

# OACG technical bulletin: governance codes and related disclosures

September 2020

This guidance note has been developed to explain the role of audit in relation to the review of information published by public entities as required under applicable governance codes.

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Corporate governance comprises the systems and procedures by which entities are directed, controlled and managed. Entities should act prudently, ethically and with transparency and conduct their activities consistent with their statutory responsibilities. Good governance strengthens accountability for the stewardship of resources by enabling entities pursue value for money on their endeavours, including managing risk appropriately.

High governance standards, whether in government departments or public bodies, are critical to ensuring a positive contribution to the overall economic efficiency, social cohesion and regional development in Ireland.

As part of governance and accountability requirements, entities are required to publish other information alongside their financial statements. The other information may comprise a statement on the effectiveness of control systems, disclosures of matters of particular significance and confirmation of compliance with specific governance requirements.

This bulletin sets out the auditor's responsibility in relation to reviewing this information.

## Reference material

The Code of Practice for the Governance of State Bodies and related guidance issued by the Department of Public Expenditure and Reform

Public Financial Procedures issued by the Department of Public Expenditure and Reform.

ISA 720 (Revised): 'The Auditor's Responsibilities Relating to Other Information'

ISA 265: 'Communicating Deficiencies in Internal Control to Those Charged with Governance and Management'

## Corporate governance requirements

Applicable guidance on corporate governance is mainly derived from the following

- In the case of other public sector bodies, *The Code of Practice for the Governance of State Bodies* (the Code of Practice) and related guidance issued by the Department of Public Expenditure and Reform.<sup>1</sup>
- In the case of government departments and offices *Public Financial Procedures* issued by the Department of Public Expenditure and Reform and *The Report of the Working Group on the Accountability of Secretaries General and Accounting Officers*.

There are a number of mandatory elements to underpin good governance common to government departments and public bodies such as the establishment of risk management processes, audit committees and internal audit functions.

In addition, all entities are required to publish a Statement on Internal Control (SIC) accompanying the annual financial statements which describes the system for maintaining effective controls.<sup>2</sup>

In the case of State bodies (other than departments), they are also required by the Code of Practice to publish information on

- the governance structures and processes, and board members' fees and expenses
- additional categories of expenditure
- their compliance with the code (which is underpinned by a 'comply or explain' principle).

This information is usually published in a Governance Statement and Board Members' Report accompanying the annual financial statements.<sup>3</sup>

## Auditor's objectives and responsibilities

By agreement with the Minister for Public Expenditure and Reform the C&AG is required to

- review the Statement on Internal Control (SIC) published by each entity to confirm that it reflects the entity's compliance with the applicable guidance on corporate governance, and
- consider if the SIC is materially misleading or inconsistent with other information of which he/she is aware from the audit of the financial statements.

<sup>1</sup> Some sectors are governed by separate codes which are based on or derived from the Code of practice.

<sup>2</sup> In the case of government departments, a Statement on Internal Financial Control is published with the appropriation account.

<sup>3</sup> See "A Guide to the implications for the Annual Financial Statements and Annual Report" issued by the Department of Public Expenditure and Reform. In many cases, bodies publish an annual report containing the financial statements and the other information. Where the entity is a company a Directors' Report is required.

Similar requirements apply in relation to the Governance Statement and Board Members' Report.

The auditor's objectives and responsibilities in relation to the implementation by entities of the applicable governance requirements are generally undertaken in the context of the annual financial audit. The entity prepares narrative information required by the applicable corporate governance guidance which accompanies the financial statements. In accordance with ISA 720 (Revised): 'The Auditor's Responsibilities Relating to Other Information', the auditor is required to read this information and conduct a 'consistency review'.

In undertaking the review of the information the auditor considers whether it is consistent with his/her understanding of the entity's compliance with governance rules based solely on the audit of the financial statements. This review is not to provide assurance on the information, but to

- consider the completeness of the disclosures in meeting the requirements of the applicable corporate governance guidance
- identify whether the disclosures are misleading and
- identify any material inconsistencies between the disclosures and the financial statements or knowledge that the auditor has obtained from the audit.

The auditor does not provide any assurance on the adequacy of the governance arrangements put in place by the entity, nor does the auditor form an opinion on the effectiveness of the entity's corporate governance procedures or its risk and control procedures. The appendix to the auditor's report discloses the scope of the audit work in relation to the other information.

As the C&AG has a wider reporting mandate compared to other auditors, he/she may report publicly on matters arising from the review of other information relating to the conduct of public business.

## Requirements for the preparation of Statements on Internal Control (SIC)

The Accounting Officer of a government department and the Chairperson or equivalent of any other public sector body is required to submit the SIC along with the financial statements. Each SIC is required to outline the key procedures put in place by the entity designed to provide effective internal control, including

- steps taken to ensure an appropriate control environment
- processes used to identify business risks and to evaluate their financial implications
- details of major information systems in place
- the procedures for addressing the financial implications of major business risks

- procedures for monitoring the effectiveness of controls including confirmation that a review of the effectiveness of the system of internal control has taken place
- confirmation that the entity has complied with procurement rules with details of any exceptions being disclosed.

Where a deficiency in controls has led to a material loss, contingency or uncertainty being disclosed in the financial statements the matter and any remedial action taken should be reported in the SIC. Where no such weakness has arisen the entity should confirm this.

### *Scope of the auditor's work in relation to Statements on Internal Control*

In carrying out the review of the SIC, the auditor has regard to the relevant auditing standards and the knowledge of the entity obtained from the audit of the financial statements including an understanding of the entity's control environment. The auditor obtains sufficient appropriate evidence from performing relevant procedures which may include the following

- reviewing the SIC in order to determine that it is in the required format
- enquiring of the directors or senior officials to obtain an understanding of the process defined by the board or management for its review of the effectiveness of internal control
- examining relevant documentation, including management or board minutes and any other material prepared by or for the managers or directors relating to disclosures made
- evaluating whether or not the evidence examined provides sound support for the disclosures made
- requesting the Accounting Officer or those charge with governance to provide written confirmation of oral representations made during the course of the review
- considering whether the information contained in the SIC is consistent with auditor's knowledge obtained during the audit of the financial statements.

In the unlikely event that the SIC describes procedures of which the auditor is unaware, the auditor satisfies himself/herself through enquiry or other work sufficient to allow him/her to conclude that the SIC is not materially misleading. The auditor does not necessarily review the operation of such procedures.

Because of the limited nature of the auditor's review and in order to avoid the possibility of misunderstandings arising, it is considered good practice that

- where a letter of understanding is issued to the client, the letter explains the scope of the review by the auditor
- prior to the release of the annual report and financial statements, the auditor communicates and discusses with the entity the factual findings of his/her review.

The SIC covers the year under review and the period up to the date of approval of the financial statements (and annual report if applicable) and therefore the review by the auditor must be consistent with this timeframe.

### *Confirmation of compliance with procurement rules*

Open competition lies at the heart of procurement practices and law. It allows transparency in that government work is openly advertised and enables value to be obtained from the market through a competitive bidding process. There is an expectation that competitive procurement is the norm. The applicable guidance on governance requires that entities establish internal reporting processes with regard to any use of non-competitive procurement. However, there can be circumstances where procurement is undertaken on a non-competitive basis (e.g. not openly advertised) but may still be compliant with procurement rules for example through permitted exemptions. In some cases, it may be necessary to obtain legal advice as to whether to the exemption applies.

The entity is required to confirm it has complied with procurement rules or make appropriate disclosures where it has failed to comply. Non-compliant procurement relates to instances where goods or services were procured without a competitive process and the circumstances did not include the exemptions or exceptions allowed under procurement rules.

The auditor reviews the evidence to support the disclosures made about procurement in the SIC. Where the entity has not complied with procurement rules or it cannot confirm the extent of its compliance, the auditor considers whether the non-compliance is material.

### *Communication of significant deficiencies discovered during audit*

ISA 265: 'Communicating Deficiencies in Internal Control to Those Charged with Governance and Management' requires the auditor to communicate significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. Significant deficiencies include those which in the opinion of the auditor could lead to a material loss or non-compliance with rules. Consequently, the auditor does not wait until the financial statement audit has been completed before reporting such deficiencies. In this way, management or directors are made aware of the deficiencies that the auditor has identified and are able to take account of them when preparing the SIC.

### *Significant internal control issues*

Where the entity is required to disclose relevant information about deficiencies or weaknesses in internal control it should explain the action taken or intended to be taken to correct the deficiencies. Where no action is proposed an explanation is given.

The auditor's responsibility in this regard consists of

- reviewing material prepared by the entity to support the disclosures made in respect of those control deficiencies and assessing whether or not it supports those disclosures

- discussing with the entity the steps that have been taken, or which it considers necessary to address the deficiencies, and
- assessing whether the disclosures made in the SIC of the processes applied to deal with such deficiencies appropriately reflect those processes.

The auditor is not required to assess whether the action proposed by the entity will, in fact, remedy the deficiency described.

### *Failure to conduct a review of the effectiveness of internal controls*

Where the entity has not conducted an annual assessment as required by the Code of Practice, the chairperson should state that fact and provide an explanation in the SIC. The auditor ascertains the reasons for the failure to conduct the review and considers the impact on the control environment.

### *Groups of entities*

The SIC covers the parent entity and any subsidiaries. Accordingly, the description of the system of internal control and the assessment of the system is made from the perspective of the group as a whole. Thus the auditor considers materiality as it applies to the group and not to individual undertakings.

## Review of the Governance Statement and Board Members' Report

Similar to the approach adopted for the review of the SIC, the auditor has regard to the relevant auditing standards when reviewing the Governance Statement and Board Members' Report in particular the knowledge of the entity obtained from the audit of the financial statements. The auditor obtains sufficient appropriate evidence from performing relevant procedures which may include the following

- considering the completeness of the disclosures the Governance Statement and Board Members' Report in meeting the requirements of the applicable corporate governance guidance
- examining relevant documentation, including extracts from financial systems, relevant minutes and any other material prepared by or for the managers or directors relating to disclosures made
- evaluating whether or not the evidence examined provides sound support for the disclosures made
- requesting those charge with governance provide written confirmation of oral representations made during the course of the review
- considering whether the information contained in the Governance Statement and Board Members' Report is consistent with auditor's knowledge obtained during the audit of the financial statements.

The applicable corporate governance rules may require other information to be presented in a 'fair, balanced and understandable' way. If the auditor identifies any aspects of the other information are not presented in a fair, balanced or understandable manner, he/she considers the implications for the audit report. The auditor considers whether the information is presented in a way that would be understandable to a wide range of potential users with varying levels of financial expertise.

## Reporting the results of the auditor's review

Based on his/her work, the auditor reports on any material instance where the SIC does not comply with the applicable guidance or where it is materially misleading or inconsistent with other information which he/she is aware of from the audit of the financial statements. This may arise where

- the description of the key procedures designed to provide effective internal control is either not supported by or does not appropriately reflect the auditor's understanding of the process
- the information disclosed about those deficiencies in internal control that have resulted in material losses, contingencies or other uncertainties being disclosed either in the financial statements, is not consistent with his/her understanding
- the explanation by the entity of the circumstances where it has not assessed the system of internal control is not consistent with the auditors' understanding, or
- the disclosure of the entity's compliance with procurement rules is not supported by evidence or with knowledge obtained during the audit.

If the auditor is aware of a material loss, contingency or uncertainty being disclosed in the financial statements but the entity has not disclosed any related internal control deficiency, the auditor discusses the position with the entity. If the auditor is not able to agree with the entity as to how the matter should be resolved, he/she considers the implications for the audit report.

Likewise, the auditor reports on any material instance where the Governance Statement and Board Members' Report does not comply with the applicable guidance or where it is materially misleading or inconsistent with other information which he/she is aware of from the audit of the financial statements.

However, as the reviews do not give rise to a qualified audit opinion on the financial statements, such comments are included under the section 'Other Matter' in the audit report.

As the C&AG has a wider reporting mandate, he/she considers whether any matters of significance related to the conduct of public business disclosed in the SIC or Governance Statement / Board Members' Report (where applicable) should be referred to in the audit report on the financial statements or in a separate special report. This may include situations where governance requirements have not been adhered to for example where the entity has failed to conduct an assessment of the effectiveness of the system of internal control.