



HFMA practical guide
Fourth edition



NHS Audit Committee Handbook

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NHS Audit Committee Handbook

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Foreword and Introduction

Welcome to the 2018 version of the *NHS Audit Committee Handbook* which is designed to help NHS governing bodies and audit committees as they review and continually re-assess their system of governance, risk management and control to ensure that it remains effective and 'fit for purpose' across all that an organisation does. It has been developed by the HFMA's Governance and Audit Committee to provide a self-contained source of guidance for all members of audit committees and will also be of interest to those who serve on governing bodies.

The Handbook replaces the 2014 edition and, although it has been fully updated to take account of the many changes that the NHS has seen since then, the underlying principles, structure and content of the Handbook will be familiar to many. In particular, it continues to provide audit committee members with a succinct summary of what is expected from them and a series of practical tips and pointers to help them put the theory into practice.

As with earlier versions, this Handbook applies to NHS organisations in England – however, the principles and much of the practical guidance is broadly relevant across the rest of the UK. In terms of its content, the Handbook starts by explaining why governing bodies need audit committees and how they provide support in fulfilling statutory duties and organisational objectives. It then looks at how audit committees should be set up before moving on to focus in detail on what they do and how they work with others. Practical examples and case studies are included throughout to bring the theory to life and cross references to further sources of guidance are included both within the text and as an appendix.

Key changes in this edition include:

- The edition of a new chapter dealing with partnership working at scale
- Guidance for audit committees on mergers and acquisitions
- Guidance for audit committees on cyber security
- Guidance for audit committees on working with the regulators.

Audit committees and their members continue to play a crucial role in the governance of every NHS organisation and members must take seriously their responsibility for scrutinising the risks and controls affecting every aspect of the business – not just in the finance and financial management sphere. We hope that you find this Handbook of real practical benefit as you carry out this demanding role.

If you have any comments or suggestions about how we could develop the Handbook in future, please let us know via publications@hfma.org.uk

Kevin Stringer

Chair, HFMA Governance and Audit Committee

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Chapter 1

Why the Governing Body needs an Audit Committee

This chapter explains that every governing body/board¹ is required to have an audit committee to support it in fulfilling its statutory and organisational objectives. It summarises the key ways that audit committees provide this support by reviewing processes and seeking assurance.

1.1 Why a Governing Body has an Audit Committee – the Statutory Basis

Every NHS organisation is required to have an audit committee that reports to its governing body². The formal requirements to have an audit committee are set out in different documents, depending on the organisation:

- For clinical commissioning groups (CCGs), s14M of the *NHS Act 2006* (inserted by s25 of the 2012 Act) and NHS England's *Model Constitution Framework* (section 6.6.3)
- For foundation trusts (FTs), Monitor's *NHS Foundation Trust Code of Governance*
- For non-foundation NHS trusts, the NHS Trust Development Authority's *Code of Conduct and Accountability*³.

1.2 What does the Audit Committee do to Support the Governing Body?

NHS governing body members have a daunting task in overseeing some of the largest and most complex organisations in the country. To fulfil this role it is the governing body's responsibility to put in place governance structures and processes to:

- Ensure that the organisation operates effectively and meets its statutory and strategic objectives
- Provide it (i.e. the governing body) with assurance⁴ that this is the case.

However, even the best structures and processes can let down an organisation if they are not operated with sufficient rigour. This is where audit committees play a key role in supporting the governing body by critically reviewing and reporting on the relevance and robustness of the governance structures and assurance processes on which the governing body places reliance. This requires the audit committee to understand and scrutinise the organisation's overarching framework of governance, risk and control. At the corporate level, this includes risk management and performance management systems underpinned by the assurance framework⁵ which sets out the organisation's 'mission critical' objectives and identifies the key risks that could prevent their achievement. In effect, it is the 'lens' through which the governing body examines the assurances it requires to discharge its duties.

¹ For many organisations the governing body is known as the board. In foundation trusts there is also a council of governors. To avoid repetition, we have used the generic term 'governing body' throughout this Handbook.

² All NHS bodies are required to have a governing body (or board) which comprises both executive and non-executive directors (NEDs)/lay members. This governing body is separate from the day-to-day management structure. The exact structure of each governing body is different for each type of NHS body and is set out in legislation and associated regulations. For non-foundation NHS trusts the relevant legislation is regulations 2 and 4 of the *1990 Trust Membership and Procedure Regulations (SI 1990/2024)*. For FTs, there is a board (or 'council') of governors and a board of directors as required in schedule 7 to the *NHS Act 2006*. For CCGs, the requirement to have a governing body (that has its functions delegated to it by the CCG 'council of members' on which all the CCG's constituent GP practices are represented) is set out in s14L of the *NHS Act 2006* (inserted by s25 of the 2012 Act) and the associated regulations (SI 2012/1631).

³ Although this document is no longer available it has yet to be replaced.

⁴ Assurance is defined by HM Treasury in *The Orange Book: Management of Risk – Principles and Concepts* as 'an evaluated opinion, based on evidence gained from review, on the organisation's risk management and internal control framework'.

⁵ This Handbook uses the generic term 'assurance framework' throughout. However, some organisations use the term 'board (or governing body) assurance framework'.

Chapter 2

How to Set Up and Support an Audit Committee

This chapter focuses on how audit committees are constituted and how they operate in practice. It also looks at the implications of collaborative and partnership arrangements that may exist and at the importance of reviewing the committee's own effectiveness via regular self-assessments.

2.1 How Many Members should an Audit Committee have?

HM Treasury's guidance as set out in its *Audit and Risk Assurance Committee Handbook* should be followed – this states that audit committees should comprise at least three non-executive directors/lay members¹.

2.2 Who are the Members of the Audit Committee?

The distinctive characteristic of the audit committee is that it comprises only independent, objective non-executive directors (NEDs) or lay members² who are appointed by the organisation's governing body. In other words, audit committee members should satisfy the governing body's definition of 'independence' and:

- **Not** be employed by the organisation (other than in their capacity as members of the audit committee)
- **Not** claim a significant proportion of their 'trading income'³ from the organisation.

In foundation trusts (FTs), the *Code of Governance* (provision C.3.1) states that 'the board of directors should establish an audit committee composed of at least three members who are **all** independent non-executive directors'. For non-foundation trusts and clinical commissioning groups, guidance for auditor panels is helpful. The *Local Audit (Health Service Bodies Auditor Panel and Independence) Regulations 2015* state that an auditor panel must have at least three members, including a chair who is an independent non-executive member of the health service body's governing body/board. A majority of the panel's members must also be independent and non-executive members of the governing body/board but the panel may include a minority of members who are not members of the governing body/board or who are not considered independent.

The governing body is responsible for determining whether or not a prospective member of the audit committee is independent.

Regulation 6 of the *Local Audit (Health Service Bodies Auditor Panel and Independence) Regulations 2015* requires the governing body to consider whether the circumstances of the prospective member could affect his or her judgement. A number of factors should be considered – for example, recent employment with the health service body, close family ties to its directors, members, advisors or senior employees or a material business relationship with the health service body.

¹ This is in line with the requirement set out in the Financial Reporting Council's 2016 *UK Corporate Governance Code* which requires boards in the private sector to establish an audit committee of at least three, or in the case of smaller companies, two independent non-executive directors. Monitor's *Code of Governance* builds on the UK Code and requires FTs to establish an audit committee composed of NEDs which should include at least three independent NEDs.

² For CCGs, schedule 2, paragraph 7 (3) of the *Health and Social Care Act 2012* says that 'Arrangements ... **may** include provision for the audit committee to include individuals who are not members of the governing body.' However, NHS England's *Model Constitution Framework* for CCGs recommends that they should follow the *NHS Audit Committee Handbook*.

³ Trading income refers to income received from the organisation for services provided. This does not include a fee or expenses that may be received for serving as a NED or lay member.