



**PUBLIC SECTOR**  
AUDIT COMMITTEE FORUM

## Challenges facing public sector audit committees

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*This guidance paper is not intended to document all the concerns and issues through one draft. The intention was to start with the most common challenges faced by audit committees in the public sector. There will be follow-on guidance papers that will provide further insight into areas of concern and where possible, recommendations will be made with practical solutions that can be implemented.*

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## 1. The role of the audit committee

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The audit committee is a key contributor to good governance. It plays a crucial role in assisting the relevant governing body<sup>1</sup> in discharging its responsibilities for overseeing financial and performance management, compliance with legal and other regulatory requirements and internal controls.

*In South Africa the following legislation is applicable to public sector audit committees:*

- The Public Finance Management Act (Act No. 1 of 1999) (PFMA) makes it compulsory for all national or provincial public sector organisations to establish an (or share an established) audit committee.
- The Municipal Finance Management Act (Act No. 56 of 2003) (MFMA), applicable to local government, makes it compulsory to establish an (or share an established) audit committee. This act also prescribes the concept of a single audit committee to be shared among a district municipality and the local municipalities within the district and also among a municipality and municipal entities under its sole control.
- The Companies Act (Act No. 71 of 2008) for public entities that are registered as companies.

*In South Africa the following best practice is applicable:*

- The King Report on Governance for South Africa (King III)

*The audit committee is an independent oversight committee reporting to the relevant governing body. An audit committee's responsibilities vary depending on the entity's complexity, size and requirements. Typically the responsibilities of a public sector audit committee include overseeing matters related to:*

- financial management
- performance management
- external audit
- internal audit
- risk management
- internal control
- IT governance
- combined assurance
- appropriateness of the finance function and
- compliance with laws and other regulatory requirements.

*In this regard audit committees make valuable contributions towards improving the governance, performance and accountability of public sector organisations. An effective audit committee has numerous benefits for public sector entities, including:*

- giving guidance on sound corporate governance practices
- monitoring the adequate and effective functioning of the system of internal controls
- monitoring the implementation of recommendations made by internal and external audit and other review activities
- ensuring that fraud and corruption is dealt with effectively
- improving the quality of financial and performance reporting
- facilitating an efficient audit process and
- improving risk management.

<sup>1</sup> "Relevant governing body" refers to the board (in the case of public entities that are registered as companies), the accounting authority (in the case of other public entities), the executive authority (in the case of departments) and the council (in the case of municipalities).

**2. Table 1**  
**Prevailing legislation/regulations/codes that govern public sector audit committees in South Africa**

Matter	PFMA	MFMA	Companies Act	King III
<b>Compliance requirements of the legislation/regulations/codes</b>	Compulsory compliance	Compulsory compliance	Compulsory compliance where the public sector entity is also a company  Compliance with the PFMA/MFMA takes precedence over compliance with the Companies Act in the event of conflict	Recommended compliance
<b>Applicability</b>	Departments  Public entities listed in schedule 2 or 3  Constitutional institutions  Parliament  Provincial legislatures	Municipalities  Municipal entities  National and provincial organs of state to the extent of their financial dealings with municipalities	State-owned company, i.e. an enterprise that is registered in terms of the Companies Act as a company, and is either:  · listed as a public entity in schedule 2 or 3 of the PFMA, or  · owned by a municipality	All entities incorporated in and resident in South Africa on an apply-or-explain basis
<b>Relevant sections</b>	Sections 76 and 77 of the PFMA  Treasury Regulations 3.1 and 27.1 <sup>2</sup>	Section 166	Section 94	Chapter 3
<b>Role in relation to relevant governing body</b>	Advisory sub-committee to accounting officer/authority	Independent advisory committee to the municipal council, the political office-bearers, the accounting officer and the management staff of the municipality, or the accounting authority, the accounting officer and the management staff of the municipal entity	Statutory committee  Sub-committee of the board	Sub-committee of the board (or other relevant governing body)

<sup>2</sup> All references are to the Treasury Regulations in effect at the date of issuing this guidance paper and may change pending new Treasury Regulations in the pipeline.

Matter	PFMA	MFMA	Companies Act	King III
<b>Membership</b>	<p>At least three persons of whom, in the case of a department:</p> <ul style="list-style-type: none"> <li>· one must be from outside the public service</li> <li>· the majority may not be persons in the employ of the department, except with the approval of the relevant treasury and</li> <li>· the chairperson may not be in the employ of the department</li> </ul> <p>May be established for two or more departments or institutions if relevant treasury considers it economical</p> <p>Chairperson must be independent, may not be a political office bearer (in the case of departments and constitutional institutions), nor the chairperson of the accounting authority or a person in an executive function (in the case of public entities)</p> <p>All members to be independent (departments, constitutional institutions and public entities)</p> <p>Majority non-executive members (public entities)</p> <p>The majority of persons serving on an audit committee must be financially literate</p> <p>The chairperson of an audit committee must be independent, be aware of the status of the position, and have the requisite business, financial and leadership skills</p>	<p>At least three persons, of whom the majority may not be in the employ of the municipality or municipal entity</p> <p>Single audit committee may be established for a district municipality and the local municipalities within that district municipality</p> <p>Single audit committee may be established for a municipality and municipal entities under its sole control</p> <p>Appointed members must have appropriate experience</p>	<p>At least three members</p> <p>Specific composition requirements</p> <p>Each member must be a director of the company</p> <p>The members may not be (or be related to) a person who is involved in the day-to-day management of the company's business or has been so involved at any time during the previous financial year</p> <p>The members may not be (or be related to) a person who is a prescribed officer or full-time employee of the company or another related or interrelated company, or has been such an officer or employee at any time during the previous three financial years</p> <p>The members may not be (or be related to) a person who is a material supplier or customer of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship</p> <p>The minister may prescribe minimum qualification requirements for members of an audit committee as necessary to ensure that any such committee, taken as a whole, comprises persons with adequate relevant knowledge and experience to equip the committee to perform its functions</p>	<p>At least three persons</p> <p>All members to be independent non-executives</p> <p>Minimum qualification and experience requirements</p> <p>The audit committee as a whole should have a good understanding of:</p> <ul style="list-style-type: none"> <li>· integrated reporting, including financial reporting, and sustainability issues</li> <li>· internal financial controls</li> <li>· internal and external audit processes</li> <li>· corporate law and risk management</li> <li>· IT governance as it relates to integrated reporting and the governance processes within the company</li> </ul> <p>The audit committee should be chaired by an independent non-executive director</p> <p>The board chairman may not be a member of the committee but may attend by invitation</p>

Matter	PFMA	MFMA	Companies Act	King III
<b>Appointments</b>	<p>Appointed by the accounting officer in consultation with the relevant executive authority (in the case of departments and constitutional institutions) and by the accounting authority (in the case of public entities)</p> <p>Shared audit committee member must be appointed by the relevant treasury in consultation with the relevant executive authority</p> <p>The National Treasury may make regulations or issue instructions applicable to all institutions to which the PFMA applies concerning audit committees, their appointment and their functioning</p>	<p>Appointed by the council of the municipality or, in the case of a municipal entity, by the council of the parent municipality</p> <p>One member, who is not in the employ of the municipality or municipal entity, must be appointed as the chairperson</p> <p>No councillor may be a member of the audit committee</p>	Appointed by the shareholders	Appointed by the board (or relevant governing body)

Matter	PFMA	MFMA	Companies Act	King III
<b>Duties</b>	<p>Must meet at least twice a year (minimum)</p> <p>Review the effectiveness of the internal control systems</p> <p>Review the effectiveness of internal audit</p> <p>Review the risk areas of the entity's operations to be covered in the scope of internal and external audits</p> <p>Review the adequacy, reliability and accuracy of financial information provided to management and other users of such information</p> <p>Review any accounting and auditing concerns identified as a result of internal and external audits</p> <p>Review the entity's compliance with legal and regulatory provisions</p> <p>Review the activities of the internal audit function, including its annual work programme, co-ordination with the external auditors, the reports of significant investigations and the responses of management to specific recommendations</p> <p>Review, where relevant, the independence and objectivity of the external auditors objectivity of the external auditors</p>	<p>Must meet as often as is required to perform its functions, but at least four times a year (minimum)</p> <p>Advise on internal financial control and internal audits</p> <p>Advise on risk management</p> <p>Advise on accounting policies</p> <p>Advise on the adequacy, reliability and accuracy of financial reporting and information</p> <p>Advise on performance management</p> <p>Advise on effective governance</p> <p>Advise on compliance with this act, the annual Division of Revenue Act and any other applicable legislation</p> <p>Advise on performance evaluation</p> <p>Advise on any other issues referred to it by the municipality or municipal entity</p> <p>Review the annual financial statements</p> <p>Respond to council on any issues raised by the Auditor-General in the audit report</p> <p>Carry out any investigations into the financial affairs of the entity</p>	<p>Appoint independent external audit</p> <p>Determine fees of external audit and the terms of the engagement</p> <p>Determine nature of non-audit services of external audit and the preapproval thereof</p> <p>Report to shareholders in the annual report</p> <p>Receive and deal with certain complaints</p> <p>Make submissions to the board (or relevant governing body) on the company's accounting policies, financial control, records and reporting</p> <p>Perform other oversight functions determined by the board</p>	<p>Should meet as frequently as is necessary, but at least twice a year</p> <p>Duties include oversight of integrated reporting, combined assurance, resources of finance function, internal audit, risk management, external audit, reporting to board and shareholders</p>

## 3. Challenges facing public sector audit committees

### 3.1 Legislative and regulatory requirements

#### Challenge

As can be seen from table 1, public sector entities operate within a unique regulatory framework with a number of pieces of legislation and regulations that need to be complied with.

The terms of reference of a public sector audit committee do not always clearly define the requirements of the audit committee in relation to the entity's environment.

#### *Recommendation*

The terms of reference is the document that gives the audit committee direction and focus with respect to its roles and responsibilities to its stakeholders. It should be clearly written and define the expectations of the audit committee.

Specifically, the audit committee's terms of reference should cover:

- all the legislated requirements together with other corporate governance best practice and
- the audit committee's responsibilities with regard to financial management, performance management and compliance.

The terms of reference should be reviewed regularly.

In planning, audit committees should:

- ensure that the number of scheduled meetings is sufficient to adequately fulfil their duties
- make use of a yearly meeting planner, whereby the specific functions/duties are linked to the scheduled meetings for the year, to ensure coverage and
- consider the number of legislative deadlines for submissions to auditors, treasury and executive authorities in the yearly meeting planner.

This will guide the audit committee in determining the number of meetings required.

### 3.2 Role clarity

#### Challenge

Table 1 summarises the role that audit committees play in relation to the relevant governing body. Accountability, role clarity and reporting lines are not always clear in the public sector (with regard to the shareholder, the "directors" and management as applicable in the private sector). King III is clear on who is charged with specific governance responsibilities and its application is encouraged.

The manner in which some public sector entities are structured makes this a specific challenge. For example, in the case of public entities, the accounting authority is seen as the board; however, the minister is involved in the appointment of the audit committee with the board. This appointment process may create some uncertainty as to direct reporting lines; however, there should be reporting to both parties.

#### *Recommendation*

In this respect, audit committees need to be aware of the following:

- Their reporting line is directly to the relevant governing body.
- There are no reporting lines to management. Management need to report to the audit committee regarding financial and performance management and internal controls, allowing the committee to determine the adequacy of the design of the internal controls and their effective operation throughout the reporting period.
- The audit committee's role and level in the organisation is that of an independent oversight body.
- Audit committees should provide feedback to the relevant governing body after each audit committee meeting, which results in the escalation of significant issues.
- Audit committees should meet with the minister (executive authority) at least annually to discuss governance matters.

Training of all audit committee stakeholders, including those who appoint them, management and internal audit, is needed on an ongoing basis to address the lack of clarity about roles in the public sector.

The audit committee should engage the executive authority to report matters not adequately dealt with to the committee's satisfaction. Interactions with the national or provincial treasury and/or oversight structures such as portfolio committees are encouraged.

## Challenge

The roles of the audit committees and other committees, such as the finance committee, risk committee (where separate), municipal public accounts committee and performance committee, should be clarified to minimise overlap and promote the effective use of these structures. The responsibilities of the above-mentioned committees are not specified in the applicable legislation summarised in Table 1.

### **Recommendation**

The terms of reference should be clear on:

- the responsibilities of the audit committee for financial and performance monitoring and compliance matters
- the requirement of possible overlapping membership of other committees to facilitate knowledge sharing, which should be clearly drafted and
- the hierarchy of reporting.

Specific training of committee members is also required to address role clarity and enable committee members to better understand the roles of the respective committees and how they integrate with each other.

## 3.3 Composition

### 3.3.1 Independence

## Challenge

The independence of the audit committee may be impaired due to previous/current relationships of audit committee members or the audit committee as a whole and political standing, among other factors.

### **Recommendation**

Measures should be in place to assess independence of audit committee members prior to appointment. Their independence should also be assessed on an ongoing basis throughout their term of office. Declarations of interest should be completed by audit committee members at every meeting.

### 3.3.2 Knowledge, skills and experience

## Challenge

The requirements of the legislative environment for public sector audit committees mentioned in 3.1 above makes the composition of audit committees an essential consideration. Members need to have sufficient knowledge, skills and experience in a number of fields. In terms of King III, the audit committee should collectively have an understanding of integrated reporting (including financial reporting), internal financial controls, the external and internal audit process, corporate law, risk management, sustainability issues, information technology governance and the governance processes in the organisation. Added to that is the public sector specific knowledge required about matters such as performance management, risk management and compliance with laws and regulations.

The difficulty in attracting a pool of suitable persons to serve on the public sector audit committees is another challenge in the public sector. Other matters that require attention are the remuneration of committee members and political influence in the appointment process.

### **Recommendation**

The individuals who are responsible for appointing audit committee members should consider the required qualifications and business intelligence during the appointment process.

Members should go through an interview process where they can display the skill and expertise necessary to fulfil the role. Members should display an enquiring mind and the ability to question management and service providers in a manner that will, if applicable, uncover all information.

Audit committee members should be inducted prior to the new members' first meeting. The induction process should not only involve taking the new members through the latest annual report, it should also involve presentations by each head of division in the organisation, providing sufficient information on the running of the division and its contribution to the entity's responsibilities including the division's



specific risks. This induction should further provide the audit committee with an understanding of the roles of the relevant governing body, chief executive officer and chief financial officer. This will ensure that the audit committees understand their roles and responsibilities.

There should be ongoing development of audit committee members, as changes in the environment and entity need to be communicated allowing sufficient understanding by members. Skills training for audit committee membership in the public sector should be implemented to meet the demand for appropriately skilled individuals.

The annual evaluation of the audit committee should take all of the above into consideration and should focus specifically on whether the current audit committee has the necessary level of knowledge, skills and experience. The relevant governing body should pay attention to the results of this evaluation so that the necessary corrective action can be taken for development areas identified.

Public sector audit committees should be remunerated sufficiently in order to attract sufficiently skilled and experienced individuals. Standardisation in remuneration practices should be aimed for – with the National Treasury providing guidance in this regard.

Staggered rotation or handing-over transition periods should be enforced to ensure a transfer of knowledge and skills to new members. Handover processes should be included in the terms of reference, particularly for members who are rotating off the audit committee.

### 3.3.3 Commitment

#### Challenge

Adequate dedication and commitment on the part of members and proper preparation for meetings, reading documents prior to meetings, follow-up procedures and attendance of and participation in meetings are not receiving sufficient attention.

#### Recommendation

The Department of Cooperative Governance and the relevant legislatures should take an active interest in the results of any audit committee evaluations. The outcomes of these evaluations should inform corrective actions against ineffective audit committees and/or audit committee members.

### 3.4 Lack of support from management

#### Challenge

The audit committee is sometimes unable to evaluate situations due to the absence of quality information which should be made available by management. The audit committee therefore cannot fulfil all its responsibilities.

#### Recommendation

The audit committee's evaluation and oversight should be designed in a manner that ensures that management fulfils its responsibility.

Audit committee members must align submissions from management to the topics listed in the yearly planning calendar. The quality of documents submitted by management needs to be evaluated to determine the quality of information and the necessary feedback should be provided to management.

There is a requirement that audit committees of departments and constitutional institutions should report on the quality of management and the adequacy of the monthly/quarterly reports submitted in terms of the PFMA, MFMA and the Division of Revenue Act (DoRA).

## 4. Summary and conclusion

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The majority of the challenges faced by audit committees listed above can be overcome by training audit committee members to better understand the legislative framework and well-drafted terms of reference that define audit committees' roles and responsibilities.

The requirements highlighted above in terms of knowledge of the sector and legislation, skills, dedication and commitment should be aligned to the overall composition of skills in the audit committee spanning the various aspects that need to be covered. Individuals appointed in these audit committees should possess the required skills mix from their date of appointment and this can only be achieved by providing the necessary training to the members.

The availability of skills for the audit committees of the outlying municipalities does however remain a major concern.

Members should have an overall understanding of the entity's environment, its risks and how other assurance providers contribute to their responsibilities. Members are encouraged to always be aware of their duties and ensure that they are satisfied with the processes followed in fulfilling these duties.

It is felt that a culture of no consequences for non-performance exists. Even though the audit committee's duties do not extend to enforcing consequences for under-performance by the relevant governing body and/or management, the audit committee is nonetheless part of the governance system and should therefore be held to account for executing its functions competently.

The audit committee must encourage and maintain open, constructive dialogue with the relevant governing body, senior management, internal and external audit and other committees.

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