

# EXECUTIVE COUNCIL

## CONFIDENTIAL

**Title of Report:** Those Charged with Governance

**Paper No:** 146/10

**Date:** 24 June 2010

**Report of:** Director of Corporate Resources

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### **1 Purpose**

1.1 This paper proposes that “Those Charged with Governance” with regards FIG and its statutory accounts are officially designated for the purposes of audit reporting. Statutory corporations and funded trusts will be expected to make their own Governance arrangements in agreement with their respective Boards.

### **2 Recommendation**

2.1 Honourable Members are invited to –

a) approve that the Governor in Council is designated as those charged with Governance;

b) approve that Standing Finance Committee is designated as a sub-group of those charged with Governance;

c) approve the audit reporting structure as outlined at 8.5.

### **3 Summary of Financial Implications**

3.1 None.

### **4 Background**

4.1 In the wake of Enron, and other similar corporate governance failures, the International Standard on Auditing (UK and Ireland) 260 was introduced, becoming effective for audits of financial statements for periods commencing on or after 15 December 2004. Compliance with ISAs is a requirement of external auditors, and they have been adopted worldwide.

4.2 ISA 260 deals with “Communication of audit matters with those charged with Governance” and seeks to establish standards and provide guidance to both auditors and audited bodies. The principles of ISA 260 have been introduced throughout the public and private sectors in the UK and are recognised as best practice.

- 4.3 The rationale behind the ISA was to ensure that important information both within the organisation and arising through audit work was made available to key individuals responsible for an entity's governance, rather than being restricted only to management.
- 4.4 The external auditors (Mazars LLP from the 2009/10 financial statements) are required to establish lines of communication with "those charged with governance" to ensure that key documents are provided by the auditors, important information and representations are received from FIG and effective dialogue is clearly defined.
- 4.5 In previous years the Principal Auditor, the individual charged under the Finance and Audit Ordinance with responsibility for arranging the audits of FIG and its associated funds, would report to the Governor and to SFC on an annual basis. The cessation of the post of Principal Auditor, the new Constitution and the creation of the PAC also provide the opportunity to clearly define relevant roles and responsibilities.

## **5 Definition of those charged with Governance**

- 5.1 ISA 260 defines those charged with governance as "the person (s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting and disclosure process. In some cases, those charged with governance are responsible for approving the financial statements (in other cases management has this responsibility.)"
- 5.2 Within FIG it appears that Executive Council has responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity.
- 5.3 SFC oversees the financial reporting for the entity, through the quarterly financial management reports and their consideration of the budget.
- 5.4 Under the Finance and Audit Ordinance 1988 the Director of Corporate Resources has responsibility for approval of the financial statements.

## **6 Additional governance considerations**

- 6.1 Under the new Constitution the external auditors are appointed by the Governor acting in his discretion (Section 80. (1))
- 6.2 Reports produced by these auditors are to be submitted to the Governor who shall cause them to be published and laid before Legislative Assembly and the Public Accounts Committee. (Constitution Section 80. (2))
- 6.3 Under Section 80. (5) of the Constitution the PAC shall examine and report on all public accounts and audit reports that are required to be laid before the Legislative Assembly.
- 6.4 The PAC, under Part II 11. (1) (a) of the PAC Ordinance has the function "to advise the Governor on appropriate arrangements for the auditing of accounts under section 80 (1) of the constitution, the respective priorities of audits under that subsection and the effectiveness of those audits.

6.5 It can therefore be seen that the responsibilities in FIG and the demarcation of duties are not as straightforward as they might be in other organisations. For example in a private company these responsibilities would sit with the Board of Directors, for an entity such as FIDC it would be FIDB etc.

## **7 Responsibilities of those charged with governance**

7.1 The principal purposes of communications with those charged with governance are to:

- (a) Reach a mutual understanding of the scope of the audit and the respective responsibilities of the audit and those charged with governance;
- (b) Share information to assist both the auditor and those charged with governance fulfil their respective responsibilities; and
- (c) Provide to those charged with governance constructive observations arising from the audit process.

7.2 Those charged with governance are required to communicate with the auditors at the planning stage to discuss the nature and scope of audit work, how the auditor proposes to address the risks of material misstatement, what reliance if any will be placed on other bodies such as internal audit.

7.3 Following completion of the audit the auditors should communicate the following findings from the audit to those charged with governance:

- (a) The auditor's views about the qualitative aspects of the entity's accounting practices and financial reporting;
- (b) The final draft of the representation letter, that the auditor is requesting management and those charged with governance to sign. The communication should specifically refer to any matters where management is reluctant to make the representations requested by the auditor;
- (c) Uncorrected misstatements;
- (d) Expected modifications to the auditors' report;
- (e) Material weaknesses in internal control identified during the audit;
- (f) Matters specifically required by other ISAs (UK and Ireland) to be communicated to those charged with governance; and
- (g) Any other audit matters of governance interest.

7.4 Where issues have been raised requiring those charged with governance to take action the auditors will also require explanation of what action has been taken, and where no action has been taken an explanation as to why.

7.5 Additionally, ISA 580 "Management Representations" state that an auditor should obtain written representations from those charged with governance on matters material to financial statements when other sufficient audit evidence cannot reasonably be expected to exist. Previously this letter has gone to the Director of Corporate Resources, as he is responsible for the preparation and approval of the financial statements.

7.6 Finally, under Auditing and Ethical Standards auditors are required to confirm their independence to those charged with governance.

## 8 Rationale behind designation of those charged with governance in FIG

- 8.1 As noted in 5.2 Executive Council most closely meets the description of those charged with governance, however given the voluminous but routine nature of the correspondence between the auditors and those charged with governance it is not felt that this is an effective use of Executive Council's time.
- 8.2 By establishing the Governor in Council as those charged with governance, but setting up Standing Finance Committee as a sub-group, this means that communication can take place at a more appropriate level, yet retains the facility to escalate serious or more noteworthy matters to an appropriate level.
- 8.3 It also allows for SFC to request attendance of key officers to provide input into the communication with auditors and also for the auditors to attend meetings and meet directly with Councillors, which would currently not readily fit with the way that Executive Council meetings are held.
- 8.4 With the exception of consideration of the letter of representation, all of the correspondence listed under 7 would be required by the Public Accounts Committee to effectively discharge its duties under the Ordinance, however there is no need for them to contribute to them.
- 8.5 The table below shows an outline of how the reporting is envisaged to operate. The Treasury Management Team will be the main driver from the Officer side, and will discuss, amend and finalise documentation where required.

Document	Why required?	Audience					
		LegAssy	Governor in Council	SFC	PAC	CMT	DCR
Audit Strategy (Including Confirmation of Independence)	ISA 260 & Auditing and Ethical Standards			✓	✓		
Interim Management Letter	ISA 260			✓	✓	✓*	
Final Management Letter†	ISA 260			✓	✓	✓*	
Unresolved governance issues (if required)	ISA 260		✓		✓		
Letter of Representation	ISA 580			✓	✓		✓
Audit Report†	FI Constitution & Finance and Audit Ordinance	✓			✓		

\* Individual Directors as appropriate where findings are relevant to their area of responsibility

† Where documents relate to Pension Funds or Currency Fund, additional discussion may take place with Pension Boards and Commissioners of Currency.

8.6 Should the organisation produce a Governance Statement, or equivalent, in the future, then either Governor in Council or SFC can review and approve as they deem appropriate.

## **9 Financial Implications**

9.1 None.

## **10 Legal Implications**

10.1 None.

## **11 Human Resource Implications**

11.1 None.