



PUBLIC SECTOR
AUDIT COMMITTEE FORUM

The Relationship between the Public Sector Audit Committee and Management

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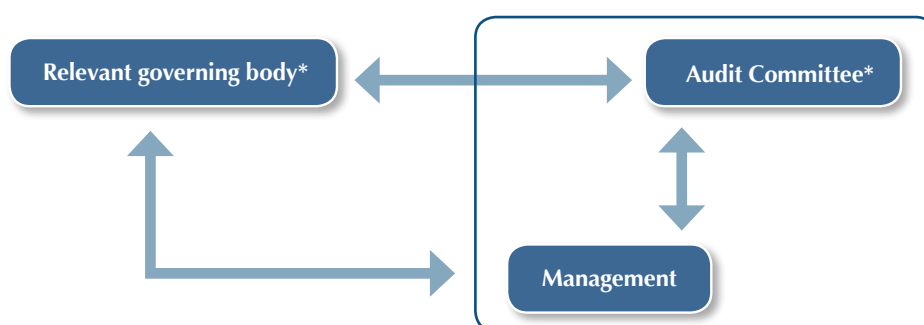
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1. Purpose of the paper

The purpose of this paper is to provide guidance on:

- the respective roles of an Audit Committee and Management in the public sector;
- the elements of a good working relationship between them; and
- practical recommendations on their interaction.



*For Local Government guidance on the relationship between the Municipal Council and the Audit Committee, refer to PSACF paper “The Relationship between Audit Committee and Council (Local Government)”.

2. Executive Summary

Each function within the governance structure of a public sector entity has its individual role to play. However, there needs to be co-operation and collaboration between the functions in pursuit of the common goal i.e. fulfilling the overall objectives of the entity.

An effective working relationship based on mutual respect between relevant governing body members, committee members, the senior management team and employees in general, will better achieve the entity’s objectives. A working relationship that values all contributions will foster a team approach, ensure effective fulfilment of responsibilities and boost morale.

The relationship between the Audit Committee and Management is one such relationship that requires focus and attention.

Balancing their role as advisor and counsellor to management with their duty to monitor and oversee management is, to say the least, challenging for most audit committees. They must communicate openly and often with management, carefully review information received, and challenge management as appropriate. They must not, though, play the management role.

The lines of authority for audit committees and management should be appropriately defined and understood. There should be a clear understanding and consensus regarding where management ends and the audit committee begins. To ensure this clarity, strong communications are essential both during and outside committee meetings. Management should view the audit committee as an asset and seek its input prior to, rather than after making key decisions. Ongoing communication will help build a trusting relationship between the audit committee and management. However, it requires time and commitment of both parties.¹

¹ Extract from The Institute of Internal Auditors, The Audit Committee: Purpose, Process, Professionalism

3. Relevant legislation, role players and terminology

Traditionally, the key role players in governance in the private sector are the board of directors, board committees, the chief executive officer (CEO) of the company, who is also an executive director and other senior management.

In the public sector however, the governance roles and structures are somewhat different. The following table aims to summarise the requirements and clarify the terminology used in this paper.

	Local Government	National and Provincial Government
Relevant legislation	<p>The Local Government: Municipal Structures Act [Structures Act] and the Municipal Finance Management Act [MFMA] establish legislation to regulate the internal systems and structures as well as to secure sound and sustainable financial management of municipalities.</p> <p>In addition, for municipal entities, the Companies Act, 2008 [Companies Act] would also be applicable.</p>	<p>In National and Provincial Government, the Public Finance Management Act, [PFMA] and Treasury Regulations regulate financial management, ensure that all revenue, expenditure, assets and liabilities of those government entities are managed efficiently and effectively and provide for the responsibilities of persons entrusted with financial management in those governments.</p> <p>In addition, for government entities that are state-owned companies, the Companies Act, 2008 [Companies Act] would also be applicable.</p>
Public sector entity	<p>In this paper, the terms “public sector entity” should be read to refer to Municipality or Municipal entity for Local Government.</p>	<p>In this paper, the terms “public sector entity” should be read to refer to any National and Provincial Government entity, which includes:</p> <ul style="list-style-type: none"> • Departments • State-owned companies • Other public entities • Constitutional entities • Provincial legislatures
Audit Committee	<p>Section 166 of the MFMA states that each municipality should have an Audit Committee, which is appointed by Council. It further describes the functions of the Audit Committee.</p>	<p>Section 76 and 77 of the PFMA read together with Treasury regulations 3.1 and 27.1 regulates the appointment and duties of the Audit Committee for National and Provincial Government entities.</p>
Relevant governing body	<p>The legislative and executive authority of a municipality is seated in the Municipal Council. In this paper, the term “relevant governing body” should be read to include the Council of the Municipality or Board of a Municipal entity.</p>	<p>In this paper, the term “relevant governing body” should be read to include the executive authority (in the case of departments and constitutional institutions), the accounting authority (in the case of public entities), and the board (in case of state-owned companies.)</p>
Management	<p>The Municipal Structures Act requires a Municipal Council to appoint a Municipal Manager. The Municipal Manager is responsible for ensuring that the policies of council are implemented. The Municipal Manager is the accounting officer of the municipality and is accountable to the executive mayor or council for implementing specific agreed outputs, and to the council for the overall administration of the municipality. In essence, the Municipal Manager fulfils the role typically referred to as the CEO.</p> <p>The Municipal Manager reports directly to the executive mayor and indirectly through the mayor to Council. This reporting structure can cause confusion, as the Executive Mayor is a political office bearer generally with a political mandate. This can also result in friction between the Municipal Manager and the Executive Mayor.</p> <p>All other municipal employees report directly to the Municipal Manager. Senior managers / heads of departments are appointed by the Municipal Council, after consultation with the Municipal Manager. These senior managers/heads of departments typically include the CFO, Senior Manager: Corporate Services and the Senior Manager: Infrastructure.</p> <p>Hence, in this paper, the term “Management” should be read to include the Municipal Manager (also sometimes referred to as the Accounting Officer, City Manager or Chief Administration Officer), the Head of Department (also referred to Deputy City Manager or Strategic Executive Officer) as well as Executive Managers and Executive Directors.</p>	<p>In state-owned companies, Management would be directly comparable to the terminology used in the private sector, and would include the CEO, CFO, other executive directors and other senior management.</p> <p>For departments and constitutional institutions, the PFMA requires the appointment of an accounting officer, who in essence fulfils the role typically referred to as the CEO in companies.</p> <p>The PFMA clarifies the division of responsibilities between the accounting officer and the executive authority. The executive authority is responsible for policy choices and outcomes, while the accounting officer implements the policy and achieves the outcomes by taking responsibility for delivering the outputs defined in the departmental annual performance plan (APP) and budget. The accounting officer prepares the departmental APP and budget (specified in terms of measurable objectives) for the Minister or MEC to approve and present to the legislature for voting. The accounting officer is then responsible for implementing and managing the APP and budget.</p> <p>Hence, in this paper, the term “Management” should be read to include all executive directors and senior management, including the accounting officer.</p>

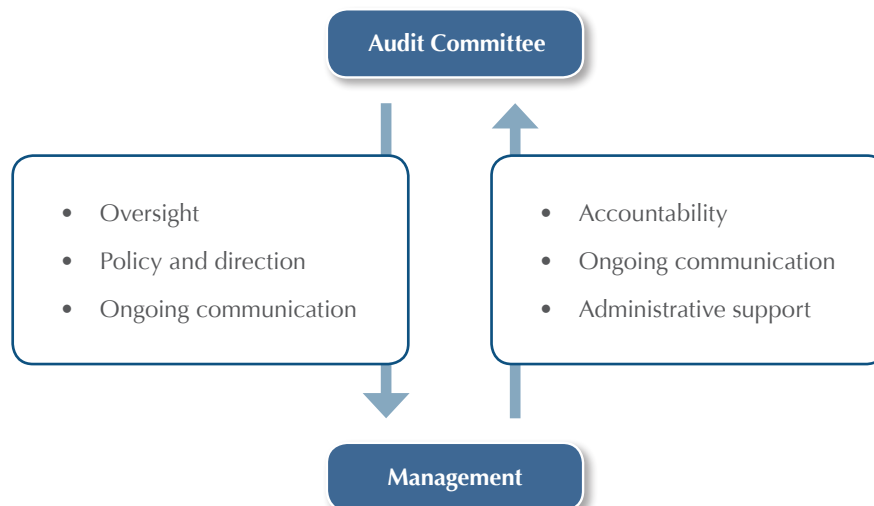
4. The Relationship between the Audit Committee and Management

The role played by the Audit Committee is critical to provide an advisory and oversight mechanism over:

- financial management;
- internal and external audit;
- risk management and internal controls;
- performance management; and
- compliance.

As the responsibility for the execution and facilitation of each of these functions is that of Management, it is therefore critical that the working relationship between the Audit Committee and Management is a healthy and effective one.

For this relationship to be effective, the following essential elements should be strived for.



Due to the nature of the Audit Committee's role, particularly being a key player in accountability to stakeholders on the financial viability and integrity of an entity, independence from Management and freedom from any undue influence are essential qualities. Members of the Audit Committee should not have any executive powers, Management functions or delegated financial responsibility. To address this, measures should be in place to assess independence of Audit Committee members prior to and during appointment.

It is equally important that the relevant members of Management have a good understanding of and appreciation for the Audit Committee's responsibilities and vice versa. Clear lines of accountability, authority and roles should be set, understood and adhered to.

Strong communication and co-operation are also key elements to a good working relationship. This includes both parties maintaining a positive culture/attitude, with mutual trust, openness and transparency.

5. Practical recommendations on how to ensure that the relationship is healthy and effective

The Public Sector Audit Committee Forum recommends the following guidance and practical tips in aiding the relationship between the Public Sector Audit Committee and Management.

#	Goal	Recommendation to the Audit Committee	Recommendation to Management
1	The Audit Committee should operate independently of Management, free of undue influence.	The Audit Committee should remain alert to situations that may impact on its independence, and formally assess its independence in the annual self-evaluation process, with input from the relevant governing body. Declarations of interest should be completed by Audit Committee members at every meeting.	Management should remain alert to situations that may impact on the Audit Committee's independence and raise this with the Audit Committee or, where necessary, with the relevant governing body.
2	A common understanding of the respective roles of the Audit Committee and Management should be strived for, with clear lines of responsibility.	The Audit Committee's terms of reference should clearly state its role and responsibilities. ²	Management should feel free to challenge the Audit Committee where they feel that the Audit Committee is overstepping its boundaries into a managerial/operational space.
3		Induction and ongoing training of Audit Committee members should confirm the roles and responsibilities of Audit Committee members.	Management should request training on the role of the Audit Committee and what its expectations are.
4		The Audit Committee should be alert to opportunities for Management representatives to attend Audit Committee meetings as non-voting invitees.	Where invited to Audit Committee meetings, Management should use the opportunity to understand what the role of the Audit Committee is.
5	Audit Committee members and Management should adopt a co-operative approach/attitude in fulfilling their respective roles and responsibilities to encourage continuous improvement, transparency and open communication in the working relationship.	The Audit Committee should demonstrate a positive approach of continuous improvement, rather than a punitive approach.	Management should also demonstrate a positive attitude towards its interaction with the Audit Committee.
6		The Audit Committee should foster a relationship where Management feels free to adopt an open and constructive attitude in its dealings with the Audit Committee.	Management should be encouraged to air its views to the Audit Committee.
7		Where the Audit Committee receives feedback/areas for improvement from Management, it should take into account this feedback and consider what actions are necessary for improvement.	Where Management feels that the Audit Committee is not performing in accordance with its responsibilities, Management should first bring this to the attention of the Audit Committee and, if necessary, the relevant governing body.
8		Where the Audit Committee feels that Management is not performing in accordance with its responsibilities, feedback should be given to Management and where necessary, to the relevant governing body.	Management should take into account feedback by the Audit Committee on Management's performance and consider what actions are necessary for improvement.
9	It is imperative for Management to provide complete and relevant information to the Audit Committee in order for it to perform its responsibilities.	Feedback should be given by the Audit Committee to Management on the relevance and adequacy of its reporting to the Audit Committee, in order to ensure continued improvement.	Management should strive to deliver fully and promptly on relevant requests from the Audit Committee, and keep the Audit Committee updated on relevant developments within the entity.
10		The Audit Committee should hold Management to account for involving it in all key decisions relating to the Audit Committee's mandate. Pre-meetings between the Audit Committee Chair and Management are encouraged to aid preparation and eliminate surprises at the Audit Committee meeting.	Key decisions relating to the Audit Committee's mandate should be tabled at Audit Committee meetings for discussion prior to decisions being made. Round-robin communication should be considered for urgent decisions that need to be made between meetings.
11	Management's arrangements for administrative/secretarial support to the Audit Committee should contribute towards the Audit Committee being able to fulfil its roles and responsibilities.	Audit Committee members should clearly communicate requests to enhance the secretarial support provided by Management (i.e. sending out of packs, agendas, minutes etc). Where possible, these requirements should be clearly articulated in the Audit Committee's terms of reference.	Management should use Audit Committee requests to inform continuous improvement and strive to meet the expectations of the Audit Committee with regards to administrative support.

² Refer to PSACF paper on Terms of Reference and Annual Planner for National and Provincial Government Audit Committees

#	Goal	Recommendation to the Audit Committee	Recommendation to Management
12	In order for the Audit Committee function to be effective, Management must effectively and timeously implement agreed upon action items.	The Audit Committee should monitor implementation of actions items by Management and provide feedback to Management thereon.	Management should endeavour to implement and execute action items emanating from Audit Committee meetings efficiently and effectively.
13	In order for the Audit Committee to adequately fulfil its functions, it must be able to rely on Management's implementation of an effective internal control environment.	The Audit Committee needs to have a good understanding of the control environment and ensure that Management follows a sound process to draw conclusions on the adequacy and effectiveness of the system of internal control.	Management needs to implement an effective internal control environment and provide feedback to the Audit Committee for its input.
14		The Audit Committee should review internal and external audit reports for aspects relating to the control environment and recommend actions for improvement based on those findings.	Management should implement actions for improvement of the control environment.
15		The Audit Committee should establish whether Management has relevant internal control policies and procedures in place that are adequate, effective and regularly updated.	Management should design and implement adequate and effective internal control policies and procedures.
16	In order for the Audit Committee to effectively fulfil its financial oversight role, it needs to be supported by a competent finance function.	The Audit Committee should assess the competence of the CFO and finance team on an annual basis and provide recommendations to Management and or relevant governing body. ³	The finance team should adopt recommendations by the Audit Committee and strive for continuous improvement. In addition, the CFO should communicate the finance team's needs, in terms of resource requirements, to the Audit Committee.
17		The Audit Committee should interrogate any financial information presented to it by the finance team and ask relevant, probing questions.	Management should be prepared to answer any questions from the Audit Committee regarding financial information. The CFO should attend the Audit Committee meetings.
18	The Audit Committee should oversee risk and have a link to the Risk Committee (if any).	Risk should be a standing agenda item for the Audit Committee. The Audit Committee should ask senior Management to advise on emerging significant risks and changes to the business, specifically those that could have a financial impact. If there is a separate Risk Committee, there should be overlapping membership with the Audit Committee to aid knowledge sharing.	Management should be forthcoming in communicating to the Audit Committee emerging and significant risks and changes to the business, specifically those that could have a financial impact Management. Management should also provide the Audit Committee with relevant risk management information.
19	In order for the Audit Committee to oversee the implementation of internal and external audit recommendations, it needs Management's support.	The Audit Committee should regularly review the actions taken by Management to implement external and internal audit recommendations and provide feedback where progress is unsatisfactory.	Management should respond to recommendations from external and internal audit. Officers responsible for implementing significant audit recommendations should attend Audit Committee meetings to report back on progress.
20	An effective performance Management system, which drives the overall achievement of the entity's goals, should be clearly defined and implemented.	The Audit Committee should review the effectiveness of the entity's performance and performance management system as part of its review of internal control and governance processes. It should advise the relevant governing body on performance management matters.	Management should design, document and implement an effective performance management system to drive a culture of performance and respect for the system.
21		The Audit Committee should ensure that performance targets are SMART (specific, measurable, achievable, relevant, timely) and review the system and performance information generated at least quarterly.	Management should link performance management to performance information and performance targets at an organisational and individual level.
22	An effective compliance function should provide support to the Audit Committee in its compliance oversight role.	The Audit Committee should review the entity's compliance with legal and regulatory provisions in addition to its focus on financial and performance information oversight.	The senior manager responsible for compliance should provide reports to the Audit Committee, action its recommendations and attend Audit Committee meetings where necessary.

3 For guidance on this, refer to the PSACF paper on Public Sector Audit Committee Assessment of Finance Function.

6. Conclusion

The table above contains guidance and practical tips for ensuring a healthy relationship between the Public Sector Audit Committee and Management.

Public Sector Audit Committees and Management should carefully consider how they can incorporate these guidelines into their interactions.

Public Sector Audit Committees should also carefully consider which aspects of their interaction with Management they should cover in their Audit Committee Report as part of the Annual Report.

The relationship between the Audit Committee and Management is a critical one in the overall governance structure of a public sector entity, and as such, should receive the attention and consideration that it deserves.

7. References

Australian National Audit Office, Better Practice Guides, Public Sector Audit Committees

http://www.anao.gov.au/html/Files/BPG%20HTML/BPG_PublicSectorAuditCommittees/4_2.html

Public Sector Working Group, Local Government and King III

http://c.ymcdn.com/sites/iodsa.site-ym.com/resource/collection/879CAE6C-7B90-49F5-A983-28AECBCE196F/PSWG_Position_Paper_2_Local_Government.pdf

MFMA Circular No 65, National Treasury

<http://mfma.treasury.gov.za/Circulars/Documents/MFMA%20Circular%2065%20-%20Internal%20Audit%20and%20Audit%20Committee.pdf>
which includes the following relevant text:

With regards to management, the Audit Committee should:

- perform the role as advisor to management;
- communicate effectively with management;
- carefully review information received and obtain clarification from management as and when appropriate
- raise relevant questions, evaluate responses and follow up on any matter that is unclear;
- act independently and be proactive in advising the accounting officer regarding issues that require further management attention
- encourage openness and transparency
- build relations with management.

Municipal Structures Act (Act 117 of 1998)

http://www.justice.gov.za/alraesa/projects/Local_Government__Municipal_Structures_Act117of1998.pdf

Municipal Finance Management Act (Act 56 of 2003)

[http://mfma.treasury.gov.za/MFMA/Legislation/Local%20Government%20-%20Municipal%20Finance%20Management%20Act/Municipal%20Finance%20Management%20Act%20\(No.%2056%20of%202003\).pdf](http://mfma.treasury.gov.za/MFMA/Legislation/Local%20Government%20-%20Municipal%20Finance%20Management%20Act/Municipal%20Finance%20Management%20Act%20(No.%2056%20of%202003).pdf)

The Public Sector Audit Committee Forum

<http://iodsa.site-ym.com/?page=ForumPSACF>

PSACF paper on “Relationship between Audit Committee and Council – local government”

[http://c.ymcdn.com/sites/iodsa.site-ym.com/resource/collection/EF25A709-D8EE-4429-8E77-247F64177641/The_relationship_between_Audit_Committee_and_Council_\(local_government\).pdf](http://c.ymcdn.com/sites/iodsa.site-ym.com/resource/collection/EF25A709-D8EE-4429-8E77-247F64177641/The_relationship_between_Audit_Committee_and_Council_(local_government).pdf)

PSACF paper: “Challenges Facing Public Sector Audit Committees”

http://c.ymcdn.com/sites/www.iodsa.co.za/resource/collection/EF25A709-D8EE-4429-8E77-247F64177641/Challenges_facing_public_sector_audit_committees.pdf

PSACF paper: “Terms of Reference and Annual Planner for National and Provincial Government Audit Committees”

http://c.ymcdn.com/sites/iodsa.site-ym.com/resource/collection/EF25A709-D8EE-4429-8E77-247F64177641/Terms_of_Reference_and_Annual_Planner_for_National_and_Provincial_Government_Audit_Committees.pdf

The Institute of Internal Auditors, The Audit Committee: Purpose, Process, Professionalism

https://na.theiia.org/about-ia/PublicDocuments/Aud_Comm_Brochure_I_1_.pdf

National Treasury - A guide to Municipal Finance Management for Councillors

<http://mfma.treasury.gov.za/MFMA/Guidelines/A%20Guide%20to%20Municipal%20Financial%20Management%20for%20Councillors.pdf>

Public Finance Management Act

<http://www.treasury.gov.za/legislation/pfma/>

The Companies Act of 2008

<http://www.acts.co.za/companies-act-2008/>

Guide for Accounting Officers, Public Finance Management Act

<http://www.treasury.gov.za/legislation/pfma/guidelines/Accounting%20Officers%20Guide%20to%20the%20PFMA.pdf>

State-owned enterprises: Governance responsibility and accountability

http://c.ymcdn.com/sites/iodsa.site-ym.com/resource/collection/879CAE6C-7B90-49F5-A983-28AECBCE196F/PSWG_Position_Paper_3_Governance_in_SOEs.pdf

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