

MPUMALANGA PROVINCIAL GOVERNMENT



Department of Finance

AUDIT COMMITTEE TOOLKIT

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1 Introduction

Good corporate governance requires independent, effective assurance about both the adequacy of financial management and reporting, and the management of other processes required to achieve the organisation's corporate and service objectives. Good practice from the wider public sector indicates that these functions are best delivered by an independent audit committee.

The role of the audit committee is one of proactive oversight of the financial and compliance reporting and disclosure process and the results of that process. Management has the responsibility to ensure the accuracy of the financial statements and compliance with laws, regulations and agreements. It is the audit committee's function to carry out due diligence by evaluating information from Management, the Internal Auditor, and External Auditors to form conclusions. The audit committee discharges its responsibilities for the benefit of funding sources, oversight agencies, and the public at large. Duties of the audit committee may differ based on the type of public sector entity. The focus of this toolkit is on the duties of the audit committee responsible for the public reporting of results.

2 Definitions and abbreviations

Definitions:

"Accounting Authority" means the Board of a public entity

"Accounting officer" means the Head of a department, the CEO of a public entity and the Municipal Manager of a municipality

"Audit Committee" means the Committee appointed in terms of Section 38(1)(a)(ii) of the Public Finance Management Act, No. 1 of 1999 and Section 166(1) of the Municipal Finance Management Act, No. 56 of 2003

"Executive Authority" means the Member of the Executive Council responsible for a specific department or the Executive Mayor of a municipality

"financial year" means the financial year ending 31 March for departments and public entities and ending 30 June for municipalities

"the province" means Mpumalanga Provincial Government

"provincial treasury" means the Programmes in the Department of Finance responsible for treasury functions

Abbreviations:

MFMA	:	Municipal Finance Management Act, No. 56 of 2003
PFMA	:	Public Finance Management Act

3 Purpose of the Toolkit

The toolkit is intended to provide a more detailed set of advice, give examples and suggest good practice to assist both officers and members who are involved in the establishment and operation of an audit committee. The toolkit was prepared taking into account the MFMA, PFMA, Treasury Regulations, King Code III and National Treasury Internal Audit Framework.

4 Scope of Application

- Audit Committee Members
- Accounting Officers
- Chief Audit Executives
- Management

5 Legislative Framework

- Municipal Finance Management Act, No. 56 of 2003
- Public Finance Management Act, No. 1 of 1999

6 Audit Committee Chairperson Toolkit

6.1 Corporate Governance in the public sector

The corporate governance arrangements of an organisation are the means by which strategy is set and monitored, managers are held to account, risks are managed, stewardship responsibilities are discharged and viability is ensured.

Organisations are increasingly recognising that good governance is the structural basis for achieving fundamental policy goals. As well as being a key element in improving efficiency and effectiveness within an organisation, corporate governance is one of the primary means by which a set of relationships is established between an organisation's management, its governing body and its stakeholders. There is a clear benefit to Departments and entities in adopting effective frameworks of corporate governance.

If corporate governance is effective, the authority can flourish and, in this context, external stakeholders can rely on that authority. Good governance enables self-regulation and minimises the need for external regulation.

Opportunities for authorities to demonstrate the effectiveness of their corporate governance arrangements include:

- publishing reports of reviews of corporate governance;
- publishing a statement of internal control that describes an effective system of risk management, control and governance, demonstrating that all key risks have been identified and managed;
- publishing with the financial statements a corporate governance controls assurance statement incorporating the statement on internal control;
- arranging for, and paying due heed to, the work of effective internal and external auditors.

6.2 Benefits of Audit Committee

Effective audit committees can bring many benefits to the public sector and these benefits are described as:

- raising greater awareness of the need for internal control and the implementation of audit recommendations;
- increasing public confidence in the objectivity and fairness of financial and other reporting;
- reinforcing the importance and independence of internal and external audit and any other similar review process (for example, providing a view on the Statement on Internal Control); and
- providing additional assurance through a process of independent and objective review.

Effective internal control and the establishment of an audit committee can never eliminate the risks of serious fraud, misconduct or misrepresentation of the financial position. However, an audit committee:

- can give additional assurance through a process of independent and objective review
- can raise awareness of the need for sound control and the implementation of recommendations by internal and external audit

6.3 Requirements and expectations of having an Audit Committee

There is a legislative requirement for all public sector entities to establish an audit committee. Audit committees are ever more widely recognised across the public and private sectors, and internationally, as a core component of effective governance.

Good corporate governance requires independent, effective assurance about both the adequacy of corporate, operational and financial management and reporting, and the management of other processes required to achieve the organisation's corporate and service objectives. Effective audit committees help raise the profile of internal control, risk management and financial reporting issues within an organisation, as well as providing a forum for the discussion of issues raised by internal and external auditors.

It is believed that these functions are best delivered by an audit committee separate from executive functions. The committee must also have a clear right of access to full authority, and other Authority groups and committees as appropriate. Throughout the wider public sector, experience and best practice indicates that separating audit committees from the executive is the obvious way in which its independence can be guaranteed. The role of scrutiny is to review policy and challenge whether the executive has made the right decisions to deliver policy goals.

This is different from the role of the audit committee which exists to provide independent assurance that there are adequate controls in place to mitigate key risks and to provide assurance that the authority, including the scrutiny function, is operating effectively. That said, an audit committee's judgments might well be informed by the results of scrutiny activity within the authority. Both audit committees and the scrutiny function deal with complex matters, sometimes requiring specialist knowledge and advice.

6.4 Responsibilities of Audit Committees

The primary responsibilities of a Committee usually include oversight of the following:

- Open communication between the Committee, management, internal auditor and external auditor;
- Internal accounting controls to safeguard assets, ensure compliance and avoid fraud;
- Budget and finance matters;

- Quality and timely financial and compliance reporting;
- The annual audit process;
- Reporting to the Executive Authority and /or Accounting Authority.

Detailed information regarding the above oversight responsibilities is attached as *Annexure A*

6.5 Recommended Skills for Audit Committee members

The Committee should be comprised of individuals with a combination of the talents listed below, the most relevant being an appropriate level of financial literacy:

- Professional certification in accounting and auditing;
- Past experience in finance or accounting at a significantly high level of responsibility; or
- Other comparable experience or background which results in an appropriate level of financial sophistication;
- Ability and willingness to ask probing questions about operating and compliance risks and financial matters;
- Independence in attitude;
- Industry experience;
- Willingness to actively participate in the Committee process.

6.6 Eight best practices for Audit Committees

6.6.1 Written Charter

Create and adhere to a written charter that identifies the audit committee functions, authority and responsibilities and the skills and experience its members must possess for the committee to discharge its duties and function effectively.

One of the charter's most important functions is its record of the various powers and authorities the committee must possess, independent of the organization's senior management. The audit committee should be free to obtain the information it needs to assess adherence to rules, regulations and the organization's core values. An audit committee that has adequate authority to ask appropriate questions and get informative answers is in a better position to provide useful commentary and recommend necessary action.

A generic Audit Committee Charter is attached as *Annexure B*.

6.6.2 Critical success factors

Specify critical success factors as competencies audit committee members must possess for the committee to discharge its duties and function effectively.

Audit committee members stay abreast of the latest developments relating to accounting rules, legislation, industry and the organisation.

6.6.3 Committee core values

Identify committee core values that reflect those of the organization and establish written procedures that foster open communication, equitable dispute resolution and active participation by all committee members.

Audit committees need to encourage mutual respect and cooperative interaction with auditors and the organisation's staff and senior management.

The Committee should also identify priorities for the organisation's audit team and oversee the evaluation of the personnel, quality, frequency and scope of the organisation's financial and internal audit functions. The chairperson also must prepare the committee for significant challenges, whether relatively new, like understanding enterprise risk management and its corporate governance implications, or longstanding and growing, such as the struggle to build and retain a high quality staff of financial professionals.

6.6.4 Working relationships

Reserve the right to invite any group or individual to an audit committee meeting.

The chairperson must establish regular communications with the Executive Authority/Accounting Authority and senior managers to obtain their views on what the audit committee should focus on and keep them apprised of audit committee activities. In his/her view, the closest relationship the chairperson should have is with the head of internal audit.

6.6.5 Committee agenda

Ensure all members actively participate in setting the committee agenda, and whenever possible avoid conducting committee business between meetings.

It is essential that the audit committee create a schedule of meetings for the coming year, including an agenda for each meeting.

6.6.6 Processes and procedures

Formulate decision-making processes and procedures for resolving stalemates.

Committee members have to agree to some ground rules, which should relate back to the charter. All audit committees are unique, and so is each organization's culture.

6.6.7 Previous meeting

At the beginning of each meeting, review the previous meeting's highlights.

In addition to highlighting results from previous meetings, the Committee should start by reviewing the organisation's written organizational vision, core values and critical success factors.

6.6.8 Summarising

At the end of each meeting, summarize it. After a meeting is over, each member should have a common understanding of key aspects of the meeting without referring to notes or minutes. For this purpose, summarize key decisions, actions to be taken, who will perform them and when, and the expected results. Require each meeting attendee to specify what aspects of the meeting he or she felt was successful or helpful and what requires improvement. Discuss whether the organization's vision and objectives are being fulfilled. Also committee members should encourage each other to organize and share in writing any thoughts they have following the meeting that would be helpful to the committee

6.7 Audit Committee self-assessment checklist

A structured and formal assessment of an audit committee's performance can help to ensure the committee delivers on its mandate and enhances continuously its contribution to an organisation.

The self-assessment checklist is attached as *Annexure C*.

7 Annexures

- A: Responsibilities of Audit Committees
- B: Generic Charter for Audit Committees
- C: Self-assessment checklist

Approved:

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ACTING HEAD OF DEPARTMENT
DATE: _____