

7. AUDIT AND RISK MANAGEMENT SUBCOMMITTEE STRUCTURE AND TERMS OF REFERENCE

General Manager responsible:	Chief Executive
Officer responsible:	Chief Executive
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PURPOSE OF REPORT

1. To review and recommend to the Council a revised structure for the Audit and Risk Management Subcommittee and approve new terms of reference which reflect good governance practice.

BACKGROUND

2. Good corporate governance practice normally includes an Audit Committee which is charged with overseeing and monitoring the relationship with external and internal auditors, and satisfying itself on behalf of the board (Council) that good risk management practices are in place in the organisation.
3. The current terms of reference of the Council's Audit and Risk Management Subcommittee were established without detailed consideration and there is now a need to give more careful consideration to whether these terms of reference adequately reflect good governance practice in today's world. These terms of reference are:
 - Approve the Annual Report and Audited Financial Statements of the Council.
 - Review and approve significant accounting policy changes.
 - Review the format of financial reports prior to audit.
 - Evaluate the adequacy and effectiveness of the administrative, operating and accounting policies through active communication with the external and internal auditors and consideration of their report.
 - The authority to recommend to the Council amended terms of reference for this subcommittee.
4. It is clear from the final point in the terms of reference that there was an intention to review these.
5. Apart from a period when a previous Council used this subcommittee to concentrate on cost savings (not the normal use of an audit committee), the Audit and Risk Management Subcommittee has had a limited role mostly relating to review of the external audit management letter, approval of the annual report and approval of some complex accounting policies.

DISCUSSION

6. The *Audit Committee's Best Practice Guide* (published by the Auditing and Assurance Standards Board of the Australian Accounting Research Foundation, Australian Institute of Company Directors and the Australian Institute of Internal Auditors) outlines the functions which are common for Audit Committees to have in order to achieve good corporate governance practice:
 - Assisting the board of directors to discharge their responsibility to exercise due care, diligence and skill in relation to:
 - Reporting of financial information to users of financial reports
 - Application of accounting policies
 - Financial management
 - Internal control systems
 - Risk management systems
 - Business policies and practices
 - Protection of the entities' assets
 - Compliance with applicable laws.

- Improving the credibility and objectivity of the accountability process.
 - Providing a formal forum for communication between the board of directors and senior financial management.
 - Improving board efficiency by allowing such matters to be discussed in sufficient depth without the whole Board being involved.
 - Improving effectiveness of internal and external audit functions by being a forum for communication with these functions.
 - Facilitating the independence of the external auditor.
 - Providing a structure for internal audit reporting and enable the independence of the internal audit.
 - Improving the quality of internal and external reporting of financial and non-financial information and reports.
 - Fostering an ethical culture throughout the entity.
7. In the case of a local authority, the Council exercises the functions of a governance board and while not all the above functions are fully applicable, most will be relevant.
8. It is accepted best practice that an audit committee would have the following membership composition:
- A subcommittee of the Council.
 - In some circumstances (particularly the public sector) independent individuals with expertise may be appointed to such committees where the Board or Council do not have that expertise.
 - A majority of the members of the subcommittee need to have financial literacy and experience with financial and business matters.
 - The subcommittee chairperson should be appointed based on the person's leadership and other skills.
 - The chairperson of the subcommittee should not be the chair of the main board (ie the Mayor).
 - Staff attending meetings have no voting powers.
9. The appointment of an Audit and Risk Management Subcommittee is an important part of the accountability chain and enables complex issues of a financial nature to be discussed by those who have sufficient knowledge and interest to be effective in a forum away from the main Council meeting. This recognises that the complexities of financial issues are too complex for general Council review and need to be focussed on by a small group with some knowledge and expertise.
10. As would be expected with any large organisation, there needs to be good systems of internal control, risk management, and internal and external audit. Each of the components has a role to play and it would not be expected that the subcommittee would get into the detail of the operations through this subcommittee. However, by having summary reports and the internal and external auditors having access to the subcommittee and its Chairperson, the subcommittee will be able to satisfy itself that there are adequate safeguards in place.
11. For example, the Internal Auditor produces very detailed reports on a wide range of topics which deal with a lot of detail, sometimes at a low operational level, and makes recommendations to management. He follows up on implementation and reports through the management structure in a summarised way. It would be inappropriate for the Audit Subcommittee to get involved in the detail of these reports, but it should be informed in summary of the work that has been done and any serious unresolved issues.
12. Internal audit is an important management tool for good internal accountability and this should remain its main focus, but the Internal Auditor should attend all meetings of the subcommittee whether he has issues on the agenda or not so that he is familiar with the subcommittee and will feel free to report and utilise his right to direct access to the subcommittee and its chair should that be necessary.
13. It would be normal practice for the Internal Auditor to submit his annual work plan to the subcommittee and report back against that on a periodic basis at summary level.

14. Because of the representational nature of the Council, it is not always going to be possible to get members of the Council with expertise in financial matters to be on the Audit Subcommittee. It is nevertheless important that the subcommittee membership has a significant number of elected members because the Council needs to have confidence in the subcommittee. Because of this, it will be sensible to add to the subcommittee some independent external expertise.
15. A local example of where this has happened is at the University of Canterbury where the Audit and Risk Committee comprises three lay members of the University Council plus two co-opted members. In the University's case, the lay members comprise an accountant and an experienced business person, and the two co-opted members are similarly qualified making for a very experienced committee. It is suggested that at least two external persons be added to the Council's Audit and Risk Management Subcommittee.
16. Ideally the Audit and Risk Management Subcommittee should have three to five members including external appointments. The current committee comprises four members and it is suggested that for the remainder of the current term of the Council that it be increased to six to accommodate two additional external members.
17. Risk management is also a topic typically reviewed by an audit committee. Such a review would ensure that management and the Council are complying with its policies, and respond appropriately to risk issues in the widest sense which include market, credit, liquidity, operational and commercial risk.
18. Risk management is a matter that needs to be embodied in all our managers' roles. It is not a function that one assigns one individual to be responsible for. Management is already charged with developing a framework and process for identifying and monitoring risk. This will be introduced to the Council by end of June. It is reporting from this process that should be referred to the Audit and Risk Management Subcommittee.

STAFF RECOMMENDATIONS

1. That the existing subcommittee be enhanced by the addition of two external appointees with experience in financial/risk management and that the CEO be authorised to negotiate a suitable retainer fee to be paid to these members.
2. That the chair of the Audit and Risk Management Subcommittee be appointed by the subcommittee from amongst its own ranks but that as a matter of policy the Mayor not be the chair.
3. That the Mayor and Chief Executive approach suitable external candidates for appointment and report back to the Council with their recommendations.
4. That the terms of reference for the Audit and Risk Management Subcommittee be amended to the following:
 - To consider and discuss with the external auditors their summary report at the conclusion of each audit and any other reports which are provided direct to the Audit and Risk Management Subcommittee.
 - To discuss with the Internal Auditor the annual work plan and approve that plan.
 - To receive from and discuss with the Internal Auditor a summary report on their audit activity.
 - To provide direct accessibility for the internal and external auditors on issues which, in the view of the respective auditors, should be made known to the subcommittee.
 - To review and approve all significant accounting policies.
 - To recommend that the Council approves the Annual Report and Audited Financial Statements.
 - To receive six-monthly reports from management regarding the adequacy of risk management practices in the organisation.

5. The following practices should be standard for the subcommittee:
- The subcommittee will meet at least four times a year.
 - At least once a year the subcommittee shall meet with the internal and external auditors without management present.
 - The subcommittee will principally rely on discussions and reports from staff, and remain at arm's length from operational activity.
 - The subcommittee may initiate investigations and call for reports on issues of concern appropriate for a committee of this type.
 - The subcommittee will act collectively and individual members will not undertake personal investigations.
 - The subcommittee will be serviced by the Secretariat.
 - The Chairperson of the subcommittee may initiate meetings as they sees fit.