**UT System Audit Office White Paper**

**The Importance of Active and Independent Members on the Internal Audit Committee at Health Institutions**

Abstract

In order to enhance the committee’s independence and the quality of the committee’s oversight, institutions should elevate the role of the external members of the audit committee. External members should play an active role in the audit committee and could serve as the audit committee chair. Recruiting additional independent external members with diverse skills encourages open discussion, improves oversight, and increases opportunities for the effective use of audit resources.

Background

After the passage of the Sarbanes-Oxley Act of 2002, The University of Texas System (UT) recognized the value of the new requirements that strengthened governance and highlighted the importance of internal controls. Although not governed by these new requirements, UTS implemented the “spirit” of Sarbanes-Oxley. As part of the implementation, the UT Systemwide Internal Audit Charter was revised to require external members on the audit committee to allow for increased independence and transparency.

Previously, audit committees at the institutions were made up of the President, Vice Presidents, and other members of executive management. Having an audit committee comprised only of managing executives increases the risk that the committee may lose objectivity and that decisions regarding the use of audit resources could be made based on the self-interest of the committee members. Sarbanes-Oxley was passed to address the fraud and corporate scandals caused, in part, by audit committees that lacked an independent member to protect shareholder interests. Adding external members can increase the independence and credibility of the audit committee. A qualified, experienced external member can bring an objective business perspective to the committee that allows for a focused exchange of ideas as well as an independent assessment of management and its actions.

The Audit Committee members are charged with providing oversight for the financial statement preparation process and the internal audit function. The internal auditor is in the unique position of being an employee and also assessing the areas under the audit committee’s oversight. In providing oversight for these functions, it is essential that some audit committee members be independent of the institution.

UT institutions have at least one external member serving on their audit committees; however, the level of involvement of the external members differs among institutions. External members at both the UT MD Anderson Cancer Center and the UT Health Science Center at Houston serve as the committee chair and vice chair. This role requires the external member to become more involved and take responsibility for the effectiveness of the audit committee.

There are a number of benefits of having active, external members on the audit committee:

* **Increased independence and oversight** – External members enhance independence and credibility of the committee because the external members do not have the additional burden of management responsibility and are in a unique position to have candid discussions with management and internal audit and provide advice to both groups. Having an active external member who understands the institution serve as the chair of the audit committee can provide the highest level of independence and help to ensure that the President can receive independent advice and assurance.
* **Efficient use of resources** – External members can provide an objective view regarding how audit resources should be allocated to ensure that those resources are directed to the areas of the highest risk and to ensure that decisions are made without regard to a committee member’s area of responsibility. Unlike other members of the committee who may be focused on their own areas of responsibility, external members can provide a more objective view.
* **Fresh perspective** – External members provide a view from an outside perspective and may be able to identifyemerging issues that could otherwise be overlooked. Also, without the burden of day to day management, external members can focus on high risk areas and mitigating activities.
* **Expertise** – An external member can bring additional expertise in the institution’s key missions - patient c**a**re, research and education, in addition to financial accounting and internal controls that can enhance the level of discussion and analysis of issues. Recruiting experienced external members with key subject matter expertise may allow for increased consultative benefits in identifying and assessing risks.

Selecting the Best External Audit Committee Member:

The ideal external members are community leaders who have a strong financial background, understand the institution’s mission and operations, and have the desire to serve the institution. Most important is to select individuals who will be active members (not passive observers), contributing to the discussion and asking thought provoking, challenging questions at each meeting. These individuals could be on the institution’s development boards or committees, members of alumni chapters, or members of other community boards. It is important to review the composition of the institution’s current audit committee to determine its strengths and weaknesses. The external member candidates should meet specific needs that are identified weaknesses. A profile should be created and agreed upon and the recruitment should be based on the profile.

Training:

Providing training to all committee members is essential to their understanding of their roles and can help to ensure active participation. For external members, training also ensures an objective and independent perspective at each meeting.

Summary

The effective functioning of an audit committee depends on the independence and abilities of the committee’s members. Enhancing the independence of the committee membership enables the audit committee to strengthen its governance and oversight of the institution.