
Performance Audits





2 Government-wide: Audit Committees

Summary

The government's Audit Committee, responsible for internal audit services to departments, provides appropriate oversight in the area of risk management, but not in controls and internal audit, in accordance with best practices. In addition, the Committee is not in full compliance with the responsibilities identified in its Charter. These responsibilities reflect best practices.

Audit committees in provincial agencies, boards and commissions generally fulfill the responsibilities assigned to them. However, these responsibilities fall short of accepted best practices in the scope of the activities they undertake. For instance, all committees we surveyed and those we examined in greater detail provided oversight of the entity's financial statements and external audit. However, few were involved in any aspect of other core governance oversight areas such as internal audit, internal controls, corporate ethics or risk management.

Boards of provincial public sector entities need to determine which best practices are most applicable for their audit committees. We recommended the Departments of Health and Education, and Treasury and Policy Board, each provide policies and guidance to agencies, to move towards best practices in audit committees throughout the provincial public sector.



2 Government-wide: Audit Committees

GOVERNMENT-WIDE: AUDIT COMMITTEES

Background

- 2.1 Audit committees are widely recognized as a key committee of a board of directors, providing oversight of financial reporting, internal controls, financial risks, an organization's values and ethics, and other responsibilities delegated to it by the board of directors. Audit committees' primary focus was once oversight of the organization's external financial statement audit. More recently, committees have been delegated critical governance responsibilities and have a key role in an organization's governance structure. The audit committee has evolved from being reactive to issues, to contributing to an environment of transparency and openness. While much attention has been focused on public company audit committees, an effective audit committee is equally important to governance in the public sector.
- 2.2 Literature on best practices for public companies has long been available. Best practices for public sector organizations and governments are more recent; however, they are similar to best practices for public companies. The *2000 December Report of the Auditor General of Canada*, Chapter 18 – Governance of Crown Corporations, outlined selected best practices. In 2003, the Treasury Board of Canada Secretariat issued *Guidelines for Audit Committees in Crown Corporations and Other Public Enterprises*.
- 2.3 Government internal audit committees are also becoming more prominent. Best practices for these committees have been developed in recent years. There are distinctions between public sector agency audit committee oversight responsibilities and a government's internal audit committee. The most significant distinction is that public sector agency audit committees are expected to provide oversight of the financial statement audit engagement.
- 2.4 Organizations in Nova Scotia's provincial public sector vary in size and complexity; all best practices may not apply equally to all. Adopting best practices does not ensure an effective audit committee; however, without appropriate best practices, the audit committee will be unable to fulfill governance expectations.
- 2.5 The audit committee is one component of an organization's governance structure. Its role is established by the board of directors and it reports to the board. Internal audit is also a key component of governance. Our



examination of audit committees is our second report on government-wide governance, and follows our November 2008 Report on Government-wide Internal Audit.

Audit Objectives and Scope

- 2.6 In fall 2008, we undertook an audit of audit committees of agencies, boards and commissions in the Nova Scotia provincial public sector. This audit was conducted in two phases. Firstly, we surveyed board and audit committee chairs in 35 entities. Several entities did not have separate audit committees. In these situations, the board chair responded to both surveys. The second phase involved completion of detailed audit procedures at seven entities.
- 2.7 We also completed audit procedures on government's Audit Committee. We did not send a survey request to the Chair of this Audit Committee as we planned detailed audit procedures and could obtain the information through interviews.
- 2.8 We conducted the audit under Section 8 of the Auditor General Act. We wanted to determine whether the audit committees of agencies, boards and commissions, as well as government's Audit Committee, provide appropriate oversight to their respective organizations. We also wanted to assess whether certain audit committees provide appropriate financial, audit, risk management and control oversight to the entity.
- 2.9 We created a survey based on accepted best practices for public sector organizations. Our audit criteria were developed from these best practices and were discussed with and accepted by management of those agencies, boards and commissions in which we conducted additional procedures. With respect to government's Audit Committee, we recognize that best practices for such committees are evolving. We developed our criteria from available information and discussed these with the Chair of government's Audit Committee. These criteria were accepted as appropriate. We have referred to these evolving practices as best practices for this audit.
- 2.10 *Survey instrument* – The survey to the chair of the audit committee (or equivalent) consisted of 46 questions organized under the following headings:
- composition and structure;
 - functioning and operations;
 - roles and responsibilities;

GOVERNMENT-WIDE:
AUDIT COMMITTEES



-
- performance monitoring and evaluation; and
 - communication and information gathering.
- 2.11 The survey to the chair of the board consisted of five questions organized under similar headings:
- composition and structure;
 - functioning and operations; and
 - performance monitoring and evaluation.
- 2.12 Both surveys allowed respondents to provide narrative comments on several questions. From those surveyed, we selected eight organizations to audit. One entity, the Nova Scotia Teachers' Pension Plan Trustee Inc., the governing body of the Nova Scotia Teachers' Pension Fund, obtained a legal opinion indicating it was not subject to audit by the Office of the Auditor General. We are pursuing our audit status with respect to this entity. Accordingly, our additional procedures were conducted in seven entities.
- 2.13 In addition to the survey, our audit approach in the seven entities included interviews with board of director and audit committee chairs, and a review of documentation to verify and clarify survey responses. We also tested compliance with a committee's mandate or terms of reference, and if applicable, with legislation. Audit procedures conducted on government's Audit Committee included interviews with the Chair, review of related documentation, and testing compliance with the Committee's charter.

Significant Audit Observations

Government Audit Committee

Conclusions and Summary of Observations

We concluded government's Audit Committee provides appropriate oversight in the area of risk management. However, the Committee did not provide appropriate oversight for controls and internal audit in accordance with best practices. We found the Committee's charter included many best practices we had identified for this audit, but the Committee did not fully comply with the responsibilities outlined in its charter.



- 2.14 *Government audit committee* – Government’s Audit Committee was established in 2004. The Committee’s charter outlines its responsibilities which include promoting a strong risk and control environment in the Province, and supporting continuing improvement in the quality and effectiveness of government’s internal audit function. The internal audit function is carried out primarily through the Province’s Internal Audit Centre (IAC).
- 2.15 *Composition and structure* – The Audit Committee consists of eight deputy ministers with several being knowledgeable regarding audit practices. Best practices indicate a government’s audit committee should include independent individuals who are neither employees nor officers of the Province. Including an independent member on the Audit Committee provides an opportunity for objective and impartial advice.

Recommendation 2.1

The Audit Committee should include one or more independent members.

- 2.16 *Functioning and operations* – The Audit Committee has a formal charter but it is not reviewed and assessed on an annual basis. The Chair advised the charter captured the initial objectives and responsibilities of the Committee, but has not been revisited to determine if these objectives are still relevant. The Chair acknowledged certain areas of the charter have not been, and will not be, complied with. Regular review and updating would ensure the charter incorporates the most current best practices.

Recommendation 2.2

The Audit Committee should review and assess its charter on an annual basis.

- 2.17 We also found several instances in which the Committee did not fully comply with its charter. Annual assessments of the Audit Committee’s charter would help ensure the Committee is operating as intended.

Recommendation 2.3

The Audit Committee should confirm annually that all responsibilities outlined in its charter have been carried out.

- 2.18 Meeting agendas and relevant background information were normally prepared and distributed to Committee members at least one week in advance of the meeting to allow sufficient time for review of information. Although meetings are scheduled a year in advance, the Audit Committee does not prepare an annual calendar. This would assist the Committee in fulfilling the oversight responsibilities included in its charter, such



as approval of the Internal Audit Centre's annual plan and budget, and evaluation of the Executive Director Internal Audit.

- 2.19 We assessed minutes to determine if Audit Committee meetings were well-documented. The Chair indicated the minutes have improved over time. During our audit we did note improvement; however we found a continued lack of continuity of items from meeting to meeting, and the minutes did not regularly identify and address old business until resolution. We suggest the Committee evaluate the adequacy of its minutes to ensure sufficient documentation is included to demonstrate the Audit Committee is fulfilling its oversight responsibilities.
- 2.20 Members do not receive formal orientation and training on the Committee's responsibilities and objectives. Without appropriate orientation and training, members may not understand the Committee's oversight responsibilities as these differ from the oversight provided by audit committees of other public sector entities.
- 2.21 *Roles and responsibilities: Internal Audit* – The Audit Committee has certain responsibilities for oversight of the Internal Audit Centre. The Audit Committee's charter notes the following:

“Supporting continuing improvement in the quality and effectiveness of the Internal Audit function by:

- reviewing with Deputy Ministers and the Director of Internal Audit the charter, plans, activities, staffing, and organizational structure of the internal audit function;*
- ensuring there are no unjustified restrictions or limitations, and review and concur in the appointment and performance review of the Internal Audit Director;*
- reviewing the effectiveness of the internal audit function, including adequacy and allocation of internal audit services across the Province;*
- reviewing the compliance of the internal audit function with The Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing;*
- ensuring appropriate independence is maintained, overseeing quality assurance processes and reviewing performance measures; and*

-
- *on a regular basis, meeting separately with the Internal Audit Director to discuss any matters that the Committee or Internal Audit believes should be discussed privately.”*

- 2.22 The Audit Committee is also to assist internal audit in achieving its mandate as defined in the Internal Audit Charter.
- 2.23 We compared the Audit Committee’s responsibilities with best practices for core government audit committees and found no significant deficiencies. We also tested for compliance with these responsibilities. Our results are detailed in the following paragraphs.
- 2.24 We were informed the Deputy Minister of Finance reviews the chief audit executive’s performance (formerly the Director Internal Audit; now the Executive Director Internal Audit) and solicits input from the Committee for this process. We found no evidence the Committee concurs with the evaluation. In addition, there was no evidence the Committee approved the recent hiring of the IAC’s new Executive Director, although we understand this individual was selected by a subgroup of the Committee. Documentation of this approval in the minutes would have strengthened the Executive Director’s independent role.

GOVERNMENT-WIDE:
AUDIT COMMITTEES

Recommendation 2.4

Audit Committee minutes should indicate whether the Committee concurs with the Executive Director Internal Audit’s annual performance appraisal.

- 2.25 The Chair noted IAC’s resources are discussed at Audit Committee meetings. A business plan is prepared and approved, and the IAC’s Executive Director recently provided a resourcing plan to complement a revised service delivery model. The Chair noted that IAC resource limitations result in deputy ministers looking to external sources for audits. Currently, IAC is not informed of all audits carried out by external sources. The Chair indicated he would like IAC to be informed of all audit activity. This information would support the resourcing requirements for internal audit in government.
- 2.26 The Audit Committee is to evaluate the effectiveness of the internal audit function and determine whether sufficient and appropriate internal audit services are being provided. This is not done. The IAC’s charter is not reviewed regularly. The Committee relies on IAC to develop an audit plan, which the Committee approves annually. However, there is no assessment by the Audit Committee to determine if the audit needs of IAC’s clients are adequately met.



2.27 We reported the results of an audit of government's Internal Audit Centre in Chapter Two of the November 2008 Report of the Auditor General. We noted that IAC's annual audit plan for 2007-08 was developed mostly from the risk assessment process facilitated by IAC. Those risk assessments result in deputy minister audit requests. We were informed the audit plan for 2008-09 was developed using a similar process, but we did not verify this because it was not part of our audit. There is no assessment by the Audit Committee of areas IAC should audit that would benefit government initiatives of improved public service. Such an assessment would assist the committee in determining whether the audit needs of IAC's clients are being adequately met. Until this is done, the Audit Committee cannot be sure government's internal audit function is effective.

Recommendation 2.5

The Audit Committee should evaluate the Internal Audit Centre's annual plans and activities to determine if they address the needs of the Centre's clients.

Recommendation 2.6

The Audit Committee should evaluate the Internal Audit Centre's effectiveness on an annual basis.

2.28 Later in this chapter, we report the results of our survey questions and additional audit procedures related to the internal audit function in agencies, boards and commissions in the Nova Scotia provincial public sector. Only four entities indicated they had or were developing an internal audit function.

2.29 We were aware of the lack of internal audit throughout government as a result of our previous audit. At that time, we reviewed the IAC's charter and noted that deputy ministers of the departments with responsibility for governmental units and government business enterprises (i.e., agencies, boards and commissions) "*...may request that Internal Audit conduct governance reviews and compliance auditing related to the contracts, agreements and other mechanisms that formalize the relationship between the Departments and the arms-length organizations.*" Although the IAC's mandate contemplates several areas in which the IAC could assist these entities, it is restrictive and excludes an assessment of their operations. The charter is therefore limited in the services the IAC can provide to these entities and should be revised.

Recommendation 2.7

The Internal Audit Centre's charter should be revised to allow the Centre to provide a full range of internal audit services to its clients.



2.30 The Audit Committee is also to review the internal audit function's compliance with the Institute of Internal Auditors Standards for the Professional Practice of Internal Auditing (IIA standards). During our audit of the IAC reported in November 2008, we tested IAC's compliance with these performance standards in the completion of their individual audits and noted the standards were met. However, the Audit Committee should ensure the IAC is meeting both the performance and attribute standards of the IIA. This would be facilitated by an external assessment of the IAC's activities. We were informed this assessment is planned for September 2009.

Recommendation 2.8

The Audit Committee should ensure there is an external assessment of the Internal Audit Centre's compliance with Institute of Internal Auditors standards.

2.31 One measure of effectiveness is the implementation of internal audit report recommendations. We were informed the Committee has decided to follow up on internal audit recommendations with relevant deputy ministers. The Audit Committee should be provided with regular progress reports on the implementation status of these recommendations.

2.32 The Audit Committee charter notes the Committee is to review the results of individual audits. We noted the Committee receives quarterly status reports for IAC audits. We saw evidence of discussion of audit results in the Committee minutes.

2.33 *Roles and responsibilities: Risk Management, Control Environment and Governance* – The charter indicates the Committee should monitor risk management, internal controls and governance systems. The Audit Committee authorized an Enterprise Risk Management (ERM) pilot project at Service Nova Scotia and Municipal Relations (SNSMR). The Chair indicated that ERM has been deployed in SNSMR; benefits have been realized, and there is now a road map to deploy ERM to all departments, and throughout government. Toolkits have also been developed. The Chair noted this deployment has not happened yet as a chief risk officer will be hired to oversee the process. Regardless of whether this individual is hired, the Committee should monitor how risk management is implemented throughout government, as required by its charter.

2.34 The Audit Committee Chair acknowledged the Committee does not monitor internal controls and governance systems. However, the Chair noted the Committee recently (January 2009) approved a project on internal controls over financial reporting. This is a significant step in the identification and documentation of key controls to ensure:



- transactions are properly authorized;
 - the safeguarding of assets; and
 - financial records are complete and accurate.
- 2.35 We are encouraged by the action taken in this regard, and note it will facilitate the oversight role of the Committee with respect to internal controls.
- 2.36 *Performance monitoring and evaluation* – We assessed whether the Committee reports at least annually to an oversight body, confirms annually that all responsibilities outlined in its charter have been performed, and that the Committee’s and individual members’ performance are evaluated on a regular basis. We were advised none of these requirements was met. The Committee can only be assured it is fulfilling its responsibilities under the charter through performance monitoring and evaluation.

Recommendation 2.9
The Audit Committee should evaluate its performance on a regular basis.

Audit Committees in Agencies, Boards and Commissions

Conclusions and Summary of Observations

While the volunteer members of agency and board audit committees generally exercise care in fulfilling the responsibilities assigned to the committees, the scope of these responsibilities falls short of accepted best practices. Treasury and Policy Board (TPB) provides guidance to agencies in the public sector. We recommended TPB develop best practices for use by audit committees. We also recommended to the Departments of Education and Health that legislation applicable to regional school boards, the Conseil acadien and district health authorities be updated to reflect best practices for audit committees in the public sector.

- 2.37 *Survey results* – We sent surveys to audit committee and board chairs of 35 entities throughout the Nova Scotia provincial public sector. We selected the entities based on size and complexity. The following table lists the entities surveyed.

Organizations Included in Survey

District Health Authorities	Other Agencies, Boards and Commissions
Annapolis Valley District Health Authority	Nova Scotia Business Inc.
Cape Breton District Health Authority	Nova Scotia Community College
Capital District Health Authority	Nova Scotia Farm Loan Board
Colchester East Hants Health Authority	Nova Scotia Fisheries and Aquaculture Loan Board
Cumberland Health Authority	Nova Scotia Innovation Corporation
Guysborough Antigonish-Strait Health Authority	Nova Scotia Municipal Finance Corporation
IWK Health Centre	Resource Recovery Fund Board Incorporated
Pictou County Health Authority	Sydney Tar Ponds Agency
South Shore District Health Authority	Waterfront Development Corporation Limited
South West Nova District Health Authority	Halifax-Dartmouth Bridge Commission
	Highway 104 Western Alignment Corporation
School Boards	Nova Scotia Gaming Corporation
Annapolis Valley Regional School Board	Nova Scotia Liquor Corporation
Cape Breton Victoria Regional School Board	Nova Scotia Public Service Long Term Disability Plan
Chignecto-Central Regional School Board	Nova Scotia Teachers' Pension Fund
Conseil scolaire acadien provincial	Public Service Superannuation Fund
Halifax Regional School Board	Workers' Compensation Board of Nova Scotia
South Shore Regional School Board	
Strait Regional School Board	
Tri-County Regional School Board	

GOVERNMENT-WIDE: AUDIT COMMITTEES

2.38 We received 31 responses from audit committee chairs and 31 from board chairs, a response rate of 88.6%. We allowed three weeks for the surveys to be completed and made a second request to several entities once the deadline had passed.

School Boards

2.39 We sent a survey request to the audit committee and board chairs at the seven regional school boards and the Conseil acadien. The committee at each of these entities varied in title from Finance and Audit Committee to Audit Committee. We refer to the committees as audit committees below, and refer to the group collectively as school boards.

2.40 In addition, we examined the audit committee activities of one school board in more detail. The results of our work are discussed in the following paragraphs.

2.41 *Legislative requirements* – Section 85A of the Education Act requires each school board to establish an audit committee with the composition and terms of reference as prescribed in regulations to the Act. Those regulations specify that, in fulfilling its purpose, an audit committee must:



GOVERNMENT-WIDE:
AUDIT COMMITTEES

“(a) review the annual report and any other report, findings or recommendations of the auditor, or any other person conducting a review of the financial management and internal controls, of the regional school board or Conseil acadien;

(b) review the management response to the annual report and any other report, findings or recommendations referred to in clause (a);

(c) monitor corrective and other actions taken by the regional school board or Conseil acadien in response to the annual report and any other report, findings or recommendations referred to in clause (a);

(d) review such other matters as directed by the regional school board or Conseil acadien or as the committee considers desirable; and

(e) report to the regional school board or Conseil acadien, at such times as the audit committee considers appropriate and at least once each fiscal year, including the findings and recommendations of the audit committee.”

2.42 *Composition and structure* – Our survey results indicate school boards have structured their audit committees in accordance with the regulations. All have at least three members and these members are independent. This is consistent with the requirement under legislation that all committee members must be school board members, and school board members are elected individuals.

2.43 Our survey included questions on the composition and structure of audit committees based on best practices in public sector audit committees. With respect to the financial expertise of committee members, two committees do not have any members with financial expertise, which we defined in the survey document as having *“requisite professional designation or any other comparable financial oversight experience or background which results in the individual’s financial sophistication.”* In order for an audit committee to fulfill its roles and responsibilities in an increasingly complex environment of controls and risks we believe each committee should have at least one member with financial expertise.

2.44 The need for such a member is recognized in the regulations to the Education Act which note that an audit committee may include one member who is not a member of the school board to supplement the financial expertise of the other committee members. This provision was not utilized in the one school board in which we performed additional procedures. We suggest



-
- each school board consider the benefit of this expertise when determining the membership of its audit committee.
- 2.45 Only one of the school board committees surveyed indicated it had a formal orientation process for new members. Orientation is an excellent tool to provide new members with information on the roles and responsibilities of an audit committee, information on a board's accounting policies, internal control processes, and the significant financial risks facing the organization. As significant risks, processes and financial reporting issues are entity-specific, orientation is critical even for those with previous audit committee experience.
- 2.46 Continuing education for committee members is equally important. The role of the audit committee has evolved over time, and the areas for which the audit committee provides oversight continue to evolve. Members should receive ongoing training on issues affecting their organization, including risk management and changes to accounting and auditing standards. Only three committees indicated they had continuing education programs. At the school board where we completed additional work, the chair noted several areas in which additional training had been provided, but these topics related mainly to the finance role of this board's finance and audit committee. We suggest all committees consider the need for formal orientation and continuing education programs.
- 2.47 *Functioning and operations* – The structure of audit committee meetings was consistent among the seven boards responding to our survey. All committee meetings were conducted through an agenda, and minutes were recorded for each meeting. Members were provided with the agenda and related information approximately one week in advance of the meeting. A quorum is achieved at each meeting held and the chairs considered the duration of the meetings sufficient to address the agenda items.
- 2.48 Regulations require each school boards' audit committee meet at least twice a year. Best practices include holding meetings at least four times a year. We feel the number of meetings held does not need to be specified, as long as each committee ensures its full responsibilities have been discharged through the meetings it holds during the year. The self-assessment process discussed in paragraph 2.57 should determine if these responsibilities have been fulfilled.
- 2.49 *Roles and responsibilities* – The role of the audit committee is specified in regulations to the Education Act and is to assist the school board in monitoring and maintaining internal controls over operations. The committee is to review the work of auditors or others who examine or conduct reviews of financial management and internal controls, review management response to reports on internal controls, and report these findings at least once a



GOVERNMENT-WIDE:
AUDIT COMMITTEES

year to the board. Our survey respondents indicated they were generally in compliance with these regulations.

- 2.50 This narrow responsibility, for internal controls only, does not fully reflect best practices for public sector audit committees. Audit committee roles and responsibilities include oversight in several areas: the entity's process to address ethical code of conduct violations; the financial risk management process; and the entity's control framework as it relates to financial risks.
- 2.51 Education Act regulations should reflect best practices and thereby promote a more active role in the financial reporting oversight of school boards. For example, monitoring and maintaining a board's control framework should not be limited to a review of the annual external audit results. It should encompass relevant aspects of the control framework from monitoring the ethical tone at the top through to review of financial information provided to the government and other stakeholders.
- 2.52 We recognize these best practices represent a standard for audit committees that may be difficult to achieve, given the diverse and often non-financial background of school board members. However, school board audit committees have the option of obtaining outside financial expertise, per the regulations to the Education Act. We encourage these committees to make use of this expertise as they move toward best practices.

Recommendation 2.10

The Department of Education should expand regulations to the Education Act to reflect best practices in the roles and responsibilities of school board audit committees. Roles and responsibilities should allow appropriate oversight of school board financial operations.

- 2.53 Despite the limited responsibility of the audit committee as noted in the regulations, the audit committee chairs indicated their committees had broader responsibilities. These included an active role in the selection and oversight of the work of the external auditor. Survey results indicated six committees recommend the appointment of the external auditor while the other committee indicated the Board issued a tender on a three-year basis. All committees responding to the survey informed us they oversee the external auditor's independence, review the terms of engagement, and the external audit scope and plan.
- 2.54 We asked whether the audit committee oversees the school board's financial risk management process, and five of the seven respondents indicated they did. A financial risk management process would include management's identification and assessment of financial risks followed by management's response to manage those risks. Our audit objective did not include an

assessment of each entity's risk management process and therefore we could not determine whether there is a process at each of these boards to fully consider financial risks. However, the audit committee chair of one school board informed us that oversight of the process was limited to discussion of budget pressures. We suggest all school boards consider whether they have sufficient risk management processes in place which adequately address financial risk identification, assessment and mitigation.

2.55 Most survey respondents indicated they also provide oversight of the school board's system of internal control. At the school board committee we examined in greater detail, we found this role was limited to review of the external auditor's annual management letter, and related discussion of findings and recommendations on internal controls. This committee has a process to hold management accountable for the recommendations in the management letter which includes discussion at committee meetings, as evidenced in the minutes, until the matter is resolved. We suggest the board and audit committee of each school board critically review their oversight role of internal controls including the regular assessment and evaluation of those internal controls to ensure approved transactions are recorded accurately, completely and on a timely basis.

GOVERNMENT-WIDE:
AUDIT COMMITTEES

2.56 Several questions in our survey related to the roles and responsibilities of the audit committee for an internal audit function, but the answers to these questions were "not applicable" in all cases. We were aware school boards did not have internal audit functions through the work we performed during our previous audit of internal audit throughout government. A recommendation from that audit was that an entity with audit oversight responsibility assess the extent of internal audit activity throughout government and develop a plan to address deficiencies. However, with respect to school boards, we feel the Department of Education should require each school board to analyze its operations and determine its need for internal audit. This does not mean that each school board requires a stand-alone internal audit function. There are a range of internal audit options, from stand-alone to shared services, or using the services of the Province's Internal Audit Centre.

Recommendation 2.11

The Department of Education should require all regional school boards prepare an assessment of their internal audit needs.

2.57 *Performance monitoring and evaluation* – The Education Act regulations provide no guidance on the performance and evaluation of audit committees. There is no requirement to self-assess performance against a mandate or terms of reference, but this could be related to the limited term of each committee. For example, the members of the audit committee we examined



were appointed each year by the board. Any feedback provided through a self-assessment process is beneficial, even if committee membership changes significantly in a subsequent year. Self-assessment by outgoing members provides new members with better information to improve the committee's oversight.

- 2.58 We asked questions about the relationship between the committee, key people in the governance structure and management. All audit committee chairs indicated senior executives and the external auditor attend audit committee meetings, but not all board chairs attend audit committee meetings. This is not a significant issue provided the audit committee reports fully to the board.
- 2.59 Finally, we asked whether the audit committee met privately with each of management, the board and the external auditors. The responses were varied; only two audit committee chairs indicated the committee met privately with each of these groups. One chair noted private meetings are not held but "*frank and open*" discussion with the audit committee takes place. Best practices suggest private meetings with the audit committee benefit each of these groups. For example a private meeting with the external auditors allows the auditors to discuss management performance as it relates to the financial reporting process. We suggest the audit committee of each school board consider holding private meetings with key groups in the governance structure.

District Health Authorities

- 2.60 We sent a survey request to the chairs of each of the audit committee and the board at all nine district health authorities and the IWK Health Centre. We refer to this group as DHAs in our analysis of their responses. As with school boards, the committee at each DHA varied in title from Finance and Audit Committee, to Resource Committee, to Audit Committee. Again, we refer to these collectively as audit committees.
- 2.61 *Legislative requirements* – Section 31 of the Health Authorities Act notes that the board of directors of a DHA shall annually appoint an audit committee. The responsibilities of the audit committee are described as:
- *“detailed review of the financial statements of the district health authority with the auditor;*
 - *evaluation of internal control systems and any management letter with the auditor;*
 - *review of the conduct and adequacy of the audit;*

-
- *such other matters as may be prescribed by the board of directors;*
 - *such matters arising out of the audit as may appear to the committee to require investigation; and*
 - *such additional matters as may be prescribed as duties of an audit committee.”*

2.62 The legislative requirements for district health authorities’ audit committees include limited responsibilities relating to the external auditor, as well as other matters as may be prescribed or appear to the committee to require investigation. Best practices for an audit committee include responsibilities such as the oversight of financial risk management and controls over financial reporting.

GOVERNMENT-WIDE:
AUDIT COMMITTEES

2.63 We met with Department of Health management to discuss best practices in the roles and responsibilities of audit committees. We provided management with a copy of our survey document to facilitate the establishment of best practices, so that DHA audit committees can provide similar and adequate oversight.

Recommendation 2.12

The Department of Health should develop a policy requiring district health authority audit committees to adopt best practices.

2.64 *Composition and structure* – The Health Authorities Act does not provide guidance with respect to the composition of audit committees. We surveyed all ten DHAs to determine compliance with best practices related to audit committee composition and structure. One committee did not have a member with financial expertise. We feel all audit committees should have at least one member with the expertise to challenge management, the external auditor, and others, on findings and processes related to financial results.

2.65 We performed additional work at two DHAs. In one instance, the audit committee includes a voting member who is a member of management. This composition does not comply with best practices and should be corrected. Audit committee members should be independent from management to ensure there is sufficient and appropriate challenge of management decisions.

2.66 Three DHAs noted they had formal processes for the selection, training and continuing education of their audit committee members. Three of the remaining seven DHAs did not have formal processes while others had



varied practices. We suggest the boards of these seven DHAs examine their processes to select, orient and educate audit committee members to ensure those individuals will contribute to the effective operation of the committee. In our two selected DHAs, it was evident from the review of minutes, and the interviews we conducted with the audit committee chairs, that the orientation of new members was a considerable process.

- 2.67 *Functioning and operations* – There were positive responses from all DHAs to the majority of questions related to functioning and operations of their audit committees. In general, the committees met regularly, agendas were prepared and information provided in advance of the meetings, and the meetings were of sufficient duration to ensure agenda items were fully discussed. These results were supported by additional work we performed at two DHAs in which we found detailed minutes for well-attended, regular meetings.
- 2.68 *Roles and responsibilities* – All audit committees indicated they recommend the appointment of the external auditor to the board, review terms of the engagement, scope, audit plan and related audit fees. Eight committees oversee the independence of the external auditor. All committees review the external auditor’s recommendations to management and indicate they have a process to hold management accountable for the implementation of those recommendations.
- 2.69 We were aware none of the district health authorities had an internal audit function as a result of our November 2008 Report on internal audit. One committee indicated the role of internal audit had been approved by the board and was to be implemented in the next year. Another noted the need for an internal audit function was being explored. The Audit Committee Chair of one DHA in which we conducted additional work informed us the need for an internal audit function had been considered by its board. This chair noted that the cost and effectiveness of an internal audit function had recently been discussed and determined to be unwarranted, given other controls in place at the DHA.
- 2.70 There appears to be a need for an internal audit function in district health authorities, given the significant funds over which they must exercise stewardship, and the important programs they deliver. As noted in paragraph 2.56, the structure of the internal audit function may vary.

Recommendation 2.13

The Department of Health should require all district health authorities prepare and submit to the Department an assessment of their need for an internal audit function.



-
- 2.71 Most of the audit committees indicated they have a means of keeping current with legislation or regulations that impact their entities. In one of two DHAs where we performed additional work, committee members indicated a recurring process to assess changes in legislation.
- 2.72 All but one committee noted they consider whether there is an appropriate tone at the top with respect to integrity and accuracy in financial reporting. For any entity, this entails an insistence that financial results are accurate and transparent, not massaged to achieve a desired result. In the two DHAs we examined in detail, we noted the audit committees scrutinized interim financial results regularly and questioned management on results to date.
- 2.73 All but one DHA surveyed indicated their audit committee provides oversight to their financial risk management process. In comments related to this question, one DHA noted this oversight was provided through their external auditors; another authority noted financial risks had been identified as part of their enterprise risk management exercise.
- 2.74 Both committees we examined in greater detail had mandates that extended beyond those of a stand-alone audit committee; responsibilities typically related to finance committees. The chair of one committee noted its activities are aimed toward risk management, including responsibility for review of, and recommending to the board, both the operating and capital budgets, recommendations to the board regarding signing authority, and cash management policies. The other audit committee had just completed an enterprise risk management process which identified eight priority risk areas, but did not specifically identify financial risk.
- 2.75 We recognize efforts to operate within the annual budget of each authority pose a significant financial challenge to DHAs. However, monitoring budget to actual variances on a monthly basis does not fully embrace the process of financial risk management. This process would include a strategy to manage these risks should they occur. We encourage DHA audit committees to determine whether their respective DHA has a financial risk management process and how they might facilitate such a process, if necessary.
- 2.76 We received varied responses on our survey questions addressing oversight of each authority's system of internal control. Six of the ten committees indicated they provide this oversight. Nine committees have regular discussions with management and their external auditors regarding the auditors' assessment of the design and function of the control framework. All committees indicated they request and receive reports from management on how well the control framework is working.

GOVERNMENT-WIDE:
AUDIT COMMITTEES



-
- 2.77 Our audit work revealed that the external auditors and results of the external audit are relied on to a great extent to fulfill oversight responsibilities related to internal control. External audit focuses on evaluating controls necessary for audit purposes and consequently would not capture a DHA's entire control framework. Each audit committee should consider how management regularly assesses the entire control framework and how to best oversee that process.
- 2.78 *Performance monitoring and evaluation* – We found mixed results in how DHA audit committees monitor and evaluate their performance. Most do not perform an annual self-assessment. Coincidentally, the two DHAs which do perform self-assessments are the two which we randomly selected for testing. We found the results of these assessments were discussed at length at audit committee meetings with members interested in improving their committee's functions and operations. We suggest all DHAs revise their terms of reference to require an annual self-assessment.
- 2.79 At each DHA, the board chair and senior members of the DHA executive attend committee meetings. In three DHAs, the external auditor does not attend committee meetings. Although the survey results for another question indicated the external auditor reported directly to the audit committee, face-to-face meetings with the external auditor allow specifics of audit plans, conduct and results to be discussed on a timely basis. Most DHAs indicated they hold private sessions with their external auditors.

Agencies, Boards and Commissions

- 2.80 Seventeen organizations other than school boards and district health authorities were surveyed. We requested a survey be completed by the chair of the audit committee and the chair of the board of directors. As with school boards and district health authorities, the committee at each organization varied in title from Finance and Audit Committee, to Finance and Risk Management Committee, to Audit Committee. We refer to them collectively as audit committees.
- 2.81 We selected four audit committees in which to perform additional audit procedures, and note the results of those procedures in the following paragraphs. We provided details of our audit findings to each of these committees and asked each to provide feedback on our audit results. One entity indicated they would be unable to provide this input until after our Report was printed. We still noted our findings but recognize additional information may have changed our results.
- 2.82 *Composition and structure* – The survey responses indicated all committees had at least one member with financial expertise. We asked if new committee members were provided with a formal orientation program and participated



in continuing education programs to enhance members' understanding of relevant auditing, accounting, regulatory and industry issues. Five committees indicated there was no formal orientation program, and six indicated the committee does not participate in a continuing education program. Two committees for which no continuing education program was in place indicated they received updates and information from the external auditor. We also asked how audit committees keep current on corporate governance and audit committee responsibilities. The answers varied from having access to continuing education programs and being in the process of compiling personal development plans, to updates provided by external auditors, management and members' own activities.

- 2.83 The survey results of one entity indicated the responsibility of an audit committee had been delegated to two employees of the organization. This results in employees being delegated the oversight of their own work. A board of directors provides ultimate oversight of an organization and, as appropriate, delegates certain oversight responsibilities to committees of the board. The oversight function of an audit committee should be independent from management to ensure there is sufficient and appropriate challenge to how management operates the organization.
- 2.84 For the four committees we selected for further examination, we generally found members possessed the financial sophistication appropriate for the committee. For those that offered orientation and continuing education, the programs were often aimed at the board of director level, rather than being relevant to audit committee members.
- 2.85 *Functioning and operations* – Survey responses indicated agendas were generally established prior to each meeting, and agendas and related information were circulated in advance of meetings. Members had as few as two days or as many as two weeks to review the information. One committee indicated it met fewer than four times per year. We also asked if the committees established an annual work plan of items to be considered in fulfilling its mandate. Eight committees indicated that an annual calendar was established.
- 2.86 None of the committees on which we completed more detailed audit procedures established an annual calendar. Three of four committees established an agenda and prepared background information for the meetings. Those meetings were well-attended and well-documented for the most part throughout the period of audit. We noted one committee did not record minutes until January 2008 which was about halfway through our audit period of April 2007 to September 2008. Once the committee began to record formal minutes, we found they were well-documented with sufficient information to understand the nature of the discussions.



GOVERNMENT-WIDE:
AUDIT COMMITTEES

-
- 2.87 We asked whether entities' audit committees were governed by a formal charter or mandate. Ten responses indicated there was a formal charter.
- 2.88 For those committees we selected for further examination, we noted the following.
- One committee's mandate consisted of two sentences and therefore was not comprehensive enough.
 - The governance manual for one entity included audit committee responsibilities.
 - One board of directors has developed terms of reference for its soon to be created audit committee.
 - One entity's board has recently approved a governance manual which identifies key responsibilities for all committees, including the audit committee.
- 2.89 We strongly suggest boards approve formal audit committee charters, outlining composition, structure, roles and responsibilities in accordance with best practices to reflect appropriate oversight for the organization.
- 2.90 We reviewed the mandates or governance documents of the four committees we examined. One committee did not perform the responsibilities outlined in its governance documents. In two other entities with governance documents, there was compliance with the noted audit committee responsibilities. The mandate of the remaining committee was not formally approved until June 2008. We did not assess compliance for this brief period of our audit.
- 2.91 *Roles and responsibilities* – We asked several questions regarding oversight of the external auditor. Committees indicated they recommend the appointment of the external auditor, unless the financial statement audit is performed by the Office of the Auditor General. The majority of those surveyed indicated they oversee the external auditor's independence, review the terms of the engagement of the external audit, and review the external audit scope and plan. All committees indicated they review the management recommendation letter provided by the external auditor at the conclusion of the audit and, with the exception of one committee, indicated there was a process for holding management accountable to act on the recommendations.
- 2.92 We assessed oversight of the external audit process in the four entities we examined in detail. Such oversight includes recommending the appointment of the external auditor, and reviewing the appropriateness of fees and the audit plan. We could not determine whether all aspects of external audit

oversight had been met for three entities. Oversight was not fully addressed in the final entity. Our detailed results for three entities follow.

- In one entity there were no committee minutes from April to December 2007. Board minutes during that period indicate contact with the auditors, as reported to the board by the audit committee chair. Committee minutes from January 2008 do not indicate meetings were held with the auditors although again there is mention of discussion with auditors in the board minutes.
- We saw discussion of the points raised in the external auditor's management letter in one entity but not in another entity where a management letter had been provided.
- No management letter resulted from the annual audits of one entity, and in the other entity, we were told this follow up was a responsibility of the full board.

2.93 We also looked for evidence of oversight of the financial reporting process in these four entities. Survey responses indicated the respective committees did provide oversight and we saw evidence of oversight in the review and discussion of the annual financial statements.

2.94 We also asked several questions regarding the oversight of the internal audit function, if any. It was indicated four organizations had an internal audit function, although two contracted out the internal audit services. One committee which indicated the organization had no internal audit function advised their external auditor prepares internal audits by request of the audit committee. Of those organizations with no internal audit function, four indicated the audit committee had not considered the need for an internal audit function. For the four organizations with internal audit services, survey results indicated:

- the mandate was generally set by the audit committee;
- the scope of work performed was approved by the audit committee; and
- the committee reviewed internal audit reports or summaries and ensured all significant matters in the reports had been appropriately addressed.

2.95 None of the committees we selected for further examination had an internal audit function nor had the need been considered by the board. We suggest all boards, agencies and commissions within the Nova Scotia public sector consider the need for internal audit services.

2.96 We asked whether the audit committee oversees the entity's financial risk management process. Ten committees indicated the committee did



GOVERNMENT-WIDE:
AUDIT COMMITTEES

-
- oversee the entity's financial risk management process; however, one of those indicated reliance was placed on the external auditor.
- 2.97 One committee we examined did provide oversight of the entity's financial risk management process, which the entity had prepared as recently as 2006. Two other committees indicated in the survey that oversight of the financial risk management process was provided, but we did not see evidence of a regular review of the financial risks facing the organization. In the remaining entity, the committee indicated, and we confirmed, that certain risks were identified in their business plan. The committee has noted that a comprehensive risk management process has recently been established and is ongoing.
- 2.98 We recognize that best practices envision an entity having a formal risk management process, for which the audit committee provides oversight. The entities surveyed and those in which we completed additional audit work vary in size and complexity. We encourage each committee to discuss with its board and entity management whether the existing risk management process is adequate.
- 2.99 The survey asked whether committees oversee the organizations' system of internal control over financial reporting. Eleven of the committees indicated they provided oversight of the system.
- 2.100 Further examination in four committees indicated that significant reliance was placed on the results of the annual audit and the resulting report provided by the external auditor. We suggest the committees assess whether reliance on the annual audit is providing adequate oversight of internal controls.
- 2.101 *Performance monitoring and evaluation* – In our survey we asked whether audit committees conduct a self-assessment to evaluate their own performance against the committee's mandate. Three committees indicated a self-assessment process was in place during the period under review, and one advised that questions related to audit committees were added to the year-end Board evaluation beginning in 2009. The remaining committees indicated a self-assessment process was not in place.
- 2.102 Self-assessments for the audit committee oversight function were not in place for those committees we examined in greater detail. In one entity, an audit committee was being developed and the proposed terms of reference for this new committee required an annual self-assessment. In another entity, the newly approved governance manual included a template to facilitate the self-assessment process, although we note this process relates to the full board.



2.103 Although not included as an objective of the audit, we did note deficiencies in the governance documents regarding the oversight function of the audit committee when compared to accepted practices for audit committees in the public sector. We were advised the survey will be a useful tool in drafting the terms of reference for an audit committee. In one instance, we noted a revised draft terms of reference included many of the accepted practices outlined in our survey.

2.104 During our audit, we were informed by management at Treasury and Policy Board (TPB) that TPB has a role in promoting good governance in agencies, boards and commissions. In January 2007, Treasury and Policy Board published *Governing in the Public Sector: A Guide for Province of Nova Scotia Government Agencies* which provides background information on preparing for the role of director of a government agency in the Nova Scotia public sector. TPB management advised it has offered information sessions to chief executive officers and chairs of boards of directors, and has participated in orientation sessions for certain boards.

GOVERNMENT-WIDE:
AUDIT COMMITTEES

2.105 We were advised that developing best practice governance guidelines for implementation in government agencies is contemplated for the future. Such guidelines would require Executive Council approval prior to implementation. Our audit revealed the oversight provided by audit committees varied across those entities surveyed and those selected for audit. Given that audit committees provide a vital component of governance in the public sector of Nova Scotia, there is a need for this guidance to be developed on a timely basis.

Recommendation 2.14

Treasury and Policy Board should develop guidance for audit committees in the government reporting entity based on best practices for audit committees in the public sector.

2.106 Finally, we note earlier in our Report that audit committees are often combined with other committees, mainly finance. We encourage agencies, boards and commissions to consider establishing stand-alone audit committees to recognize their distinct responsibilities. In the absence of a separate audit committee, meetings of joint committees should be structured so that audit responsibilities are clearly addressed.

Response: Treasury and Policy Board

Treasury and Policy Board would like to thank the Auditor General for the opportunity to respond to the report on the Government Audit Committee.

We accept most of the recommendations of the report, and believe some will be addressed by documenting in the minutes activities that are already taking place.

Specifically,

Recommendation 2.1

The Audit Committee should include one or more independent members.

As the scope of the majority of audits is limited to one department, and the Audit Committee is comprised of Deputies from many departments, we believe there is already a degree of independence. However, we will consider this in the future.

Recommendation 2.2

The Audit Committee should review and assess its charter on an annual basis.

We agree, and will amend the charter to better reflect the appropriate role of the Committee.

Recommendation 2.3

The Audit Committee should confirm annually that all responsibilities outlined in its charter have been carried out.

We agree.

Recommendation 2.4

Audit Committee minutes should indicate whether the Committee concurs with the Executive Director Internal Audit's annual performance appraisal.

We agree.

Recommendation 2.5

The Audit Committee should evaluate the Internal Audit Centre's annual plans and activities to determine if they address the needs of the Centre's clients.

The Audit Committee does evaluate annual plans and activities of the IAC. In future, we will document this activity in the minutes.

Recommendation 2.6

The Audit Committee should evaluate the Internal Audit Centre's effectiveness on an annual basis.

The Audit Committee currently discusses the effectiveness of the IAC during the annual business planning process. We will document this activity in the minutes.

Recommendation 2.7

The Internal Audit Centre's charter should be revised to allow the Centre to provide a full range of internal audit services to its clients.

We believe the IAC currently has the authority to provide a full range of internal audit services to its clients. Clients do have to fund services above the level provided by the base funding of IAC. We will review the charter to ensure this is clear.

Recommendation 2.8

The Audit Committee should ensure there is an external assessment of the Internal Audit Centre's compliance with Institute of Internal Auditors standards.

We agree.

Recommendation 2.9

The Audit Committee should evaluate its performance on a regular basis.

We agree.

RESPONSE:
TREASURY AND
POLICY BOARD

RESPONSE:
EDUCATION

Response: Department of Education

The Department of Education is pleased to provide a response to the Auditor General's review of audit committees and the recommendations applicable to all school boards in the Province.

The Department strongly supports the value of audit committees in maintaining an appropriate governance and accountability environment across a key public service. Indeed, that is the rationale under which school boards were legislated to establish audit committees in 2003.

The Department generally supports the recommendations of the Auditor General arising from this report, however, we believe there is a need to consult with all school boards on the review findings. For example, the recommendations suggest that audit committees actively engage in the oversight of internal controls, risk management and related responsibilities - the extent of which may present challenges practically for audit committees to deliver. To that end, the Department will consult with school boards and incorporate their views in any planned implementation of these recommendations.

Response: Department of Health

Recommendation 2.12

The Department of Health should develop a policy requiring district health authority audit committees to adopt best practices.

DoH Response: We agree with the recommendation and intend to implement it.

Recommendation 2.13

The Department of Health should require all district health authorities prepare and submit to the Department an assessment of their need for an internal audit function.

DoH Response: We agree with the recommendation and intend to implement it.

RESPONSE:
HEALTH

RESPONSE:
TREASURY AND
POLICY BOARD

Response: Treasury and Policy Board

The Treasury and Policy Board would like to thank the Auditor General for the opportunity to respond to the report on Audit Committees in Agencies, Boards and Commissions.

The report recommends that Treasury and Policy Board should develop guidance for audit committees in the government reporting entity based on best practices for audit committees in the public sector.

Treasury and Policy Board agrees with this recommendation. As detailed in the report, work on preparing best practice governance guidelines for implementation in government agencies is contemplated for the future. Treasury and Policy Board will consider this report in the preparation of those guidelines.