenge questions

- Review the last annual report of your HEI's audit committee (perhaps with a governor colleague) and consider how much assurance you can draw from it. From what you know of your HEI, identify areas of activity or risk where there seems to be no element of assurance in the report.
- Review the terms of reference for the audit committee. Do you have assurance from the annual report (or the discussion in the board) that all the terms are being covered?

⁷ CUC Governance Code of Practice, in the CUC Guide for Members of Higher Education Governing Bodies in the UK, revised version 2009.

⁸ See www.cipfa.org.uk

⁹ See particularly www.nao.org.uk/practice_areas/FMAG/Audit_Committees.htm