

# **AUDIT AND RISK COMMITTEE**

## **AGENDA**

Meeting to be held

**THURSDAY 7 JULY 2016**

**11.00am**

In the Manawatu District Council Chambers,  
135 Manchester Street, Feilding

*R.G. Templer*

Dr Richard Templer  
**Chief Executive**

## **MEMBERSHIP**

### **Chairperson**

To be appointed

### **Deputy Chairperson**

To be appointed

### **Members**

Her Worship the Mayor, Margaret Kouvelis  
Councillor Barbara Cameron  
Councillor Tony Jensen  
Councillor Howard Voss

External Member – to be appointed

# ORDER OF BUSINESS

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**3. APOLOGIES**

**4. DECLARATIONS OF INTEREST**

Notification from elected members of:

4.1 Any interests that may create a conflict with their role as an elected member relating to the items of business for this meeting; and

4.2 Any interests in items in which they have a direct or indirect pecuniary interest as provided for in the Local Authorities (Members' Interests) Act 1968

**5. NOTIFICATION OF LATE ITEMS**

Where an item is not on the agenda for a meeting, that item may be dealt with at that meeting if:

5.1 The Council by resolution so decides; and

5.2 The Chairperson explains at the meeting at a time when it is open to the public the reason why the item is not on the agenda, and the reason why the discussion of the item cannot be delayed until a subsequent meeting.

**6. DISCUSSION OF CHIEF EXECUTIVE'S VIEW OF RISK**

**7. OFFICER REPORTS**

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## **Principles that help an audit committee add value**

### **Independence**

Audit committees need the independence of perspective, experience, and knowledge to bring the test and challenge that adds value to the governance of a public entity. The amount and nature of independence needed should be carefully considered. Sometimes, having members who do not have entity roles but bring knowledge of the industry or public sector can help provide this challenge.

An independent chairperson is often the best option to promote free and frank debate during committee meetings. It also gives governors confidence knowing that they are receiving independent advice and assurance.

Members of an audit committee are in the best position to provide objective and impartial advice when they are independent from management. An audit committee is likely to want staff to attend its meetings to hear their views and get their expert advice on certain topics. But an audit committee will also want time to turn issues over and debate them, so it should feel comfortable asking for “member only” time to debate more sensitive issues and seek independent advice when necessary.

### **Clarity of purpose**

To get the best, governors need to be clear about what they want from their audit committee, and entity management needs to help provide support that allows governance needs of the committee to be met. It is useful to set out the purpose, roles, and responsibilities of the audit committee and its scope in the context of the entity’s governance framework.

This will make it easier to shape the committee so that it is fit for purpose. For instance, the audit committee arrangements will need to be appropriate given the entity’s size, complexity, whether the audit committee role is primarily

advisory or assurance-related, and the sort of membership and expertise required.

But an audit committee can only strengthen and supplement, not replace or supplant the governance arrangements of a public entity. The audit committee should not duplicate the purpose and functions of other governance arrangements. It must enhance the governance framework, risk management practices, and the controls the entity uses to monitor achievements. Being clear about the purpose of the audit committee helps to ensure that it remains focused on supporting governance (and not any other matters, either governance or management).

Trying to get clarity on the purpose and role of the committee and other parts of the assurance cycle has been a key challenge for many committees and organisations, where expectations have been mismatched.

## Competence

Competence is about having the right mix of skills and experience on the audit committee to give oversight of the matters sought of the committee. Audit committee members need to have relevant experience and expertise to bring valuable insights and perspectives to the areas of the committee's responsibility.

The better the skills and experience of audit committee members, the better the committee can add value. Collectively, people appointed to serve on audit committees need to have expertise, such as:

- finance and accounting, including financial reporting;
- broad governance, assurance, and risk management disciplines;
- understanding of internal controls and assurance frameworks, including understanding of the roles of internal and external audit;
- knowledge of the sector or industry in which the public entity operates; and
- other attributes as specifically relevant to the entity (for example, legal or information technology experience).

A variety of perspectives is needed in an audit committee to ensure ideas are fully debated and the group is aware of its strengths and weaknesses in various aspects of governance. Diversity of membership is a way of achieving a variety of perspectives. This means an audit committee needs a mix of experience levels, skill-sets, background experiences, and thinking styles. This

can be achieved through demographic diversity, such as gender, ethnicity, education types, career and community experiences, and academic disciplines.

## **Open and effective relationships**

To be effective, an audit committee needs to operate in an environment of co-operation and trust. Audit committee members also need to communicate effectively among themselves and with many others interested and involved in the governance and management of the entity.

The central figure among the people and relationships involved in an audit committee's work is the chairperson of the audit committee. This person is the most important appointee for ensuring the committee functions in a way that adds value. That person needs to have expertise and experience in governance and bring personal qualities and independence to the role. The chairperson is best placed to achieve this when the audit committee is clear about its purpose, has no perceived or actual conflicts, and contains diverse, skilled, and experienced members.

When the chairperson promotes open and proactive dialogue with management and the governing body, the audit committee is able to effectively influence the organisation and its achievements.

Another relationship that is important to the effectiveness of an audit committee is with the chief executive. Audit committees seek information from management of the entity to test and challenge. In turn, they provide insight and guidance to management about how the entity's risks are perceived, what matters to stakeholders about the entity's performance and opportunities for improvement from a governance perspective.

Because of the governance arrangements of public entities, the relationship of the audit committee with the chief executive is often particularly important. When the audit committee works effectively to test and challenge and get assurance, it provides useful insight, guidance, and support to the chief executive. Good communication and relationship management are critical for audit committees to provide the governance test and challenge needed for organisational improvement and risk management. Good working relationships and mutual respect between the audit committee chairperson, chief executive, and chairperson of the board of governors increases the audit committee's ability to effectively test and challenge the things that matter to the entity.

Some audit committees have access to support from an internal auditor and get much of their information and assurance from the internal auditor's work. The independence and effectiveness of the internal auditor is greatly strengthened by the support of the audit committee. One of the main functions of the audit committee is to consider the internal audit work programme to ensure it meets entity needs and oversee the completion of the programme.

Timely communication of significant issues between the audit committee and the external auditor is critical to the auditor discharging their responsibility to the Auditor-General. The audit committee should also meet regularly with the external auditor, for example, to discuss the audit plan, interim audit findings, and results of the final audit. The audit committee needs to fully understand the role and responsibilities of the external auditor as an agent of the Auditor-General.

## **Making it real and keeping the principles in balance**

What makes an audit committee work best is balancing the principles in the realities of the entity. For example, there is no point having...

... a very independent audit committee, if it knows very little about the entity and the industry or context within which that entity operates;

... a lot of individuals with good knowledge, if they struggle to work as a group or if they are reluctant to challenge each other and express different views or ask the "dumb" questions;

... a very experienced audit committee, if there is no succession planning for those who will be responsible for governance of the entity in the future; and, finally

... an audit committee, if the entity, its governors, and managers don't respect the purpose of the committee and its members or want to make time to hear and use their advice.

Putting principles into practice isn't always easy. We find that, generally, common sense works. Common sense is the action of need, not compliance. Audit committees are a way to help focus on common sense and give governance test and challenge to the organisation. If an entity chooses to have an audit committee, it needs to be fit for purpose. Audit committees created solely for compliance reasons are unlikely to be effective and add value to the entity.

We see, and those involved with audit committees tell us, that those committees that are thoughtful about applying principles in practice and in their context are most effective and valued.

A lot of formal guidance is available that encourages and sets out ways for an audit committee to take stock and focus on its effectiveness. From our perspective, the main point is that once an entity has decided to have an audit committee, it and its committee members need to reflect on how things are working – whether and how the committee can better add value and insight in the areas sought. Honest exchange about how well the committee is working and balancing the principles is what is important.

« Previous: Why have an audit committee?      Next: Know your environment »



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## **What works?**

*If you have decided that having an audit committee is the right option for your entity, here are some tips and tools that we've been told have worked well for others.*

## **Fundamentals to get right**

### **Principles as a foundation**

Before the audit committee gets stuck into any detailed work, there are some fundamentals to get right. Most importantly, audit committees must be fit for purpose. In some of our previous work on audit committees, we identified four principles to use as the foundation for an effective committee. They are:

- independence;
- clarity of purpose;
- competence; and
- open and effective relationships.

Making it real and keeping the principles in balance is what will make an audit committee work best.

### **Fundamental areas of work**

From our conversations with those working with audit committees we know that an audit committee being clear about its purpose is very important. Other topics that can be just as important are:

- assessing the entity's risk appetite;
- asset management; and
- performance management.

## **Tools and techniques to help audit committees add value**

Sometimes, adding value can be as simple as asking a powerful question.

But there are also many tools and techniques that audit committees can use. Here are the ones that experienced people told us were the most useful.

## Scanning tools

To be able to anticipate opportunities, risks, and other factors that might influence a committee's decision, scanning its environment is important. We often find that although all audit committees intend to do this kind of scanning, more urgent matters tend to come up and scanning moves to the bottom of the agenda.

Even if you feel that there are more urgent matters to attend, at the very least, the audit committee should scan the entity's "total assurance picture" and perform a value chain analysis.

The section on "Knowing what you don't know" also gives you some useful questions to ask that might help reveal some missing insights.

If you are looking for more information about the current and future environment, here are some links that you might find useful:

- The New Zealand Data Futures Forum is a group of public officials and experts raising questions about the future of data use.
- Thinking Futures has some resources available that will give you a basic knowledge of how to use foresight in organisations, including a presentation on foresight.
- Some global companies have used their reach to better understand global trends that are likely to impact us all. Deloitte's "predicted human resource trends" and PricewaterhouseCooper's "predicted megatrends 2015" make this information accessible.
- We also shared our views on how well the public sector is preparing for the future in our report *Reflections from our audits: Our future needs - is the public sector ready?*

## Specific tools

- risk management;
- "three lines of defence"; and
- effective commonsense tips: setting agendas and quickly fixing control weaknesses.

If you know a particularly useful technique that you think others should know about, tell us in our LinkedIn group.

## Some useful guides

We have included a list of links to useful guides that might help you in your work as part of, or with, an audit committee.

Next: Powerful questions »



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## Know your environment

An environmental scan is a typical part of any good planning and strategy session. It can also be a useful tool for getting the most from an audit committee. The type of committee and the context in which the audit committee and its public entity and industry are operating will affect how the committee is run and how it can most add value. Below are some of the current and enduring matters related to the operating environments of many public entities.

This is not a comprehensive list. It is a list of the most common issues that public sector leaders are talking about. Where appropriate, we have included links to resources that governors have told us might be useful for thinking through your own context.

- Differences between audit committees in the public and private sectors
- Current areas of change (as seen by governors and others)
- Are there other audit committees like yours?
- Knowing what you don't know – revealing the insights
- Advice from experts on assurance-related issues

Have you thought about any of these or experienced them within your committee? Let us know your experience and we will add it to the case studies (anonymously if you prefer).

Next: Differences between audit committees in the public and private sectors »



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## **Differences between audit committees in the public and private sectors**

*There are differences in the reasons for, and arrangements of, audit committees in the public and private sectors and in the public sector.*

In the private sector, an audit committee is usually a committee of the board. Therefore, its role within the company is well understood and the expectations on it are clear. That model works in the public sector too. For example, many public entities have a board that selects a subcommittee to consider risks and ensure that the entity meets its compliance obligations. Examples of public entities where the audit committee is a subset of the board are State-owned enterprises and Crown Research Institutes. In these arrangements, shareholding Ministers appoint company directors to a board, and then an audit committee is selected from those board members.

Sometimes the form of governance in a public entity is different. There may be no board. Governance and management responsibilities can rest with the chief executive. Government departments are an example of this form of governance. Or the governors are wholly or partly elected. Local authorities, district health boards, and school boards of trustees are all elected by local communities.

Different organisational governance settings pose specific opportunities and challenges. At times, the audit committee provides advice at a distance from the real pressures and decision-making demands of a public entity. Audit committees are still valuable in this context, but they need to be clear about functions, roles, expectations, and the opportunities available to them and their entities. For example, the audit committee may only be advisory.

Audit committees can still help entity governors to test and challenge new ideas as well as business-as-usual operations to ensure that the entity is improving as well as meeting its expectations as a public entity. Public entities have different expectations than private entities because they often have coercive powers (such as raising levies, setting fees, or enforcing laws), public funding, or other support from central government.

Understanding the governance and management arrangements of the public sector and respecting the roles of governors and managers is important and public sector understanding within an audit committee can be a useful skill set. An audit committee must be aware of, and complementary to, a public entity's governance arrangements and public accountability requirements if it is to give useful advice.

Successful governance is built on good information that supports shared understanding and mutual respect. Those from primarily a private sector background must work to understand the difference between the public and private sector use of audit committees and the implications of those differences for their roles. To give governors confidence in the audit committee's work and advice, it must understand the entity, its needs, and its expectations of the audit committee.

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## Current areas of change

Effective audit committees can provide objective advice and insights into the public entity's strategic and organisational risk management framework. In doing so, they can identify potential improvements to governance, strategy, risk management, and control practices.

*Many experienced board members understand that the audit committee is where the board can gain real insight into the entity's main drivers and how the organisation is performing.*

Audit committees need to constantly scan their operating environment to know what is coming and how different players in their sector and the public sector are being influenced by changes in the wider environment. They need to bring insight to understand how all this affects their organisation's ability to add value and achieve its purpose.

We set out below what governors have told us are current areas of change that create risks and opportunities. Audit committees can provide insight for the public sector and its entities because they can have a useful view on the risks and opportunities presented by these trends.

How do you see the issues and risks changing – are the things that you work to understand and manage with your audit committee covered here? If there are other things, let us know.

## Global forces affecting our public sector

A wide range of global forces are affecting the New Zealand public sector, including:

- **Demographics:** Demographic change, particularly the ageing population, is a challenge (as it is for many governments). It cannot be controlled or prevented, but its effects can be anticipated, managed, and planned for.
- **Productivity:** New Zealand's productivity has been increasing but not as quickly as in other countries, and our income growth has been slower.

- **Technology and digital disruption:** There have been "waves of creative destruction wrought by technological innovation" and competency-destroying technology transitions. Digital innovation has positive and threatening effects on the strategy and operations of public entities and their ability to sustainably deliver future value. Significant disruption of public sector computer networks or systems can negatively affect service delivery, reputations, and trust in individual entities and sectors.
- **Public-centricity:** Public entities are becoming more customer-oriented. Electronic government is shaping services to be more customer-oriented, and those ideas extend to how services are designed and managed. However, a range of factors undermine the achievement of the public sector's results, leading to underuse of resources and value creation opportunities. These factors include fragmentation between and within agencies, incompatibility of business strategies, resources deployment, and the quality of implementation. The challenges of co-operation mean some duplication and wasting of resources.
- **Austerity:** Public entities are grappling with the pressures of financial austerity, which includes freezes or cuts in public spending when demand for services is growing. Entity reinvestment rates (both financial and non-financial) in core capabilities reach a point where they are not enough to sustain service delivery at expected levels for the foreseeable future. This puts entity reputations and public confidence at risk. In some cases, there is concern that "safety margins" have been lost or eroded.
- **Changing business models:** Public services are being delivered through a broader and changing mix of delivery models (including public-private models), driven by a combination of public sector austerity and innovation. The public sector is feeling the effects of increasing internal and external competition. Choice-based and competition-dependent models of public service provision are aimed at improving quality, efficiency, and value for money for a range of public services.
- **Capability:** The wider environment of public sector pressure and change can result in transformation fatigue and failure risks. Public sector employees can become cynical and exhausted from transformation and change. There are accompanying feelings of increased anxiety, uncertainty, and job insecurity. When "transformation" does not occur as planned, it puts transformation objectives, and wider entity and Government outcomes, in doubt. The public sector's ability to attract and retain a highly skilled and capable workforce is paramount in enabling it to meet the current and future needs of the Government and the

population. The public sector needs to attract, develop, and retain the capability and capacity to manage large projects and long-term services.

- **Crisis preparation and management:** Governors and managers need to be aware of and understand emerging threats and opportunities, and identify symptoms of wider problems. Some of our reports have identified the need to strengthen the planning for low-probability but high-impact events, whether entity-specific or systemic (such as natural disasters or substantive changes in market demand or supply).
- **Accountability:** Traditional accountability practices are under pressure by developments in public management and governance, including increased focus on getting results, using partnering arrangements between government agencies and with other stakeholders, and developing a flexible and innovative public service. These pressures increase the risk of, for instance:
  - **Transparency loss:** Restricted information disclosure and opaque practices that prevent people from accessing information to make better decisions (such as reducing risk exposures or protecting personal interests) and undermine entity and public sector effectiveness and accountability.
  - **Erosion of integrity:** Significant impairment of the integrity and trust in the public sector through wrongdoing (such as a breach of law, codes, policies, or rules, misuse of funds, gross mismanagement, or a serious breach of a code of conduct) that is detrimental to the public interest.

Managing changes in the way public services are operated and delivered is complex, demanding, and time-consuming. It can result in conflicting priorities and leave little time for other needs.

Audit committees need to ask themselves: How is the environment of the entity changing? Do these changes raise any risks, issues, or concerns for the entity? Does the audit committee change its focus because of the changing environment? If so, how does the audit committee communicate this change in focus and manage the expectations that management or other stakeholders might have? Does it balance its focus on success with its focus on risk?

We see that the least effective audit committees tend to work in isolation and therefore have difficulty influencing governors and other stakeholders. This suggests that audit committees might benefit from knowing strategic risks and the future of the public entity. They might also benefit from making

dedicated time for discussing and considering these as they carry out their advisory work.

« Previous: Differences between audit committees in the public and private sectors

Next: Other audit committees like yours »



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## Knowing what you don't know

There might be issues that your environmental scan hasn't covered. It is difficult to know what you don't know. So here are some questions to ask to reveal potentially missing insights.

### Identifying risk

	Issues	Risk	Appetite
<b>Headline questions</b>	What are the major prevailing and anticipated future issues/trends for the public sector?	How might these issues/trends shape and define the risk profile (hazards/opportunities) of this organisation?	What is the organisation's strategic response to these issues/trends?
<b>Sub-questions</b>	Are there (mega) trends that underpin these? (Cyclical, increasing, decreasing?)	Are there particular features of this organisation that amplify or attenuate the effects of these issues/trends on the organisation?	Which risks have management and the board implicitly chosen to accept? Should these be made more explicit? How?
	Which of these issues/trends are most relevant to this organisation and why?	Does the risk management framework take enough account of these issues/trends?	Which risks have management and the board chosen to avoid? Are these clearly articulated?
	How and within what time frames do we expect any of these issues/trends to make themselves felt on this organisation?	Does the risk management framework make a clear distinction between "controllable" and "uncontrollable" factors?	Which risks are management and the board willing to accept and under what conditions and within what specified ranges?
	How should we as a committee explicitly inform our decision-making in the context of the above? Are committee's views and those of management aligned?		

### Identifying the entity's value

- Sustained performance raises organisational and public value.

- Constructive challenge of underlying organisational performance provides the committee its "business" risk edge.

	<b>Value 1</b>	<b>Value 2</b>	<b>Value 3</b>
<b>Headline questions</b>	How well do we know the business of this organisation?	What are the Crown/Treasury expectations of performance?	What are the major strategic (and operational) trade-offs that need to be made in realising "value"?
<b>Sub-questions</b>	<p>Are we clear how the organisation's value is defined, created, delivered, and measured across all divisions/units?</p> <p>What does this tell us about how and where that value can be depleted or destroyed?</p>	<p>Are we clear how outputs under the applicable "service agreement" reconcile with long-term (organisational and public) value?</p> <p>Does the strategy adequately capture both of the above, and is it convincing/compelling?</p>	<p>How and where has management framed and determined the trade-offs to realise value? How are these expressed in the organisation's risk appetite?</p> <p>Are the trade-offs between genuinely mutually exclusive factors or are they potentially "false trade-offs" and performance could (and should) deliver equally against each?</p>
<p>What do the responses to the above questions, including supporting evidence, tell us about the organisation's ability to deliver sustainable performance and public value?</p>			

## Managing change

	<b>View 1</b>	<b>View 2</b>	<b>View 3</b>
<b>Headline questions</b>	Where and what are the potential opportunities, challenges, and threats to the organisation's current business and business operating model?	Are accountabilities and responsibilities clear and explicit?	Is the control environment wholly "fit for purpose" to ensure that targets are fully realised?
<b>Sub-Questions</b>	<p>What change programs are under way or planned, and are these limited in scope or extensive (that is, "transformational")?</p> <p>How can we gain comfort that the organisation has the requisite capacity and capability to execute change/transformation</p>	<p>Do we observe a "clear and unambiguous line of sight" between the target outputs and outcomes and those individuals charged with their delivery?</p> <p>Are performance measures, incentives, and target delivery aligned at all levels?</p>	<p>In our own analysis and evaluation, where do we have residual concerns about the effectiveness of controls, given the risks?</p> <p>Do management representations and assurances have enough substance to demonstrably</p>

View 1	View 2	View 3
within pre-agreed parameters?		evidence the veracity of the controls in place to assure delivery?

What do the responses to the above questions, including supporting evidence, tell us about the organisation's ability to change/transform with a high degree of reliability?

« Previous: Other audit committees like yours

Next: Advice from experts on assurance-related issues »

## 38. Audit and Risk Committee

<b>Subordinate to</b>	Council
<b>Subordinate Committees</b>	-
<b>Legislative basis</b>	Committee delegated powers by Council in accordance with Schedule 7, Clause 32, LGA.
<b>Membership</b>	Mayor Margaret Kouvelis and three councillors, appointed by the Mayor, plus an independent member selected by the Audit and Risk Committee.
<b>Meeting cycle</b>	At least four times a year. The Chair of the Audit and Risk Committee may convene additional meetings, as they deem necessary.
<b>Termination date</b>	Next triennial general election for local government.
<b>Review of decisions</b>	Refer to Section 25 of this Manual.
<b>Responsibilities</b>	<ol style="list-style-type: none"> <li>1 Financial reporting including the following:             <ol style="list-style-type: none"> <li>a. long term planning including the financial strategy;</li> <li>b. appropriateness of accounting policies;</li> <li>c. annual report; and</li> <li>d. internal report (monthly and/or quarterly)</li> </ol> </li> <li>2 Risk management and the system of internal controls             <ol style="list-style-type: none"> <li>a. setting the Council's appetite for risk;</li> <li>b. understanding the key risk areas including likelihood and consequences;</li> <li>c. effectiveness of internal controls; and</li> <li>d. fraud risk and procurement risk.</li> </ol> </li> <li>3 External audit             <ol style="list-style-type: none"> <li>a. relationship with auditor;</li> <li>b. understanding scope and engagement;</li> <li>c. review significant audit findings /recommendations; and</li> <li>d. monitor progress on recommendations.</li> </ol> </li> <li>4 Internal audit             <ol style="list-style-type: none"> <li>a. appointment and relationship with internal auditor;</li> <li>b. scope of work; and</li> <li>c. responses to internal audit recommendations.</li> </ol> </li> </ol>
<b>Delegated authority</b>	<ul style="list-style-type: none"> <li>• None.</li> </ul>
<b>Limits to delegations</b>	-
<b>Recommendations</b>	-