
Good practice guide

Audit and Risk Assurance Committee effectiveness tool



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Foreword

Audit and Risk Assurance Committees (ARACs) play a crucial role in supporting the effective governance of central government departments, their agencies and arm's-length bodies.

ARACs are operating in a highly challenging context. Government organisations are managing many short- and long-term risks and are required to be resilient to a number of pressures. This has created an environment where ARACs need to be dynamic and responsive to the changing risk profiles and demands of their organisations. ARACs can see this as an opportunity to work out how they can most proactively work with the Board and accounting officer.

Against this background, our effectiveness tool provides a way for ARACs to assess their effectiveness against more than just the basic requirements: it provides aspects of good practice to give ARACs greater confidence and opportunity to meet the requirements of their role.

Introduction

About this effectiveness tool

Our tool is primarily based on guidance from central government, most notably [HM Treasury's Audit and Risk Assurance Committee Handbook](#).

Other sources of guidance from across government and beyond have allowed us to develop aspects of good practice within the tool – including key guidance from the National Audit Office in specific areas such as cybersecurity, climate change, project management and procurement.

How to use our effectiveness tool

Our tool is a comprehensive way for ARACs in central government to develop their effectiveness, and we would recommend it for use on an annual basis, where possible.

We recognise that government organisations vary significantly in terms of size, spend and risk profile. Our tool should be used in a manner that is proportionate to the size and capacity of your ARAC, and the complexity and risk profile of your organisation.

Our effectiveness tool comprises two types of questions:

Essentials – these questions reflect guidance set out in the body of the [HM Treasury Audit and Risk Assurance Committee Handbook](#). Ideally, all ARACs in central government should aim to assess their effectiveness against these questions on an annual basis.

Good practice – these questions go beyond basic requirements and set a standard for ARACs to demonstrate leading behaviours. ARACs in central government should aim to assess their effectiveness against these questions on an annual basis, if possible. ARACs of smaller organisations with fewer resources may decide that a cyclical approach can be taken to some of these areas.

Feedback can be sought from all members and any other regular attendees. You should attempt to answer each question. You will be asked to select from three ratings:

- 1 Room for improvement.** The ARAC is falling short of requirements and should consider how it can work towards becoming more effective in this area.
- 2 Meeting standards.** The ARAC is performing to the required standard in this area. There may be room for improvement, but the ARAC can be seen to be discharging its responsibilities effectively.
- 3 Excelling.** This is an area where the ARAC is performing beyond the standard expectations and is a real area of strength when it comes to exercising its responsibilities.

Each area of the effectiveness tool allows space for comments. This provides an important opportunity to expand on any considerations relating to that section of the effectiveness tool and to highlight any concerns about the ARAC's performance.

It should take you less than an hour to complete. This does not include any time taken to read additional guidance included within the tool.

Forming an overall view of effectiveness

To gain an overall view of ARAC effectiveness, it is important that the individual views of all members are considered as a whole. You can do this very easily by using our accompanying [outcome analyser](#) to:

- generate an overall view of ARAC effectiveness; and
- drill down and analyse specific areas of strength or improvement on a section, sub-section and individual question level.

It is important to also consider any comments or key insights from individual members as part of the review process. When reflecting on comments as an ARAC, anonymity should be preserved so individuals cannot be easily identified from their comments or insights.

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Continual improvement

After completing the assessment, and bringing together the ARAC's collective views, the ARAC should review the outcomes and collectively agree what actions should be taken, including areas of prioritisation, and timescales for delivery.

It may take some ARACs longer to address 'room for improvement' areas than others, depending on priorities and resources. For other ARACs, 'room for improvement' areas may be an indication that remedial action is required quickly to address a key weakness.

However you use the effectiveness tool – and whatever your responses are – the objective should be to allow yourselves the time to consider your effectiveness honestly, and regularly.

This effectiveness tool has been produced by Alan Banks and Chris Coyne, under the direction of Mfon Akpan. To find out more about our work on corporate governance, and our other work on financial and risk management, contact us at HubFaRM@nao.org.uk.

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Part One

Membership, independence, objectivity and understanding

It is important that the Audit and Risk Assurance Committee (ARAC) is independent and objective. The chair and ARAC members should have a solid understanding of the objectives and priorities of the organisation.

ARACs are under pressure to carry out their responsibilities with limited time and resources: exercising good practice in managing meetings and knowing which areas to channel their focus is increasingly vital.





1.1 Membership, independence and objectivity

- The Audit and Risk Assurance Committee needs to be sufficiently resourced in terms of individuals and experience.
- The chair of the ARAC plays a pivotal role in leading the ARAC to successful outcomes. The wider membership needs to be independent and bring a breadth of skills and experience.
- There is regular attendance and valued input from other attendees, especially the head of internal audit, the head of risk, and external audit.

Essentials (including paragraph references from the HM Treasury *ARAC Handbook*)

1 = Room for improvement 2 = Meeting standards 3 = Excelling		Rating		
		1	2	3
1.1.1	The chair is a non-executive Board member and possesses an appropriate level of relevant experience (3.1).			
1.1.2	In terms of numbers, membership of the ARAC is sufficient to discharge its responsibilities (3.1). ¹			
1.1.3	The ARAC explores the option of bringing in additional independent, non-executive members from sources other than the Board to ensure an appropriate level of skills and experience (3.1).			
1.1.4	The accounting officer and the finance director routinely attend meetings (3.3).			
1.1.5	The head of internal audit, the head of risk, and external audit routinely attend meetings (3.3).			
1.1.6	ARAC members understand their responsibilities regarding identifying, declaring and resolving conflicts of interest (3.6).			

1 The HM Treasury ARAC Handbook stipulates that there should be a minimum of three non-executive members on the ARAC. The chair and at least one other committee member should be non-executive members of the Board. This helps to facilitate a strong working relationship between the Board and the ARAC.

Essentials *continued*

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating
1 2 3

1.1.7 ARAC members have a clear understanding of what is expected of them in their role, and this was set out clearly at the time of appointment **(3.7, 3.8)**.²

1.1.8 The ARAC has access to sufficient funding to cover the costs incurred in fulfilling its role **(5.25)**.³

Good practice

1.1.9 Contribution to meetings

All members and attendees make valuable contributions to meetings.

1.1.10 Monitoring conflicts of interest⁴

If any conflicts of interest are identified, the ARAC chair is effective in ensuring the associated risks are effectively managed and continually monitored.⁵

Additional comments or key takeaways

² A model letter of appointment is provided in [Annex C to the HM Treasury ARAC Handbook](#).

³ The funding should be sufficient to:

- a) meet the remuneration and working expenses of its members;
- b) meet the relevant training needs of its members;
- c) provide specialist (external) advice or opinions when required; and
- d) provide external review of the effectiveness of the Audit and Risk Assurance Committee.

⁴ Comptroller and Auditor General, *Conflicts of interest*, Session 2014-15, HC 907, National Audit Office, January 2015. Available at: www.nao.org.uk/wp-content/uploads/2015/01/Conflicts-of-interest.pdf.

⁵ If it is the chair who has a conflict of interest, the Board should ask another member of the ARAC to lead in determining the appropriate course of action.



1.2 Making the most of your time

- The regularity, timing and duration of meetings is critical to the ARAC being able to exercise its responsibilities effectively throughout the year.
- Strong agenda planning and management by the chair is vital to ensuring the ARAC devotes the right amount of time to issues competing for priority.
- ARAC members can help make the most of their time by working collaboratively with key individuals from the organisation in the months between meetings.

Essentials

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating

1 2 3

1.2.1 The ARAC meets at least four times during the year (5.24).

1.2.2 The number of meetings held during the year is sufficient to allow the ARAC to perform as effectively as possible (5.24).

1.2.3 Meetings are well-aligned with the audit and assurance cycle (5.24).

Good practice

1.2.4 Preparation

The ARAC receives information and papers far enough in advance for members to fully consider before the meeting.⁶

1.2.5 Coverage

All matters falling within the terms of reference of the ARAC are covered adequately over the course of the year or a reasonable time period.

1.2.6 Length of meetings

Meetings of the ARAC are long enough to ensure that all agenda items are covered in sufficient detail.

6 Financial Reporting Council, *Guidance on Audit Committees*, April 2016, paragraph 25. Available at: www.frc.org.uk/getattachment/6b0ace1d-1d70-4678-9c41-0b44a62f0a0d/Guidance-on-Audit-Committees-April-2016.pdf.

Good practice *continued*

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating
1 2 3

1.2.7 Deep dives

Deep dives are undertaken in core and emerging risk areas, and these are sufficiently detailed so the ARAC can understand the risk and challenge management.

1.2.8 Time between ARAC meetings and main Board meetings

There is sufficient time between ARAC meetings and main Board meetings to allow any work arising from the meeting to be undertaken and reported to the Board as appropriate.⁷

1.2.9 Communications between meetings

The ARAC chair – and other members where relevant – keep in touch with other key attendees on a continuing basis between meetings.⁸

1.2.10 Private meetings

The ARAC meets in private – without the presence of management – when necessary and this time is used effectively.

1.2.11 Resources

The ARAC is provided with sufficient administrative and secretarial support to undertake its duties to the required standard.⁹

1.2.12 Appointments

The ARAC is clear on the type of skills and experience should be sought in a new member – and the chair is involved in the appointment process.

⁷ Financial Reporting Council, *Guidance on Audit Committees*, April 2016, paragraph 19.

⁸ This could include the chair of the Board, the accounting officer, the finance director, external audit, head of internal audit and the head of risk. Paragraph 22 of the Financial Reporting Council's (FRC's) guidance on Audit Committees states: "Formal meetings of the audit committee are the heart of its work. However, they will rarely be sufficient."

⁹ See footnote 7, paragraph 24. "The audit committee should have access to the services of the company secretariat on all audit committee matters including:

- i assisting the chair in planning the audit committee's work;
- ii drawing up meeting agendas;
- iii taking minutes;
- iv drafting of material about its activities for the annual report; and
- v collection and distribution of information and provision of any necessary practical support."

Good practice *continued***1 = Room for improvement | 2 = Meeting standards | 3 = Excelling**

Rating

1 2 3

1.2.13 Balance of agenda

Sufficient time is afforded to the different providers of assurance to the ARAC across the various lines of defence, notably risk management, internal audit and external audit.

1.2.14 Forward planning

The ARAC has a forward plan for its meetings so it can consider issues at the right time and in the right level of detail.¹⁰

1.2.15 Culture and behaviour

The ARAC acts in an inclusive and respectful manner, avoids ‘group think’, and provides an appropriate balance between challenge and support.

Additional comments or key takeaways

¹⁰ An example core programme of work for an ARAC meeting four times a year is provided at Annex E to HM Treasury’s ARAC handbook.

Part Two

Skills and experience

Audit and Risk Assurance Committees (ARACs) across government are increasingly faced with significant new and emerging risks. It is important for ARACs to have a strategy so they know where they need to upskill, build expertise and draw on specialist skills from elsewhere. This will allow the ARAC to effectively deal with risks and challenges as they emerge.





2.1 Range of skills

- The ARAC as a whole should have a mix of skills that enables it to provide assurance to the Board and accounting officer.
- Essential skills and experience are required in governance, risk management, the control environment and assessing the integrity of the financial statements.
- Skills and experience should be tailored to the challenges and objectives of the organisation.
- The skills mix should be regularly reviewed to ensure the ARAC is equipped to discharge its responsibilities to the Board and accounting officer.

Essentials		
1 = Room for improvement 2 = Meeting standards 3 = Excelling		Rating
		1 2 3
2.1.1	The ARAC possesses a good range of skills and experience in relation to governance, risk and control (4.1) . ¹¹	
2.1.2	At least one member of the ARAC has recent and relevant financial experience sufficient to allow them to analyse the financial statements and understand good financial management disciplines (4.1) .	
2.1.3	The ARAC proactively identifies which skills it requires to discharge its responsibilities most effectively (4.2) .	
2.1.4	The required skill sets for the ARAC are reviewed at regular intervals (4.2) .	
Good practice		
2.1.5	Diversity The ARAC draws on a sufficiently diverse membership, containing a variety of demographic attributes and characteristics.	

¹¹ Annex G to the HM Treasury ARAC Handbook provides a Competency Framework for ARAC members.

Good practice *continued*

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating

1 2 3

2.1.6 Skills mapping

The ARAC documents and maps the skills of its members so it can identify areas of strength and any skills gaps.

2.1.7 Relevance of financial reporting experience

The financial reporting expertise held by members is relevant and appropriate to the significant financial reporting risks of the organisation – particularly in respect of any complex estimates or judgements.

2.1.8 Non-technical skills

The ARAC benefits from a good mix of non-technical skills – for example, communication, influencing, negotiating, leadership and facilitation skills.

2.1.9 Co-opting members and procuring specialist skills

The ARAC uses the powers of co-opting members and procuring specialist skills where these are required.

Additional comments or key takeaways



2.2 Training and development

- ARAC members should have an induction programme which outlines the requirements of the role, the organisation and – for those new to government – an understanding of public sector governance processes.
- Training and development should be flexible and tailored to individuals' needs.

Essentials			
1 = Room for improvement 2 = Meeting standards 3 = Excelling			Rating 1 2 3
2.2.1	Members who have recently joined the ARAC have been provided with induction training to help them understand their role and the organisation (4.6).		
2.2.2	Members of the ARAC who are unfamiliar with corporate governance and wider practice in government are specifically upskilled in this area (4.6).		
2.2.3	Members keep their skills and knowledge up to date through networking and conferences to allow them to focus on key issues facing the organisation (4.3).		
2.2.4	The ARAC chair ensures that members have an appropriate programme of engagement with the organisation and its activities to help them understand the organisation, its objectives, business needs, priorities and risk profile (4.7).		
Good practice			
2.2.5	Learning culture There is a positive culture of learning and personal development within the ARAC.		
2.2.6	Emerging developments The ARAC’s strategy for training and development takes account of developments in corporate governance and emerging risk areas.		

Good practice <i>continued</i>			
1 = Room for improvement 2 = Meeting standards 3 = Excelling			Rating 1 2 3
2.2.7	Public sector context For ARAC members unfamiliar with the operations of government and the public sector, special focus is given to this as part of their training programme. ¹²		
2.2.8	Cross-government networking The ARAC chair attends cross-governmental (if a government department) or cross-departmental (if an arm's-length body) ARAC chair meetings.		
Additional comments or key takeaways			

12 The National Audit Office has [Departmental Overviews](#) on a number of government departments.



2.3 Other skills

- There are some core skills that all ARACs should have in order to fulfil their role around governance, risk and assurance (outlined in Part Three).
- ARACs should additionally consider whether they have the skills and capability to challenge organisations across a number of emerging risk areas, some of which are outlined in this section.
- Areas requiring skills and expertise develop over time and differ from organisation to organisation. Skills requirements and gaps should be continually monitored.

(a) Cyber and digital

Cyber security is a key area of management activity that ARACs should scrutinise. The ARAC will support the Board and accounting officer in reviewing cyber and digital risks. The ARAC should be confident in its ability to challenge management’s assessment of cyber and digital risk – and know when and how to draw upon expertise if this is required.

Our [good practice guide on cyber and information security](#) makes clear how important it is for ARACs to understand whether the organisation is adopting a clear approach to cyber and information risk. The guide outlines ways that ARACs can challenge management on whether it has adequate resources with the required skills and capabilities to deliver this approach.

Good practice			
1 = Room for improvement 2 = Meeting standards 3 = Excelling			Rating
			1 2 3
2.3.1	The ARAC understands how cyber and digital risks impact on the organisation.		
2.3.2	The ARAC has the level of skills and expertise required to challenge management, and provide assurance to the Board that the organisation is properly managing its cyber and digital risks.		
Additional comments or key takeaways			

(b) Climate change and ESG

The ARAC should critically assess the organisation's progress with environmental, social and governance (ESG) commitments. Disclosures should be in line with standards and the ARAC should be satisfied that the organisation is appropriately managing its ESG risks.^{13,14}

Our good practice guide on climate change risk provides a means for ARACs to challenge the organisation on its identification and management of climate-related risks. ARACs should have the ability to assess the process for managing climate-related risks, and understand how they can impact on organisations.

The United Kingdom has committed to achieving 'net zero' greenhouse gas emissions by 2050. Government organisations have significant challenges ahead to develop their own strategies to achieve 'net zero' and this represents another area where ARACs can challenge management on progress.¹⁵

Good practice		
1 = Room for improvement 2 = Meeting standards 3 = Excelling		Rating
		1 2 3
2.3.3	The ARAC is satisfied the organisation's approach to managing ESG risks, and making appropriate disclosures, is in line with relevant standards such as the Greening Government Commitments and Sustainability Reporting Guidance.	
2.3.4	The ARAC is able to effectively assess the organisation's approach to managing climate-related risks.	
2.3.5	The ARAC assesses the organisation's net zero strategy with sufficient detail, and at regular intervals.	

Additional comments or key takeaways

13 Greening Government Commitments 2021 to 2025, October 2021. Available at: www.gov.uk/government/publications/greening-government-commitments-2021-to-2025/greening-government-commitments-2021-to-2025.

14 Public sector annual reports: sustainability reporting guidance 2021 to 2022, November 2021. Available at: www.gov.uk/government/publications/public-sector-annual-reports-sustainability-reporting-guidance-2021-to-2022.

15 Comptroller and Auditor General, *Achieving net zero*, Session 2019–2021, HC 1035, National Audit Office, December 2020. Available at: www.nao.org.uk/report/achieving-net-zero/.

(c) Projects and programmes

Government organisations regularly manage complex projects and programmes. ARACs play a key role in challenging management throughout the project or programme lifecycle, so it is important that ARACs understand how and when to assess and challenge project and programme risks.

Our [Framework to review programmes](#) provides a means of auditing major programmes, drawn from our experience of auditing major projects and programmes across government. We have also provided our insights for deciding if and when the risks associated with [delivering programmes at speed](#) are worth taking and can be managed.

On a broader scale, our [Transformation guidance for audit committees](#) provides a series of questions for ARACs to ask management when an organisation is going through a significant period of organisational change.

Good practice			
1 = Room for improvement 2 = Meeting standards 3 = Excelling			Rating
			1 2 3
2.3.6	The ARAC is appropriately briefed on significant projects and programmes throughout their lifecycle.		
2.3.7	The ARAC has the skills and expertise to provide effective critical challenge on the financial management, delivery risks and overall progress of projects or programmes.		
Additional comments or key takeaways			

(d) Procurement

The COVID-19 pandemic drew significant attention to procurement in government. In its role providing assurance to the Board and accounting officer over risk management and the control environment, the ARAC should have the necessary skills and expertise to understand the complexities of commercial activities – and challenge organisations to provide value for money for goods and services.

Our [good practice guidance on managing the commercial lifecycle](#) is helpful in outlining the key considerations. [Procurement policy notes](#) outline best practice for public sector procurement.

Good practice		
1 = Room for improvement 2 = Meeting standards 3 = Excelling		Rating
		1 2 3
2.3.8	The ARAC has an appreciation of the risks associated with procurement in the public sector context.	
2.3.9	The ARAC has the skills and expertise to challenge commercial activities and the procurement of goods and services.	
Additional comments or key takeaways		

Part Three

Roles and responsibilities

The overall role of the Audit and Risk Assurance Committee (ARAC) is to support the Board and accounting officer by helping them to formulate their assurance needs and by reviewing the comprehensiveness and reliability of assurances on governance, risk management, the control environment and the integrity of financial statements.

The purpose of assurance is to provide – through a systematic set of actions – confidence to senior leaders and stakeholders that work is controlled and supports safe and successful delivery of policy, strategy and objectives. It is vital that ARACs understand how they receive their assurance, and can identify any significant gaps. This will give ARACs the best possible chance of focusing on high-priority issues and fulfilling their role effectively.





3.1 Assurance

- Assurance is central to the ARAC's role in providing an independent assessment on governance, risk management and control processes.
- Assurance mapping will draw attention to the aspects of risk management, governance and control that are functioning effectively and, just as importantly, the aspects which need to be given more attention.

Essentials		
1 = Room for improvement 2 = Meeting standards 3 = Excelling		Rating
		1 2 3
3.1.1	The ARAC helps the accounting officer and Board to formulate their assurance needs (5.2).	
3.1.2	The ARAC assesses whether the assurance received is of sufficient quality to meet the assurance needs outlined in 3.1.1 (5.2).	
3.1.3	The ARAC understands the key sources of assurance in the organisation, and how and why each of these sources provides assurance to them (5.4).	
3.1.4	The ARAC understands the three lines of defence model, and how this applies in practice to the organisation (5.5). ¹⁶	
3.1.5	The ARAC is proactive in commissioning assurance work from appropriate sources where it identifies any significant governance, risk and control issues which have not been subject to sufficient review (5.6).	
3.1.6	The ARAC ensures the organisation operates appropriate and effective whistleblowing practices, and this is regularly considered by the ARAC. ¹⁷	

¹⁶ Government Finance Function and HM Treasury, The Orange Book, 2020, Annex 2 – The Three Lines of Defence. Available at: www.gov.uk/government/publications/orange-book.

¹⁷ HM Treasury, *Audit and Risk Assurance Handbook*, Annex H – Whistleblowing.

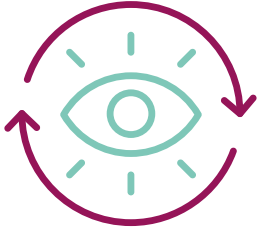
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Good practice			
1 = Room for improvement 2 = Meeting standards 3 = Excelling			Rating
			1 2 3
3.1.7	Assurance mapping	The ARAC uses assurance mapping to identify where assurance is required and identify any key gaps where no assurance is provided, or where the quality of the assurance is poor. ¹⁸	
3.1.8	Recommendations	The ARAC has an effective system for monitoring management’s progress with recommendations from internal and external sources. ¹⁹	

Additional comments or key takeaways

18 An assurance map is a structured means of identifying and mapping the main sources and types of assurance in an organisation. Institute of Chartered Accountants in England and Wales, Assurance mapping: a vital governance and management tool. Available at: <https://www.icaew.com/technical/audit-and-assurance/assurance/assurance-mapping>.

19 These could include regulatory reports, internal audit, external audit, value-for-money reports and recommendations from the Committee of Public Accounts.



3.2 Governance

- Good governance is vital to the success of the organisation. The ARAC requires a solid understanding of how governance arrangements support achievement of the organisation's strategic objectives.
- Monitoring developments in corporate governance is important so the ARAC can proactively advise the Board and accounting officer on any changes to assurance requirements.

Essentials

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating
1 2 3

The ARAC understands how governance arrangements support achievement of the organisation's strategies and objectives. In particular the ARAC understands (5.16):

- | | |
|-------|---|
| 3.2.1 | the Board's operating framework, including the organisation's vision and purpose; |
| 3.2.2 | mechanisms which ensure effective organisational accountability, performance and risk management; |
| 3.2.3 | role definitions, committees and other structures which support the effective discharge of responsibilities, decision-making and reporting; |
| 3.2.4 | how appropriate ethics and values are promoted within the organisation; |
| 3.2.5 | how management information is communicated to the Board and other appropriate areas of the organisation; and |
| 3.2.6 | the nature of relationships with arm's-length bodies, if applicable. |

Good practice

3.2.7 Corporate governance policy

Without duplicating the work of the Board, the ARAC advises on – and scrutinises the implementation of – its organisation’s corporate governance policy.²⁰

3.2.8 Governance statement

The ARAC reconciles assurance from internal audit, external audit and other sources of assurance with conclusions drawn in the organisation's annual governance statement.

3.2.9 Future assurance requirements

The ARAC monitors developments in corporate governance so it can proactively advise the Board and accounting officer on any changes to assurance requirements.

Additional comments or key takeaways

20 HM Treasury and Cabinet Office, *Corporate governance in central government departments: code of good practice*, April 2017, paragraph 5.15. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/609903/PU2077_code_of_practice_2017.pdf.



3.3 Risk management

- The ARAC has a key role to play in providing assurance regarding the organisation's risk management processes.
- ARACs need to understand the risk management framework of the organisation and the assignment of responsibilities.
- ARACs must critically challenge the effectiveness of the organisation's risk management frameworks, policies and processes.
- The ARAC has a responsibility in monitoring the organisation's risk culture, in addition to reviewing how well risk appetite is understood across the organisation.

Essentials		
1 = Room for improvement 2 = Meeting standards 3 = Excelling		Rating
		1 2 3
3.3.1	The ARAC understands the organisation's business strategy, operating environment and the associated risks to executing the strategy (5.17).	
3.3.2	The ARAC is satisfied that management takes an enterprise-wide view of the organisation's risks, including those that cross organisational boundaries (5.17).	
3.3.3	There is a clear understanding of the role and activities of the Board in relation to managing risk (5.17).	
3.3.4	The ARAC discusses with the Board how its policies, attitude to, and appetite for risk are defined and communicated across the organisation (5.17). ²¹	
3.3.5	The ARAC understands and challenges the risk management framework and the assignment of responsibilities (5.17).	

21 Government Finance Function and HM Treasury, Risk Appetite Guidance Note, August 2021. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1012891/20210805_-_Risk_Appetite_Guidance_Note_v2.0.pdf.

Essentials *continued*

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating
1 2 3

3.3.6 Adequate assurance has been obtained on the risk and control environment encompassing services outsourced to external providers, including shared service arrangements, and the wider supply chain **(5.9)**.

3.3.7 (For government departments and groups only) assurance has been obtained on risks from across the group – and there is timely communication and visibility of these risks **(5.8)**.

Good practice

3.3.8 Risk culture

The ARAC promotes the importance of a positive risk culture in the organisation.²²

3.3.9 Risk tolerance

The ARAC challenges management on whether there is a comprehensive process for identifying and evaluating risk, and for deciding what levels of risk are tolerable.

3.3.10 Risk registers

The ARAC has sufficient understanding of the organisation to assess whether the risk register is an appropriate reflection of the risks facing the organisation.

3.3.11 Resources

The ARAC can assess whether there are sufficient resources to manage risk effectively across the organisation.

3.3.12 Emerging risks

The ARAC challenges whether management's approach to identifying risks is broad enough to effectively identify new and emerging risks.

²² An effective risk culture is one that enables and rewards individuals and groups for taking the right risks in an informed manner. Institute for Risk Management, *Risk Culture*, October 2012. Available at: www.theirm.org/media/4703/risk_culture_a5_web15_oct_2012.pdf.

Good practice *continued*

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating

1 2 3

3.3.13 Risk evaluation

The ARAC challenges management on its approach to evaluating risks, including the effectiveness of scenario planning and stress testing.

3.3.14 Review of ‘near misses’

The ARAC reviews information on ‘near misses’ to help determine whether the systems in place are sufficiently robust to mitigate future risk events.²³

3.3.15 Fraud and error

The ARAC understands the main fraud and error risks and entry points, and challenges management to consider timely options for tackling fraud and error risks.

3.3.16 Resilience

The ARAC considers the cumulative impact of risks and how these could impact on the ongoing resilience of the organisation.

Additional comments or key takeaways

23 A 'near miss' is an unplanned risk event that did not result in harm, but had the potential to do so.



3.4 Internal control

- The ARAC has a key role in providing assurance on systems of internal control, and assuring the Board and accounting officer that controls are effective in mitigating the risks identified by management.
- ARACs should have a clear understanding of management's control environment and how it is designed to mitigate risk across the organisation.

Essentials

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating

1 2 3

- | | |
|--------------|---|
| 3.4.1 | The ARAC critically challenges and reviews the adequacy and effectiveness of control processes in responding to risks (5.17) . |
| 3.4.2 | The ARAC challenges whether the extent of the controls in place to mitigate risks is excessive, and whether any action is needed to address this (5.7) . |

Good practice

- | | |
|-------|--|
| 3.4.3 | <p>Understanding of internal control</p> <p>The ARAC has a good understanding of how the organisation develops, operates and monitors the system of internal control.</p> |
| 3.4.4 | <p>Controls over material or significant risks</p> <p>The ARAC seeks assurance on how any material or significant risks are managed through strategic, operational and compliance controls.</p> |
| 3.4.5 | <p>Timely indicators</p> <p>The ARAC assesses whether the system of internal control would provide timely indicators of weaknesses and failings.</p> |
| 3.4.6 | <p>Root cause analysis of significant failings or weaknesses in internal control</p> <p>When any significant failings or weaknesses in internal control arise, the ARAC reviews management's analysis of the root cause and subsequent action plan.</p> |

Good practice *continued*

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating

1 2 3

3.4.7 Financial control

The ARAC is satisfied that the organisation has a sound system of financial control – including the structure of delegations – which enables the organisation to achieve its objectives with good value for money.

3.4.8 IT controls

The ARAC has sufficient assurance over the quality of IT controls.

3.4.9 Design of fraud controls

The ARAC is satisfied that the organisation's controls are designed to effectively prevent and detect known fraud and error risks.

3.4.10 Evaluation of fraud controls

The ARAC has oversight of how controls are evaluated so it can understand how effectively fraud and error risks are being addressed.

Additional comments or key takeaways



3.5 Financial reporting

- Challenging the quality of the annual report and accounts requires a thorough understanding of the processes in place to produce the financial statements.
- The ARAC should seek sufficient assurances on the quality of the disclosures within the organisation's annual reports and accounts.
- The ARAC's understanding of the organisation, alongside its experience and knowledge of the external environment, will add significant value to its role.

Essentials			
1 = Room for improvement 2 = Meeting standards 3 = Excelling			Rating 1 2 3
3.5.1	The ARAC reviews the clarity and completeness of disclosures in the year-end financial statements (5.18).		
3.5.2	The ARAC uses its understanding of the organisation to assess whether disclosures in the financial statements are set properly in context (5.18).		
In reaching a view on the annual accounts, the ARAC specifically considers (5.19):			
3.5.3	key accounting policies and disclosures;		
3.5.4	assurances about the financial systems which provide the figures for the accounts;		
3.5.5	the quality of the control arrangements for preparing the accounts;		
3.5.6	key judgements made in preparing the accounts, and management’s consideration of their ongoing relevance;		
3.5.7	any disputes arising between those preparing the accounts and the auditors; and		
3.5.8	reports, advice and findings from external audit – especially the Audit Completion Report.		

Good practice

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating

1 2 3

3.5.9 Compliance with standards

The ARAC assures itself that accounting policies comply with relevant requirements, particularly [HM Treasury's Financial Reporting Manual](#).

3.5.10 Review of accounts preparation process

In addition to receiving a detailed overview from the finance director, the ARAC is confident that the organisation's approach to preparing the accounts is sufficiently rigorous.

3.5.11 Annual Report

The ARAC challenges that the Annual Report is fair and balanced.

3.5.12 Complex judgements and use of experts

Where novel accounting issues or complex judgements have arisen during the year, the ARAC has satisfied itself that management took specialist advice or enlisted expertise.

3.5.13 Fraud

The ARAC is satisfied with management's processes for identifying and responding to the risks of fraud.

3.5.14 Continual monitoring of significant issues

The ARAC is effective in monitoring significant financial reporting issues throughout the year, particularly those which could lead to qualification of the accounts.

3.5.15 Reports from third parties

In reaching a view on the accounts, the ARAC considers the implications of reports from third parties – for example, on legal matters, valuations or reports from regulators.

Good practice *continued*

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating

1 2 3

3.5.16 Key matters

The ARAC considers key matters on its own initiative rather than relying solely on the work of the external auditor.²⁴

3.5.17 Understanding of the organisation

The ARAC has a detailed understanding of the organisation and its context and can successfully challenge whether the accounts provide a fair representation of activity.

3.5.18 Going concern

The ARAC sufficiently challenges the going concern assessment in the context of its review of the financial statements and understanding of the business.

3.5.19 Use of financial models

The ARAC offers appropriate challenge to any information which is generated through financial modelling.²⁵

3.5.20 Financial reporting developments

The ARAC is familiar with developments in financial reporting standards and can challenge their application in financial statements.

3.5.21 Group reporting

(For government groups only) the ARAC has sufficient oversight of significant financial reporting risks from across the department or group.

Additional comments or key takeaways

24 Financial Reporting Council, *Guidance on Audit Committees*, April 2016, paragraph 31. Available at: www.frc.org.uk/getattachment/6b0ace1d-1d70-4678-9c41-0b44a62f0a0d/Guidance-on-Audit-Committees-April-2016.pdf.

25 Comptroller and Auditor General, *Financial modelling in government*, Session 2021-22, HC 1015, National Audit Office, January 2022. Available at: www.nao.org.uk/report/financial-modelling-in-government/.

Part Four

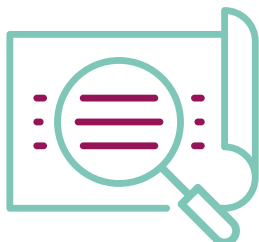
Scope

It is important that the Audit and Risk Assurance Committee (ARAC) fully understands the scope of its work, and that this is set out clearly in its terms of reference.

The ARAC, the Board and the accounting officer must be clear on their respective responsibilities – particularly when it comes to assurance requirements. Being clear on expectations and accountabilities will ensure that the ARAC focuses its time and resources on its core requirements.

The ARAC should understand how it interacts with the organisation's various lines of defence – and how it should engage with other providers of assurance, such as internal and external audit.





4.1 Terms of reference

- The terms of reference of the ARAC should be agreed by the Board, made publicly available and reviewed regularly.
- The terms of reference should clearly establish the independence and core responsibilities of the ARAC.

Essentials			
1 = Room for improvement 2 = Meeting standards 3 = Excelling			Rating 1 2 3
4.1.1	The ARAC's terms of reference are agreed by the Board (5.20).		
4.1.2	The terms of reference are reviewed regularly and at appropriate intervals (5.20).		
4.1.3	The terms of reference do not conflict with guidance in HM Treasury's Audit and Risk Assurance Committee Handbook (5.21).		
4.1.4	The terms of reference make clear the ARAC's independence as a committee (5.21).		
4.1.5	The ARAC's terms of reference are made publicly available, including on the organisation's website (5.20).		
4.1.6	The terms of reference allow for the ARAC to sit privately without any non-members present for all or part of a meeting if they wish (3.3).		
At a minimum, the following areas are covered by the ARAC's terms of reference (5.20): ²⁶			
4.1.7	Details of the ARAC membership.		
4.1.8	Reporting requirements to the Board.		
4.1.9	The key areas of responsibility the ARAC will advise the Board and accounting officer on.		

26 An example terms of reference is in Annex D of the [Audit and Risk Assurance Committee Handbook \(publishing.service.gov.uk\)](https://www.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/61222/audit-and-risk-assurance-committee-handbook.pdf).

Essentials *continued*

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating
1 2 3

- 4.1.10** Rights of the ARAC over co-opting additional members or procuring specialist advice.
- 4.1.11** The head of internal audit and a representative from external audit will have free and confidential access to the chair of the ARAC.
- 4.1.12** Meeting information, including the number per year, the number of members required for the meeting to be quorate, and expected invitees.
- 4.1.13** Information requirements, including what information will be provided for each meeting, and what will be provided on request.

Good practice

- 4.1.14 Benchmarking**
The ARAC has compared its terms of reference against those of similar profile organisations.
- 4.1.15 Expectations**
In addition to core requirements, the terms of reference contain information which allows the ARAC to function more effectively – for instance, expectations about how far in advance of meetings papers will be provided.
- 4.1.16 Proportionality**
The terms of reference properly reflect the role and scope of the ARAC, and are proportionate to the way the ARAC actually operates.

Additional comments or key takeaways



4.2 Internal audit

- The work of internal audit is carried out primarily for the benefit of the accounting officer and Board of the organisation and is likely to be the single most significant resource used by the ARAC in discharging its responsibilities.
- There is a major synergy between the purpose of the head of internal audit and the role of the ARAC.
- The ARAC should advise the accounting officer and Board on the work of internal audit as a key strand of its assurance.

Essentials			
1 = Room for improvement 2 = Meeting standards 3 = Excelling			Rating
			1 2 3
4.2.1	The ARAC performs a risk-based review of internal audit’s strategy and plan (5.14).		
4.2.2	The ARAC assesses the adequacy of the budget and resources available to internal audit (5.14).		
4.2.3	The ARAC reviews the internal audit charter or terms of reference (5.14).		
4.2.4	The ARAC assesses the results of internal audit’s work, and management’s responses to the issues raised (5.14).		
4.2.5	The ARAC reviews the annual internal audit opinion and associated annual report (5.14).		
4.2.6	The ARAC assesses the performance of internal audit against applicable standards, expected performance measures and the results of any internal or external quality assurance assessments (5.14).		

Good practice

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating

1 2 3

4.2.7 Other assurance activity

The ARAC frames the work of internal audit in the context of other assurance activity that takes place in the first and second lines of defence.

4.2.8 Recommendations

The ARAC is proactive in tracking that the recommendations agreed by management are actually implemented.

4.2.9 Support

The ARAC plays a role in providing support for, and acceptance of, the work of internal audit.

4.2.10 Coverage

The ARAC challenges whether the effectiveness of the risk, compliance and finance functions is evaluated as a part of its internal audit strategy.

4.2.11 Overall opinion

The ARAC considers how the individual components of the annual internal audit plan provide reasonable assurance on governance, risk and control for the organisation in totality.

Additional comments or key takeaways



4.3 External audit

- External audit is a significant source of independent and objective assurance for ARACs to utilise.
- In central government, the National Audit Office under the Comptroller and Auditor General is responsible for external audit.
- The work of external audit is normally primarily conducted for the benefit of Parliament – but the process and conclusions are a significant source of assurance for the ARAC to draw on.

Essentials

1= Room for improvement | 2= Meeting standards | 3= Excelling

Rating		
1	2	3

- | | |
|--------------|---|
| 4.3.1 | The ARAC considers and makes relevant enquiries about the external auditor's planned audit approach (5.15) . |
| 4.3.2 | The ARAC considers the impact of the results of external audit work (5.15) . |
| 4.3.3 | The ARAC promotes cooperation between the external auditor and internal audit to maximise overall audit efficiency, capture opportunities to derive a greater level of assurance and minimise unnecessary duplication of work (5.15) . |
| 4.3.4 | The ARAC reviews and considers any implications for the organisation of the wider work carried out by the external auditor, for example, value-for-money reports or good practice findings (5.15) . |

Good practice

- 4.3.5 Objectives of external audit**
- The ARAC has a clear understanding of the objectives, scope and remit of external audit work.
-
- 4.3.6 Review of adequacy of scope**
- The ARAC reviews the scope of external audit work and – if not satisfied as to its adequacy – challenges whether additional work should be undertaken by the external auditor.

Good practice *continued*

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating
1 2 3

4.3.13 **Quality of information provided to external audit**

The ARAC takes steps to ensure external audit receives quality, robust and timely audit evidence from the finance function.

4.3.14 **Support for external audit**

The ARAC is supportive of external audit’s challenge of management and does not act as management’s advocate.

4.3.15 **Findings and recommendations**

The ARAC reviews and monitors management’s responsiveness to the external auditor’s findings and recommendations.³²

Additional comments or key takeaways

32 See footnote 27, paragraph 77.

Part Five

Communication and reporting

To be successful, the Audit and Risk Assurance Committee (ARAC) must have clear lines of communication with the Board and other key stakeholders. Establishing an effective mechanism for working with the Board is particularly important. Communication should be tailored to the requirements and preferences of key stakeholders – and should be a way to ensure that the ARAC can perform at its optimum effectiveness.

The ARAC should be clear on reporting expectations and requirements. The reports received by the ARAC to exercise its responsibilities should be at the right level of detail, and presented in a manner which makes it easy for members to review and challenge. Reports from the ARAC to the Board should meet its expectations in terms of content, scope and proportionality.





5.1 Communications and reporting

- The ARAC should ensure that it has effective communication with all key stakeholders, for example, the Board, the group chief internal auditor, head of internal audit, the external auditor, the head of risk management and other relevant assurance providers.

Essentials			
1 = Room for improvement 2 = Meeting standards 3 = Excelling			Rating
			1 2 3
5.1.1	The ARAC produces a report after each meeting for the Board and accounting officer (with a copy to the head of internal audit and the external auditor) covering: <ul style="list-style-type: none"> • the key business taken by the ARAC, and • the ARAC's views and advice on any issues they believe the Board or accounting officer should take action on (6.1). 		
5.1.2	The ARAC has effective communications with those it seeks briefings from (the executive and internal and external audit) and those it provides assurance to (the Board) (6.3) .		
5.1.3	The ARAC provides an Annual Report timed to support the preparation of the Governance Statement (6.4) .		
5.1.4	The ARAC's Annual Report is open and honest in presenting the ARAC's views (6.4) .		
5.1.5	The ARAC's Annual Report summarises the ARAC's work for the past year and how it discharges its responsibilities in accordance with HM Treasury's ARAC Handbook (1.6, 6.5) .		
5.1.6	There are mutual rights of access between each of the chair of the ARAC, the accounting officer, head of risk management (if a separate function), head of internal audit and the external auditor (6.7) .		
5.1.7	There are periodic discussions with key attendees outside of the formal meetings to help ensure that expectations are managed and there is mutual understanding of current risks and issues (6.7) .		

Part Six

Continual improvement

As the challenges and requirements of Audit and Risk Assurance Committees (ARACs) evolve, a high-performing ARAC will strive for continual improvement.

It is important that the ARAC adopts a positive attitude to learning and development, regularly appraises its performance and is open to feedback from others.





6.1 Continual improvement

- Assessing the performance of the chair, individual members and the committee as a whole and as a team is vital to the continuing effectiveness of the ARAC.
- The assessment of performance should include clear actions to drive improvement.

Good practice

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating
1 2 3

6.1.1 Chair's performance

The chair seeks appraisal of his or her performance from the accounting officer or chair of the Board, as appropriate.³⁴

6.1.2 ARAC members' performance

The chair assesses the performance of the individual members of the ARAC, discusses their training and development needs and agrees a training and development plan.³⁵

6.1.3 Periodic reviews

The chair ensures a periodic review of the overall effectiveness of the ARAC.³⁶

6.1.4 Assessment of outcomes

After completing an effectiveness review, there is sufficient time and effort devoted to discussing results, and agreeing an action plan based on the outcomes.

6.1.5 Monitoring of trends

Evaluation of performance is not done in isolation, and year-on-year trends in different areas of performance are measured.

6.1.6 Feedback from key stakeholders

The chair considers ways in which to obtain feedback from the executive and other key stakeholders – for example, internal and external audit – on the performance of the ARAC.

³⁴ HM Treasury, *ARAC Handbook*, Annex A – the role of the Chair: good practice.

³⁵ See footnote 34.

³⁶ See footnote 34.

Good practice *continued*

1 = Room for improvement | 2 = Meeting standards | 3 = Excelling

Rating

1 2 3

6.1.7 Succession planning

The results of the performance evaluation are used to inform and influence succession planning – for instance in highlighting skills gaps or a lack of diversity.³⁷

6.1.8 Method of evaluation

The ARAC carefully considers the extent and method of performance evaluation – for instance, whether aspects could be externally facilitated.³⁸

6.1.9 Objectivity and rigour

The evaluation of performance is objective and rigorous enough for meaningful conclusions to be drawn.³⁹

Additional comments or key takeaways

37 Financial Reporting Council, *Guidance on Board Effectiveness*, July 2018, paragraph 109. Available at: www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-guidance-on-board-effectiveness-final.pdf

38 See footnote 34, paragraph 84.

39 See footnote 34, paragraph 106.

Appendix A

Useful guidance

A number of documents and useful guidance have been used as a basis for establishing good practice in our effectiveness tool.

Overall

HM Treasury, [Audit and Risk Assurance Committee Handbook](#), March 2016.

Financial Reporting Council, [Guidance on Audit Committees](#), April 2016.

Cabinet Office, [Functional Standards](#), November 2020.

Part One – Membership, independence, objectivity and understanding

1.1

National Audit Office, [Conflicts of interest](#), January 2015.

1.2

HM Treasury, [Audit and Risk Assurance Committee Handbook](#), March 2016, Annex A – the role of the chair.

Part Two – Skills and experience

2.2

National Audit Office, [Departmental overviews and short guides](#).

2.3 (a)

National Audit Office, [*Good practice guide for ARACs on cyber and information security*](#), October 2021.

National Audit Office, [*Guidance for audit committees on cloud services*](#), April 2021.

HM Treasury, [*Audit and Risk Assurance Committee Handbook*](#), March 2016, Annex I – Cybersecurity.

Central Digital and Data Office, [*Government Functional Standard: Digital, data and technology*](#), July 2020.

2.3 (b)

National Audit Office, [*Good practice guide for ARACs on climate change risk*](#), August 2021.

HM Treasury, [*Greening Government Commitments*](#).

HM Treasury, [*Sustainability reporting guidance*](#), November 2021

National Audit Office, [*Achieving net zero*](#), December 2020.

Accountancy Europe, [*ESG governance: recommendations for audit committees*](#), April 2022.

2.3 (c)

National Audit Office, [*Transformation guidance for audit committees*](#), May 2018.

National Audit Office, [*Framework to review programmes*](#), April 2021.

National Audit Office, [*Lessons learned: Delivering programmes at speed*](#), September 2021.

2.4 (d)

National Audit Office, [*Good practice guide on managing the commercial lifecycle*](#), July 2021.

Government Commercial Function, [*Government Functional Standard: Commercial*](#), September 2021.

Cabinet Office, [*Procurement policy notes*](#).

Part Three – Roles and responsibilities

3.1

HM Treasury, [Assurance frameworks](#), December 2012.

Institute of Chartered Accountants in England and Wales, [Assurance mapping: a vital governance and management tool](#).

National Audit Office, [Government whistleblowing policies](#), January 2014.

HM Treasury, [Audit and Risk Assurance Committee Handbook](#), March 2016, Annex H – Whistleblowing.

3.2

HM Treasury and Cabinet Office, [Corporate governance code in central government departments: code of good practice](#), April 2017.

Department for Business, Energy & Industrial Strategy, [Restoring trust in audit and corporate governance](#), March 2021.

3.3

Government Finance Function and HM Treasury, [The Orange Book](#), 2020.

Government Finance Function, [Risk Appetite Guidance Note](#), August 2021.

Institute of Risk Management, [Risk culture](#), October 2012.

Financial Reporting Council, [Guidance on Risk Management, Internal Control and Related Financial and Business Reporting](#), September 2014.

National Audit Office, [Good practice guidance: Fraud and Error](#), March 2021.

Cabinet Office, [Government Functional Standard: Counter Fraud](#), August 2021.

3.5

HM Treasury, [Government Financial Reporting Manual](#).

Government Finance Function and HM Treasury, [Government Functional Standard: Finance](#), September 2021.

National Audit Office, [Financial modelling in government](#), January 2022.

Part Four – Scope

4.1

HM Treasury, [Audit and Risk Assurance Committee Handbook](#), March 2016, Annex D – Example terms of reference.

4.2

Chartered Institute of Internal Auditors, [How internal audit works with the audit committee](#).

Government Internal Audit Agency, [Government Functional Standard: Internal Audit](#), July 2021.

4.3

Financial Reporting Council, [Audit Quality Indicators](#), May 2020.

Part Five – Communication and reporting

5.1

National Audit Office, [Good Practice in Annual Reporting](#), January 2022.

Communication Function, [Government Functional Standard: Communication](#), November 2020.

Part Six – Continual improvement

6.1

Financial Reporting Council, [Guidance on board effectiveness](#), July 2018, Chapter 3.

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