

An evaluation of the effectiveness of the audit committee in the Westonaria Local Municipality

M.M. Chaka
22687823

Mini-dissertation submitted in partial fulfillment of the requirements for the degree of Masters in Public Administration at the Potchefstroom Campus of the North-West University

Supervisor: Dr Willie Van Wyk
November 2013

An evaluation of the effectiveness of the audit committee in the Westonaria Local Municipality

**M. M. Chaka
22687823**

**Mini-dissertation submitted in partial fulfilment of the requirements for the degree
of Masters in Public Administration at the Potchefstroom Campus of the
North-West University**

Supervisor: Dr Willie Van Wyk

November 2013

DECLARATION

I hereby declare that the mini dissertation submitted for the degree of Masters of Public Administration (MPA) at North West University is my own work and has not previously been submitted, in whole or part, to any institution of higher learning. I further declare that all material and sources cited in this study have been duly acknowledged by means of complete references.

M.M Chaka

ACKNOWLEDGEMENTS

I would like to express my sincere gratitude and appreciation to my family and friends for their continued encouragement and support throughout my studies. I would also like to thank the SASSA Gauteng Region for the opportunity to further my education, and extend further thanks to my colleagues for their encouragement during the period of my studies.

My appreciation is also conveyed to Ms Farzanah Loonate, the Coordinator, for her words of encouragement and excellence in assisting with all the administrative matters at the university.

A special thanks is also due to my supervisor, Dr Willie Van Wyk. Thank you very much for your time, patience, support and guidance from the drafting of my proposal to the finalisation of my dissertation.

ABSTRACT

Audit committees are an integral part of good corporate governance and their establishment strengthens the credibility of governments. As a foundation of good governance, audit committees are positioned to provide an objective assessment of whether or not public resources are responsibly and effectively managed. They also promote accountability and integrity, as well as improvement in the operations of governments and municipalities. The establishment of audit committees in the local sphere of government came with the advent of modernisation in terms of the budget and financial management, which was intended to strengthen accountability. The requirement for effective utilisation of resources by local government is critical for the support and empowerment of local communities and delivery of effective services.

The audit committee framework for local government, which is provided by the Municipal Finance Management Act (56 of 2003), is underpinned by principles of good governance and accountability, which promote the effective functioning of audit committees. However, there are perceptions and arguments advanced in the literature regarding the effectiveness of audit committees as an accountability structure. This was brought about by the recurring reported incidences of the failure of businesses, which took place despite the existence of rules and laws regulating the function. As a result, trends of leading best practices were established, which enhanced audit committees' performance and were adopted as a proxy for the measurement of audit committees' effectiveness.

The focus of the study is on validating the perception by management that the audit committee of the Westonaria Local Municipality (WLM) is effective in the execution of its oversight role. A literature study on the functioning of audit committees have been undertaken, official municipal documents were analysed and a questionnaire has been developed and utilised as a means for gathering data, in order to prove the hypothesis to be either true or false. The areas investigated in this study demonstrate that the audit committee of WLM is generally effective in the execution of its oversight function. The findings of the study also identified certain areas in the audit function which require the attention of both management and the audit committee of the municipality. More specifically, the observations made in the study include the following: (i) that audit

committee members are not provided with the agendas and reports in sufficient time for them to adequately prepare for meetings; (ii) that a productive relationship between the audit committee and the management of the local government has to be maintained; (iii) that there is a lack of informal meetings between the audit committee and the external and internal auditors; (iv) that no appropriate training of the audit committee on existing and potential audit risks in local government is in place; (v) that there is an absence of continuous learning programmes for the members of the audit committee; and (vi) that audit committee members do not evaluate themselves in terms of their level of knowledge regarding the functioning and activities of their audit committee.

Attending to these aspects, as identified through this study, will further improve the audit committee's activities in the WLM. These aspects are therefore not viewed in a negative light, but are rather regarded as a positive venture to be addressed by municipal management and the audit committee, in order to improve the functioning of the audit committee. These aspects should therefore be added to the many positives aspects that are identified concerning the WLM audit committee, as discussed in this study.

Keywords: effectiveness; accountability; governance; oversight; auditing; principles; and independence.

OPSOMMING

Ouditkomitees is 'n integrale deel van goeie korporatiewe bestuur en hul vestiging versterk die geloofwaardigheid van regerings. As 'n grondslag van goeie finansiële bestuur, is oudit komitees geposisioneer om 'n objektiewe beoordeling van openbare hulpbronne te verskaf. Dit bevorder ook finansiële aanspreeklikheid en integriteit en in wese sorg oudit komitees vir die verbetering van al die bedrywighede van 'n munisipaliteit. Die vestiging van ouditkomitees in plaaslike regering het met die koms van die modernisering van die begroting en finansiële bestuur 'n baie belangrike taak bygekry, naamlik om verantwoordingdoening as beginsel in 'n munisipaliteit te versterk. Verantwoordingdoening vereis die effektiewe benutting van hulpbronne deur die munisipaliteit en is van kritieke belang vir die bemagtiging van plaaslike gemeenskappe in die proses van effektiewe dienslewering.

Die ouditkomitees se werksaamhede in plaaslike regering word in die Municipal Finance Management Act (56 van 2003), uiteengesit. In wese ondersteun die Wet goeie bestuursbeginsels en aanspreeklikheid wat beoog om die effektiewe funksionering van ouditkomiteeste te bevorder en te reguleer. Daar word egter dikwels in die literatuur persepsies en argumente aangevoer dat oudit komitees nie altyd effektief is in hul werksaamhede nie. Dit word gekoppel aan die feit dat daar by herhaling munisipaliteite in Suid-Afrika was wat oor die afgelope jare wat misluk het op finansiële gebied en omdat ouditkomitees 'n integrale deel van die finansiële stelsel van 'n munisipaliteit is, word sulke komitees dan ook as oneffektief beskou.

Die fokus van die studie word daarom gevind in die persepsie dat die ouditkomitee in WLM effektief funksioneer en dat sy oudit funksie suksesvol uitgevoer word. Om dit te bepaal is 'n literatuurstudie oor ouditkomitees onderneem, offisiële dokumentasie ontleed en 'n vraelys ontwikkel om data oor die aangeleentheid te bekom en om die persepsies van die bestuur van WLM oor sy ouditfunksie wetenskaplik te bepaal. Die studie het egter ook onthul dat daar gebiede in die werksaamhede van die ouditkomitee is wat die aandag van beide die bestuur en die oudit- komitee van die munisipaliteit moet kry. Verder is dit belangrik dat die ouditkomitee meer ondersteuning van die munisipale bestuur moet kry om te verseker dat die Komitee effektief sal funksioneer. Aandag moet gegee word aan die samestelling van 'n jaarlikse ouditkomiteeprogram en beide die munisipale bestuur en ouditkomitee moet hieraan werk en die munisipale

bestuurspan moet hul toewyding tot 'n goed funksionerende oudit funksie deurlopend beklemtoon. Effektiewe kommunikasie tussen die munisipale bestuur en die ouditkomitee is krities belangrik om die werksaamhede van die ouditkomitee te belyn met bestuur en so sorg te dra dat ouditwerksaamhede glad verloop. Effektiewe kommunikasie sal in beginsel verseker dat daar 'n positiewe en konstruktiewe verhouding tussen die munisipale bestuur en die ouditkomitee sal wees.

Table of Contents

DECLARATION	i
ACKNOWLEDGEMENTS	ii
ABSTRACT	iii
OPSOMMING	v
TABLE OF CONTENTS	vii
ACRONYMS	xi
LIST OF FIGURES	xii
LIST OF TABLES	xiii
CHAPTER 1	
BACKGROUND AND ORIENTATION	1
1.1 INTRODUCTION	1
1.2 PROBLEM STATEMENT	6
1.3 RESEARCH OBJECTIVES	8
1.4 RESEARCH QUESTIONS	8
1.5 HYPOTHESES	9
1.6. RESEARCH METHODOLOGY	9
1.6.1 Quantitative research design	9
1.6.2 Case study method.....	10
1.7 LITERATURE REVIEW	11
1.7.1 Databases consulted	11
1.8 EMPIRICAL INVESTIGATION.....	12
1.8.1. Research design	12
1.8.2. Sampling.....	12
1.8.3 Data collection technique.....	13
1.8.4 Data analysis.....	13
1.8.5 Limitations and delimitations of the study.....	14
1.9 SIGNIFICANCE OF THE STUDY	14
1.10 ETHICAL CONSIDERATIONS	15
1.11 CHAPTER OUTLINE.....	15
1.12 CONCLUSION.....	17
CHAPTER 2	
FUNCTIONAL AND LEGISLATIVE FRAMEWORK FOR AUDIT COMMITTEES AT LOCAL GOVERNMENT LEVEL.....	18
2.1 INTRODUCTION.....	18
2.2 AN AUDIT COMMITTEE AS A PHENOMENON.....	20

2.2.1 Best practices for audit committee to promote effectiveness	20
2.3 AUDIT COMMITTEES WITHIN THE LOCAL SPHERE OF GOVERNMENT	22
2.3.1 Composition and structure of an audit committee.....	23
2.3.2 Terms of reference of an audit committee	25
2.3.3 Authority and powers of an audit committee	26
2.3.4 Organisational requirements.....	26
2.3.5 Reporting requirements	27
2.3.6 Performance measurement and evaluation	28
2.4 THE PURPOSE AND FUNCTIONS OF AUDIT COMMITTEES	28
2.4.1 Purpose of an audit committee	29
2.4.2 Principles for establishing an ethical code for public sector organisations.....	29
2.4.3 Attributes and characteristics of an audit committee.....	31
2.4.4 Functions of an audit committee	33
2.4.4.1 Oversight of financial reporting.....	33
2.4.4.2 Internal control and risk management	35
2.4.4.3 Compliance and the audit committee	36
2.4.4.4 Oversight of the internal audit function	37
2.4.4.5 Oversight of the external audit function	38
2.4.4.6 Performance Audit Committee	40
2.5. LEGISLATIVE FRAMEWORK FOR AUDIT COMMITTEES AT LOCAL GOVERNMENT LEVEL	40
2.5.1. The Constitution of South Africa (RSA)	41
2.5.2. Local Government Transition Act (LGTA).....	42
2.5.3. White Paper on Local Government	43
2.5.4. Local Government Municipal Structures Act	44
2.5.5. Local Government Municipal Systems Act	45
2.5.6. Local Government Municipal Finance Management Act	46
2.5.7. Public Finance Management Act and Treasury Regulations.....	49
2.5.8. Local Government Municipal Planning and Performance Management Regulations	51
2.6. CONCLUSION	52
CHAPTER 3	
AUDIT COMMITTEE EFFECTIVENESS	55
3.1 INTRODUCTION.....	55
3.2 DEFINING EFFECTIVENESS	56
3.3 DIFFERENCES BETWEEN EFFECTIVENESS AND EFFICIENCY	57
3.4 EFFECTIVE LOCAL GOVERNMENT.....	59
3.5 EFFECTIVE AUDIT COMMITTEES IN LOCAL GOVERNMENT	62
3.5.1 Principles of effective auditing.....	63

3.5.2 Discussion on general audit principles	65
3.5.2.1 Discussion on audit process principles	69
3.6 THE EFFECTIVE FUNCTIONING OF AUDIT COMMITTEES.....	69
3.6.1 Audit committee composition	71
3.6.2 Audit committee authority	73
3.6.3 Audit committee resources	75
3.6.4 Audit committee process	76
3.7 EFFECTIVE AUDIT COMMITTEE MEMBERS	78
3.7.1 Audit Committee members' independence.....	79
3.7.2 Audit committee members' diligence.....	80
3.7.3 Personal qualities associated with effective audit committee members.....	81
3.8 PRICEWATERHOUSE COOPERS AUDIT REPORT ON STANDARDS FOR THE EFFECTIVENESS OF AUDIT COMMITTEES (2012)	82
3.8.1 Enhancement of communication with external auditors	83
3.8.2 Promotion of financial reporting quality and transparency.....	84
3.8.3 Achievement of audit quality and process transparency	85
3.8.4 Enhancement of effectiveness through continuous learning with regard to audit committee matters.....	86
3.9 NATIONAL TREASURY GUIDELINES	87
3.9.1 Audit committee's responsibilities	88
3.9.2 Audit committee's authority and reporting requirements	88
3.9.3 Audit committee's evaluation of annual financial statements	89
3.9.4 Enhancement of audit effectiveness in audit committees	90
3.10 KING III ON AUDIT COMMITTEE EFFICACY	92
3.10.1 Key risks and reporting implications	93
3.10.2 Other concepts introduced.....	94
3.11 INTERNAL AUDIT STANDARDS	95
3.11.1 Attribute standards	97
3.11.2 Performance standards	98
3.12 EVALUATION OF AUDIT COMMITTEE'S FUNCTION	101
3.13 CONCLUSION	104
CHAPTER 4	
EMPIRICAL FINDINGS ON THE EFFECTIVENESS OF THE AUDIT COMMITTEE OF THE WESTONARIA LOCAL MUNICIPALITY.....	107
4.1. INTRODUCTION.....	107
4.2 FOCUS OF THE EMPIRICAL STUDY	107
4.3 RESEARCH METHODOLOGY.....	108
4.3.1 Population	108
4.3.2. Data collection.....	109

4.3.3 The questionnaire as a research tool	110
4.3.3.1 Advantages and disadvantages of questionnaires	111
4.3.3.2 Development of the questionnaire for this study	112
4.3.3.3 Structure and content of the questionnaire for this study	114
4.3.3.4 Questions formulated for the questionnaire	115
4.4 DATA ANALYSIS AND INTERPRETATION	117
4.5. RESEARCH FINDINGS AND ANALYSIS	118
4.5.1 Section A of the questionnaire: Effective functioning of the audit committees	118
4.5.2 Overall analysis of Section A: Effective functioning of the audit committees	128
4.5.3 Section B of the questionnaire: Effectiveness of audit committee members	130
4.5.4 Overall analysis of Section B: Effectiveness of audit committee members	137
4.5.5 Section C of the questionnaire: Standards for the effectiveness of audit committees	139
4.5.6 Overall analysis of Section C: Standards for the effectiveness of audit committees	147
4.6 SUMMARY OF THE FINDINGS OF THE TWENTY QUESTIONS	148
4.7. CONCLUSION	152
CHAPTER 5	
DISCUSSION, CONCLUSION AND RECOMMENDATIONS	154
5.1. INTRODUCTION	154
5.2 ACHIEVEMENT OF THE OBJECTIVES OF THE STUDY	155
5.2.1 The research question	155
5.2.2 The research objectives	155
5.2.3. Hypothesis	156
5.2.4 Content of the chapters	156
5.3 RECOMMENDATIONS TO BE ADDRESSED BY THE WESTONARIA LOCAL MUNICIPALITY TO IMPROVE THE EFFECTIVENESS OF THE AUDIT COMMITTEE	158
5.4 CONCLUSION	161
BIBLIOGRAPHY	163
APPENDICES	178
Appendix 7.1	178
Appendix 7.2	179

LIST OF ACRONYMS AND ABBREVIATIONS

AARF	Australian Accountancy Research Fountain
AC	Audit Committee
AGA	Association of Government Accountants
AGSA	Auditor General of South Africa
AICPA	American Institute of Public Accountants
ASB	Auditing Standards Boards
DoRA	Division of Revenue Act
IIA	Institute of internal Auditors
IIARF	Institute of Internal Auditors Research Foundation
IIASA	Institute of Internal Auditors in South Africa
INTOSAI	International Organisation of Supreme Institutions
IODSA	Institute of Directors in Southern Africa
IPA	Institute of Public Administration
IRBA	Independent Regulatory Board for Auditors
ISPPIA	International Standards for the Professional Practice of Internal Auditing
ISSAIs	International Standards of Supreme Audit Institutions
IT	Information Technology
LGTA	Local Government Transition Act
MEC	Member of Executive Council
MFMA	Municipal Finance Management Act
NCPO	National Council of Provinces
NWU	North West University
PFMA	Public Finance Management Act
PSACF	Public Sector Audit Committee Forum
PWC	Price Waterhouse Coopers
SAI	Supreme Audit Institutions
SAICA	South African Institute of Accountants
SALGA	South African Local Government Association
SCOPA	Standing Committee on Public Accounts
RSA	Republic of South Africa
Triple E	Economy, Efficiency and Effectiveness
WLM	Westonaria Local Municipality

LIST OF FIGURES

Figure 2.1 - Elements of audit committee oversight	23
Figure 3.1 - Role of Supreme Audit Institutions (SAI) in improving public sector auditing	64
Figure 3.2 - Audit committee's (AC) effectiveness model	70
Figure 3.3 - The IIA effective governance model	100
Figure 3.4 - Determinants of an audit committee's performance	102

LIST OF TABLES

Table 4.1 - Audit committee authority provided by the charter	118
Table 4.2 - Relevance of audit committee members' qualifications	119
Table 4.3 - Audit committee members' experience in financial reporting	120
Table 4.4 - Sufficient number of audit committee meetings held	122
Table 4.5 - Timely receipt of meeting' agenda and related documents and reports	123
Table 4.6 - Audit committee's discussions with internal and external auditors on their scope	124
Table 4.7 - Maintenance of a productive relationship with management	126
Table 4.8 - Maintenance of effective communication with management	127
Table 4.9 - Overall perspective regarding the effectiveness of the audit committee	128
Table 4.10 - Audit committee members' independence	130
Table 4.11 - Audit committee members' impartiality	131
Table 4.12 - Probing of details from management when responses are not satisfactory	132
Table 4.13 - Extensive questions beyond financial information are being asked by the audit committee	133
Table 4.14 - Audit committee's familiarity with developments in local government	135
Table 4.15 - Audit committee members' consistency in attending meetings	136
Table 4.16 - Overall perspective regarding the effectiveness of audit committee members	137
Table 4.17 - Frequency of informal engagements with internal and external auditors	139
Table 4.18 - Probe for explanation of financial risks associated with areas of management judgement	141

Table 4.19 - Provision of appropriate training on existing and emerging risks in local government	142
Table 4.20 - Provision of sufficient assistance and support for meetings and reporting	143
Table 4.21 - Developed programme on continuous learning for audit committee members	145
Table 4.22 - Audit Committees' self-evaluation	146
Table 4.23 - Overall perspective regarding standards for effectiveness of audit committees	147

CHAPTER 1

BACKGROUND AND ORIENTATION

1.1. INTRODUCTION

Audit committees are regarded as a valuable and integral part of governance activities in the public service (Van Der Nest, 2006:v). Therefore, their existence as an oversight structure is an important ingredient of good corporate governance (Marx, 2009a:5). Good corporate governance enhances the image of the organisation and makes a valuable contribution towards the improvement of performance and accountability (Lipman & Lipman, 2006:4).

According to Van Der Nest (2006:1), the concept of an audit committee was introduced in the 1970s in the United Kingdom by the Great Western Railway Company. However, during the 1990s, the audit committee's role became more prominent as a result of the collapse and bankruptcy of multinational companies in the United States of America (Marx, 2008:1). The prevalence of the credit crunch in the global market brought about an increase in the risk of unethical behaviour and potential fraud in companies (Marx, 2009a:1). As a result, the boards of companies relied on audit committees to provide assurance that mitigating strategies would be developed and implemented to address these emerging risks (Marx, 2008:14). It was on this basis that audit committees became the main pillars of the governance structure in public and private sectors (Van Der Nest, 2006:1).

Local government is mainly responsible for the delivery of basic services to local communities (Apollo, 2008:15). The White Paper stresses the fact that a developmental type of local government system must promote developmental objectives, with an emphasis on serving and creating a better life for all South African citizens (White Paper, 1998). By implication, this refers to effective service delivery. The quality of the governance of a municipality has a direct impact on service delivery (Dlalisa, 2009:7). In recent years, municipalities have been confronted with civil protests as a result of service delivery backlogs (Jones, 2011:4). A viable local governance system, as envisaged by the White Paper, is the system which is capable of effectively serving and developing people, and which is also able to create an enabling environment for effective governance (Gregory & Simms, 1999:2). The Auditor-General of South Africa,

hereafter referred to as the AGSA, in the report on the 2010/11 audit outcomes for municipalities, alluded to deficiencies in the governance and financial management of municipalities, and recommended an improvement in the accountability and governance framework of the municipalities which, among others, include the internal audit and audit committee function (AGSA, 2011).

In the South African government, the establishment of audit committees is currently guided by legislation (Van Der Nest, 2008:176). Audit committees in the local sphere of government were formalised through the promulgation of the Municipal Finance Management Act of 2003, hereafter referred to as MFMA. The audit committee, as a statutory committee, is defined as a committee in the private or public sector, which performs specialist functions in order to enhance confidence in the integrity of an organisation's processes and procedures with regard to internal controls and financial reporting (Spencer Picket, 2005:38). Financial accountability is based on the provisions set out in the Constitution of 1996 (Van Der Nest *et al.*, 2008:545). The principles underlying the legislative framework for the establishment of audit committees in the public sector are thus based on provisions contained in the Constitution of 1996 (Van Der Nest, 2008:176).

The following are some of the important and relevant pieces of legislation with regard to audit committees' regulation in the public sector:

- National and Provincial Departments: Section 77 of the Public Finance Management Act No 1 of 1999, amended by Act No 29 of 1999 (PFMA);
- National Treasury Regulations: TR 3.1.10 and 13; and
- Local Government: Section 166 of Municipality Finance Management Act No 56 of 2003 (MFMA).

The best practices guidelines for audit committees provide for their membership to include those with diverse experience and expertise in financial reporting, as well as knowledge about the organisation's operations, policies and legislative framework (Braiotta, 2004:34). The guidelines take cognisance of the critical need for audit committees' increasing role and scope, which have been brought about by the ever-increasing challenges posed by the rising demand for accountability and complexity in

financial reporting (Australian Accountancy Research Foundation, 2000:4), hereafter referred to as AARF. An audit committee plays a critical role in ensuring the integrity, reliability and credibility of the financial reporting process (Marx, 2008:14). It is on this basis that audit committee members are required to have financial management expertise, as well as an understanding of local government operations and risk profiles, in order to be able to apply their business expertise and judgement to issues for which they are responsible (Braiotta, 2004:23).

The initial role of an audit committee focused on assisting the board of directors or management cadre in a government institution to fulfil their financial reporting, control and audit-related responsibilities (Marx, 2009c:33). However, the role of the audit committee has evolved over the decades in response to changes in the business or government environment within which organisations operate. The role of the audit committee in local government, to be more specific, includes the following responsibilities (National Treasury, 2011:4; Deloitte, 2011:53):

- To monitor the integrity of the financial statements and announcements relating to financial performance;
- To review the municipality's internal financial controls, in order to ensure compliance with regulations and risk management systems;
- To pay particular attention to management's use of 'going concern' assumptions in financial statements;
- To review and monitor the external auditor's independence and objectivity, as well as the effectiveness of the audit process, in line with professional and regulatory frameworks;
- To monitor and review the effectiveness of the municipality's internal audit function;
- To review the arrangement by which staff of the municipality may, in confidence, raise concerns about possible improprieties in matters related to financial reporting or other matters such as allegations of fraud; and
- To request the internal audit officer, compliance officer or external auditors to conduct a special investigation, if the need arises, in order to probe sensitive issues within its scope of responsibilities.

Although the functions of audit committees are generic, the degree of their involvement in the audit function may vary considerably from organisation to organisation (Van der Nest *et al.*, 2008:545). The audit committee can also only be effective if it is properly constituted and if proper guidelines are developed (Van Der Nest, 2008:4). In South Africa, the National Treasury, through its guidelines on Normative Measures for Financial Management (National Treasury: 2003), established norms and standards for the formation and operation of audit committees in all spheres of government. Section A5.2 to A5.8 of the guidelines provide for the following:

- The accounting officer should make available to the audit committee written terms of reference which set out the committee's objectives, membership and composition of qualifications, rights and authority, responsibilities, reporting lines and independence. The terms of reference may be supported by policies and operating procedures;
- The audit committee should develop a direct and open relationship with the external auditors, with a line of communication that facilitates independence from management and encourages the external auditors to communicate on a confidential basis with the audit committee;
- The audit committee must have formal meetings with the external auditors at least once a year, without the presence of the accounting officer, in order to ensure that there are no unresolved issues which are pertinent to their scope of responsibilities;
- The audit committee is required to provide regular reports and make recommendations to the accounting officer. The committee may also communicate concerns to the executive authority, relevant treasury or external auditors;
- The audit committee should hold adequately planned meetings at least four times a year and ensure that relevant people attend the meetings. The committee should be the advisory and not the executive, and is not supposed to assume any management responsibilities, as this will prejudice their objectivity;
- The effectiveness of the audit committee should be assessed periodically and reviewed by the accounting officer;

- The audit committee is required to provide a report for inclusion in the annual report on the effectiveness of the internal controls of the government department; and
- The government department is required to disclose, in the annual report, whether or not the committee adopted the formal terms of reference, as well as whether or not the committee performed those functions during the period under review.

The Municipal Finance Management Act (MFMA) makes provision for audit committee members to be appointed by the council of the municipality and to respond to council on issues raised by the external auditors (Deloitte, 2011:54).

With regard to the monitoring of financial reporting, audit committees have a key role to play (MFMA, 2003). During the review of their financial information, which includes financial statements, the audit committee should be primarily concerned with its completeness, accuracy and fairness, with a focus on the following areas:

- Significant accounting policies in terms of appropriateness and conformity with accounting standards;
- Judgment issues and accounting estimates in cases where the exact figures are not available and management have made estimates;
- Disclosures, such as an explanation of unusual transactions reported, which occurred during the period under review, should be reviewed by the audit committee. This comprises material, non-recurring items such as acquisition or disposal of assets, contingent liabilities or litigations;
- Significant audit adjustments which may have resulted from the correction of accounting errors, and to determine if any investigation is required with regard to the causes of such errors; and
- Auditors' concerns and adjusted audit differences such as irregularities, including fraud or cases of non-compliance with the law or regulations, fundamental uncertainties, which may have an impact on the 'going concern' ability of the entity, any significant risks and exposure that needs to be disclosed in the financial statements, and expected modifications to the auditor's report.

With the ongoing occurrence of business failures (including government institutions), it has become imperative for an audit committee to focus on critical disclosure requirements, trends and fundamental uncertainties that may occur, as well as on the factors that may lead to doubt regarding the entity's 'going concern' ability (Braiotta, 2004:124). An evaluation of liquidity ratios can assist the auditor in determining the validity of an entity's 'going concern' status. This, however, should be considered in combination with other elements such as the liquidity risk and prevailing uncertain economic conditions, and which will contribute to the future uncertainty of the entity (Gray & Mansion, 2000:510).

1.2 PROBLEM STATEMENT

The consolidated report of the AGSA on the outcomes of the audit of local government for 2008/09 and 2009/10 indicates that 59 and 52 municipalities for the respective years were identified as not being financially sustainable. This raised concerns in terms of the financial sustainability of the operations of the municipalities in question, as the provision of essential services and maintenance of infrastructure may be severely disrupted. The factors that were found to have affected the 'going concern' abilities of these municipalities were the following (AGSA, 2011): (1) unusually high reliance on grants because own revenue is insufficient to fund operating costs; (2) failure in terms of consumer debt recovery; (3) no cash to back up unspent grants; (4) disestablishment/liquidation; and (5) current liabilities exceeding current assets. The situation is of great concern for the AGSA and the institution made one specific recommendation, namely that the affected municipalities must put financial recovery plans in place to turn this situation around.

The Westonaria Local Municipality, hereafter referred to as WLM, is one of the seven municipalities in the Gauteng province. According to the AGSA (2012:12), the audit outcome for the financial year 2011/12 showed no signs of improvement for municipalities in Gauteng, with 95% falling in the category of receiving either a qualified audit opinion with other matters or a financially unqualified audit opinion with other matters. The WLM's position was highlighted by the AGSA in the 2011/12 report, in which it was shown to have degenerated from having an unqualified audit report with

other matters to a qualified audit opinion (AGSA, 2012:13). The WLM is also one of the municipalities that were mentioned in the report on the audit outcomes for 2009/10 as having financial problems due to its 'going concern' status and other related liquidity problems (AGSA, 2011:3).

The AGSA (2011:3) further highlighted the key areas that need to be improved in order to achieve better audit outcomes in local government. The focus areas highlighted by AGSA concern the funding of municipality operations, financial sustainability and 'going concern' ability. The WLM had, for three consecutive financial years, presented its annual financial statements as a 'going concern', despite its negative liquidity ratio, which means that the municipality's current liabilities exceeded its current assets (AGSA, 2011). This was as a result of a high consumer debt book, with 76% of the debtors' accounts being outstanding for more than 120 days. The municipality's consumer debtors with accounts outstanding for more than 120 days for 2009 and 2010 represented 70% and 72% respectively. This trend indicates that the situation is deteriorating, since it went from 72% in 2010 to 76% in 2011 (WLM, 2011). The municipality has an overdraft facility with a bank, which is renewed every year, in order to meet its financial obligations. In addition, it has a significant amount of unspent grants for infrastructure (WLM, 2011), although it could not be determined if these amounts are still available to the municipality.

According to Gray and Mansion (2000:510), the evaluation of liquidity ratios can assist a municipality to determine the validity of the entity's 'going concern' status. The 'going concern' status should, however, be considered in combination with other elements that contribute to the future financial uncertainty of the municipality (Deloitte, 2010:13).

According to Deloitte (2010:19), the global credit crunch and recessionary conditions in which South Africa finds itself have raised concerns about the 'going concern' status of business entities. This has, in turn, had an impact on entities in terms of their ability to repay their debts in the ordinary course of business (Deloitte, 2010:13). This situation is therefore having a direct impact on government spending, especially with regard to the local government's revenue base. Furthermore, local government has also been plagued by incidences of mismanagement, which have a negative impact on service

delivery (Van der Nest, 2006:231). In light of the responsibilities entrusted to local government's audit committees, it is vitally important for these entities to function effectively and to assist municipal management to manage the finances of the municipality effectively.

From the foregoing appraisal of the financial position of the WLM in conjunction with the reports on the audit outcomes of local government by the AGSA, the problem that arises is, how effective is the audit committee within the WLM in inculcating sound financial management and good governance.

Based on the above background and problem statement, the following research question can be formulated: ***Are the audit activities of the audit committee of the Westonaria Local Municipality effective from a managerial point of view?***

1.3 RESEARCH OBJECTIVES

The following objectives need to be achieved by this study:

- To describe the functional and legislative frameworks applicable to audit committees on local government level;
- To determine what is meant by the effectiveness of audit committees at local government level;
- To determine whether or not the audit committee of the Westonaria Local Municipality is functioning effectively according to management (empirical study); and
- To make recommendations on the basis of the empirical findings regarding the audit function in the Westonaria Local Municipality.

1.4 RESEARCH QUESTIONS

The following research questions are based on the objectives of this study:

- What legislation and functional standards on local government level are applicable to audit committees?
- What is meant by effective audit committees at local government level?

- Is the audit committee of the Westonaria Local Municipality functioning effectively according to the management?
- Are there any recommendations to be made regarding the state of affairs of the audit function in the Westonaria Local Municipality?

1.5 HYPOTHESIS

A hypothesis is a proposed explanation of a phenomenon that still has to be tested through research to determine whether it is true or false. It is a statement that is provisionally accepted by the researcher (Shields, 1998:217).

The following hypothesis has been formulated for this study:

It is believed by the management of Westonaria Local Municipality that the audit committee is functioning effectively.

This hypothesis is directly related to the title of this study, as well as to the research questions and objectives mentioned above.

1.6 RESEARCH METHODOLOGY

The selection of a research design depends on what the study aims to achieve, as well as the best way of conducting the study (Babbie, 2010:91). In order to achieve the research objectives listed above, information will be sought through the review of literature pertinent to the research topic. This study is based on quantitative research methods, and also makes use of case study methodology, which is in line with the formulation of a hypothesis.

1.6.1 Quantitative research design

Quantitative research is defined as a systematic, empirical investigation of a social phenomenon using statistical, mathematical or computational techniques (Babbie, 2010:91). According to Du Plooy (2006:29), the following assumptions guide the researcher when conducting a quantitative study:

- Empirical observations, experiences or experiments are important sources of real knowledge;
- Empirical evaluations are applied - in other words, the hypothesis which is formulated about the nature of the reality can be accepted or rejected based on the findings;
- The hypothesis can be used to predict and control the phenomenon that is being studied; and
- Data from questionnaires can be measured in quantitative terms.

Quantitative research involves the gathering of data that is absolute, such as numerical data. The analysis of such data can be examined in an unbiased manner. Because numbers are an important entity in quantitative studies, questionnaires can be regarded as the primary data collection instrument in a study. The results of a quantitative study or research can thus be subjected to statistical analysis to come up with answers (WiseGeek, 2013).

1.6.2 Case study method

The case study method is described as a research method which investigates a single instance of a social phenomenon within its real- life situation and “provides the basis for application of ideas and extension of methods” (Webb & Auriacombe, 2006:599). According to Gravetter and Forzano (2009:373), the case study method has a long history of being successfully applied in social science research.

The Westonaria Local Municipality was selected and used as a case study for this research. The motivation for the selection of the WLM is because of the year-on-year trend that it showed with regard to its degenerating financial audit outcomes (AGSA, 2012:13), as well as because of its geographical accessibility and availability to the researcher.

According to Babbie (2010:309), the limitation of focus in order to understand one instance within a single setting is the most defining characteristic of the case study method. The rationale for focusing on one instance is to bring about the general by focusing on the one instance (Apollo, 2008:5). Taking cognisance of the challenges

faced by local municipalities, the case study method has also been chosen in order to carry out an in-depth investigation into the effectiveness of the auditing function at the local level of government and the function's impact on the improvement of municipalities' financial performance and accountability.

1.7 LITERATURE REVIEW

A literature review lays the foundation on which the research is based, and also provides current knowledge on the topic of the study (Fink, 2010:196). The review of existing literature in this study included legislation related to the promotion of effective auditing in local government, as well as codes of conduct developed by local and international regulatory and professional bodies in the fields of accounting and auditing. The literature review explored best practices regarding how audit committees are established in the public service. The researcher also identified and analysed sources such as journal articles, dissertations, books and scholarly articles, as well as government policy documents and reports on the research topic.

1.7.1 Databases consulted

The following databases were consulted for the literature review of this study:

- Sabinet database;
- South African (SA) ePublications;
- National Treasury Website;
- Catalogue of books; Ferdinand Postma Biblioteek of North West University (NWU); and
- Catalogue of theses and dissertations of South African universities (NEXUS).

It was determined by the researcher that no postgraduate research on this specific topic has been undertaken before. It was also determined that sufficient sources on the topic are available to the researcher, in order for her to undertake a study of this nature.

1.8 EMPIRICAL INVESTIGATION

The gathering of information was conducted by means of an empirical study. In this regard, a questionnaire was developed and utilised as the main instrument for collecting data.

1.8.1 Research design

Qualitative and quantitative approaches are the two main research methods in the field of social sciences and the selection of either of the approach determines research method to be adopted for the study (Webb & Auriacombe, 2006:599). In order to address the research objectives of this study and to determine whether the hypothesis is true or false, a quantitative methodology and a case study approach were employed. Quantitative research instruments, particularly questionnaires, were used to collect data (Babbie, 2010:255), and the results were presented in the form of tables and diagrams (Gravetter & Forzano, 2009:429).

1.8.2 Sampling

The population was selected from the persons (from senior management) who are directly concerned with the audit function in the WLM. This sampling method is known as non-random sampling. Non- random sampling is also referred as non-probability sampling when the selection of the respondents does not make provision for all of the population to stand a chance of being selected to participate in the study (Sampling-UIAH, 2012). In most cases, the researcher predicts or controls the choice of units to be analysed (Du Plooy, 2006:113). To control the sample to be selected, the researcher uses judgment or expert knowledge in the selection of units that are representative of the population to participate in the study (Burger & Silima, 2006: 656). As previously mentioned the motivation for the selection of the senior management group of the WLM as a population to participate in the study is because of their working relationship and interaction with the audit committee of the WLM.

The senior management group selected consisted of the following senior officials in the Westonaria Local Municipality:

- Municipal Manager

- Chief Financial Officer
- Chief Risk Officer
- Manager: Internal Audit
- Senior Manager : Internal Audit
- Manager: Performance Management
- Director of Strategic Services
- Executive Director of Corporate Services
- Executive Director of Infrastructure Development and Planning
- Executive Director of Community Services

1.8.3 Data collection techniques

A close-ended questionnaire was designed as a tool to collect valid and reliable information in this study, in order to test the hypothesis scientifically. A close-ended questionnaire contains a list of survey questions to which the respondent is requested to select an answer from a list provided by the researcher (Babbie, 2010:256). Questionnaires are generally used by researchers to obtain information and to act as a platform to convert data sourced during the empirical study (Gravetter & Forzano, 2009: 360). In Chapter 4, there is a discussion on the advantages and disadvantages in the utilisation of questionnaires, which the researcher took into account during the gathering of data. In this study, the questionnaire was designed using a 5-point Likert scale for the collection of data for analysis.

1.8.4 Data analysis

Following the data collection phase is the data analysis and interpretation phase, which seeks to draw conclusions based on the information collected during the study (Mouton, 2012:108). The data collected in this study was analysed by the researcher with reference to the results of the questionnaires, and was then processed and evaluated using descriptive analysis. Such quantitative data analysis, using numbers to discover and describe patterns in the data, is one of the most commonly used techniques in the field of the social sciences (Babbie, 2010:422). The results of the analysis are presented in the form of pie-charts and bar graphs in Chapter 4 of this study.

1.8.5 Limitations and delimitations of the study

Although data collection instruments in quantitative research simplify data collection, they also have inherent limitations and weaknesses. The use of a questionnaire as a data collection technique must involve interaction with people, and therefore necessitates cooperation. The person to be interviewed may not be willing to share all the information required. In addition, the language and culture may create a barrier, resulting in incorrect answers being provided. Apart from language being the medium of communication, it also plays a role in a person's self-identity and relational orientation. The social identification theory suggests that the inability of a person to identify with other cultural groups may have negative outcomes in a study (Kim & Mattila, 2011:2). The impact of this may be seen in the response rate, which may be below the acceptable level, thus producing distorted results or outcomes. Furthermore, some respondents may not be truthful in their responses or may not understand the questions.

Being aware of these limitations, the researcher guided the study professionally and meticulously monitored each step in the research process. For example, a follow-up exercise was conducted by the researcher, in which she physically collected the outstanding questionnaires from those respondents, with their consent, who did not send them back to the researcher in time. A further limitation was that this is a mini-dissertation with limited capacity, which placed certain restrictions on the volume of material presented and the length of the study.

1.9 SIGNIFICANCE OF THE STUDY

The recent economic decline has brought regulatory and oversight agencies for listed corporations to the fore, as well as the regulating bodies that review compliance provisions, in an attempt to enforce discipline and compliance. The audit committee's roles and responsibilities have been increasingly expanded to mitigate the risk of financial reporting errors. In South Africa, the government was equally affected by the global financial crisis, as spending was curtailed and austerity measures were implemented. Service delivery for basic services has thus been affected and municipalities' liquidity level is on the decline. A limited amount of research has thus far

been conducted on the effectiveness of local government audit committees and how these committees' oversight role can be improved. This study therefore provides insight into the basic functioning of an audit committee on local government level, and it is hoped that this will lay the foundation for further studies in this area.

1.10 ETHICAL CONSIDERATIONS

According to Lutabingwa and Nethonzhe (2006:695), ethics in social research is a very important aspect, and is one with which every researcher needs to be familiar with. The collection and analysis of data, treatment of participants and responsibility towards society have to be handled ethically during the research process. Researchers must be upfront with participants about why they are undertaking the study, as well as for what and how they will use the collected information, depending on the circumstances. Therefore, in the case of this study, consent was obtained from the respondents to use the information collected from the questionnaires. The respondents were also made aware of the fact that their participation in the study was voluntary and that their anonymity and confidentiality would be upheld.

The ethical application of this research proposal and study were also approved by the Faculty- and North West University Ethical Committee, which make this research a valid academic study.

1.11 CHAPTER OUTLINE

This study is divided into five chapters as follows:

Chapter 1: Background and orientation

This chapter introduces the topic under investigation by providing the background and problem statement. It outlines the scope of the study, as well as the research question that the study seeks to answer. The objectives of the study are discussed, and the hypothesis that was formulated is presented. Lastly, this chapter describes the research methodology to be used in order to achieve the research objectives.

Chapter 2: Functional and legislative framework for audit committees at local government level

In this chapter, the functional and legislative framework for audit matters is presented, with a focus on audit committees and local government. More details are provided on the formation and definition of an audit committee. An explanation of the oversight role of an audit committee within the local sphere of government is presented in this chapter, together with an outline of the requirements for the establishment of an audit committee, as well as its purpose and functions.

Chapter 3: Audit committee effectiveness

In this chapter, an exploration of the concept of an audit committee is conducted, as well as a look at the principles underlying an effective audit committee in the local sphere of government. The phenomenon of effective audit committees is also investigated in this chapter, as well as the related underlying principles that were used as a basis for the questionnaire and empirical study.

Chapter 4: Empirical findings on the effectiveness of the audit committee of the Westonaria Local Municipality

This chapter describes the research design and methodology that were used in this study. This includes a description of the target population and sampling and methods used for the collection of data, as well as the procedures followed to obtain information from participants. The chapter also discusses and interprets the findings of the empirical study with reference to the questionnaires, and concludes by discussing the interpretation of these findings.

Chapter 5: Discussion, conclusion and recommendations

This final chapter presents a summary of the main findings of the study and provides conclusions based on the empirical research findings that were presented in the previous chapter. Recommendations are also made based on the findings of the study, and these recommendations, can be applied by the Westonaria Local Municipality to bring about changes if and when necessary.

1.12 CONCLUSION

This chapter provided a background and orientation to the study, which aims to determine perceptions regarding the effectiveness of the audit committee of the Westonaria Local Municipality. The chapter discussed the research problem and objectives of the study, together with the related questions to be answered and the research design and methodology to be used in the empirical study. The discussion on the research design and methodology included details regarding the sample population, as well as data collection and analysis methods employed in the empirical investigation. In chapter two, literature on the functioning of audit committees in the local sphere of government is presented and reviewed, with details on the applicable legislative framework, in order to contextualise the phenomenon under investigation.

CHAPTER 2

FUNCTIONAL AND LEGISLATIVE FRAMEWORK FOR AUDIT COMMITTEES AT LOCAL GOVERNMENT LEVEL

2.1 INTRODUCTION

The role and responsibility of an audit committee have undergone an evolution in the past two decades. As with corporate governance in general, the role of audit committees also came under scrutiny due to corporate scandals and reported business failures. These incidents resulted in a review of the oversight role of an audit committee, which inevitably led to the regulation of such committees' best practices worldwide (Braiotta, 2004: xv). The ensuing changes were meant to strengthen corporate governance practices and enhance the effectiveness of audit committees (Marx, 2008:11).

An audit committee in government has an important role to play and also offers the same strategic benefits as audit committees in the private sector. An audit committee serves as the cornerstone of good governance and provides an objective assessment of whether or not public resources are responsibly and effectively managed. It also promotes accountability and integrity, as well as improvement in government operations (Deloitte, 2011:6). As an oversight structure, an audit committee also provides a valuable benefit, as it results in a greater focus on controls and risk management, as well as financial reporting. According to the Institute of Public Administration (2011:11), hereafter referred to as IPA, an audit committee should also promote the integrity and effectiveness of audit activities. An audit committee as a mediator between the external audit and the organisation ensures that the audit results that are recommended in the form of corrective actions are implemented (Institute of internal Auditors, 2011:20), hereafter referred as IIA.

The establishment of audit committees in the local sphere of government came with the reform of the budget and financial activities in local government. The objective of the reform aimed at improving the financial affairs of the local government, as well as strengthening good governance and accountability (National Treasury, 2004:1).

Therefore, the formation of audit committees in the local sphere of government serves as mechanism to promote much-needed financial accountability.

In recent times, the need for an effective audit committee within the local sphere of government has become even more important, mainly in order to assist management to be more focused on how to use their resources optimally. According to Deloitte (2010:20), the current economic climate has resulted in an increasing number of businesses experiencing financial problems, which have a ripple effect on local government revenue. The budget shortfalls and the struggle to sustain service delivery with fewer resources require local government to diligently monitor expenditure. This ensures that effective revenue collection policies are in place and that such revenue is optimally allocated to appropriate programmes. According to the AICPA (2011a:11), the current global economic situation dictates a high degree of accountability, and there should be no provision made for any inefficiencies or wastage.

In this chapter, attention will be given to the understanding of what an audit committee is. It will also provide an explanation of the oversight role of an audit committee within the local sphere of government. The requirements for establishment of an audit committee, its authority and terms of reference, as well as its purpose and functions, will also be discussed. This chapter will also examine the principles underlying the audit framework in relation to its oversight role and the prescribed best practices to render the audit committee effective. Furthermore, this chapter will provide an outline of the legislative framework relevant to audit committees in the local sphere of government, in order to contextualise the phenomenon under investigation.

It should be mentioned that the audit function within the local sphere of government is a comprehensive field of study consisting of numerous activities, but the researcher selected only the most important literature and legislation to include in this chapter. The reader should therefore take note of the fact that this is a mini-dissertation with limited scope, and it is therefore impossible to cover the research topic in any great depth here.

2.2 AN AUDIT COMMITTEE AS A PHENOMENON

Audit committees originated in the private sector and were initially introduced in large companies. These committees were first introduced in 1872, with the first audit committee being established by the Great Western Railway in the United Kingdom (Marx, 2009c: 13, as cited in Brewer, 2011:11). The concept was adopted by other companies in later years due to their concern about the credibility of financial reporting. Audit committees were established as subcommittees of the board of directors, and as a result of this structural arrangement, they became accountable to the board (Al-Lehaidan, 2006:37).

Audit committees in local government during the new dispensation in South Africa were, as mentioned in Chapter one, formalised through the promulgation of the Municipal Finance Management Act of 2003. As part of the requirement for good governance and sound financial management, the MFMA requires municipalities to implement appropriate financial management systems and related internal control measures. An audit committee is one such measure to strengthen financial management and ensure proper management of public resources (National Treasury, 2004:63).

An audit committee in government institutions (including local sphere of government) is defined as an independent governance structure whose function is primarily to provide an oversight role in internal financial control activities, including the review of financial statements (National Treasury, 2009:12). An audit committee in the local sphere of government also serves as an advisory body to a municipal council. The roles and responsibilities of an audit committee and its functionaries are set out in an audit committee charter (MFMA, 2003:154).

2.2.1 Best practices for audit committees to promote effectiveness

The concept of audit committees has, inter alia, to do with a properly constituted body or entity, including independent members who, as a collective, have sufficient knowledge and relevant experience in auditing, finance, risk and internal controls, which will assist the entity to function effectively (IIA, 2006:21). In recent years, there has been a review

of regulations governing the affairs of audit committees, with a view to reinforcing their effectiveness and implementing best practices regarding audit activities (Braiotta, 2004: xv). This initiative was supported by auditing and accounting professional agencies, which developed a code of best practices to promote the effectiveness of audit committees (Marx, 2008:11).

However, the Association of Government Accountants (2008:5), hereafter referred to as AGA, stated in their recommendations on best practices, that not all audit practices are applicable or useful to all audit committees. It is therefore incumbent upon the organisation to evaluate the potential role of the audit committee in its environment and select those practices that are applicable to rendering effective audit services. The Westonaria Local Municipality regarded a code of best practices as an important mechanism to administer and guide its audit committee effectively. In this regard, the IIA, in their guide on the Role of Auditing in Public Sector Governance (IIA, 2006:21), cited the following as best practices with regard to the establishment of an effective audit committee:

- To establish the audit function within an organisational entity and furnish it with adequate delegated authority, as prescribed by legislation;
- To ensure that the chairperson of the audit committee is not the same individual whom the head of the internal audit reports to administratively;
- To assess the extent of effectiveness of the organisation's audit function regularly to determine if best practices are in place and to address any problems;
- To provide an oversight role for the internal and external audit functions, and assess and approve internal audit plans;
- To secure the appointment of quality internal and external auditors or to terminate the services of those auditors who do not perform as they should;
- To ensure that financial reporting and accounting standards are of high quality in the organisation;
- To have a direct link to the municipal council and to provide regular reporting to the council, but at the same time ensures the independence of the audit committee.

In his study, Al- Lehaiden (2006:69) ascertained that best practices should be developed together with the statutory laws of a country, which will then serve as standards and guidelines for the audit committee's operating framework. The influence of statutory laws on the audit function will be elaborated on later in this chapter. The same analogy is applicable to local government (IIA, 2006.20).

Keeping the knowledge of what an audit committee represents in mind, it is important to determine the place of an audit committee within the local sphere of government.

2.3 AUDIT COMMITTEES WITHIN THE LOCAL SPHERE OF GOVERNMENT

An audit committee is an essential component of good governance within the local sphere of government, due to its independence from the management and council. The need for the establishment of an audit committee in the local sphere of government arose with the introduction of financial management reforms by the South African government (National Treasury, 2004:1). The Municipal Finance Management Act of 2003 (MFMA), which came into effect in 2004, identifies an audit committee as part of the governance structure in local government. The Act is in response to the Constitution (1996), which strives to entrench transparency in the budgeting and financial management of all three spheres of government. The Act is also aligned with the principles of municipal finance reform which are outlined in the White Paper on Local Government of 1998. An audit committee in the local sphere of government also provides mechanisms through which an independent oversight can be factored into the governance process, in order to deal specifically with the challenges posed by the emerging emphasis on accountability.

Figure 2.1 below illustrates the elements of an audit committee's oversights, which are constituted by the oversight responsibilities and reporting relationship with the Board of Directors. The elements, as indicated in Figure 2.1, are also relevant to audit committees in local government, except for the fact that the audit committee in local government reports to the Municipal Council instead of a Board of Directors.

Figure 2.1 Elements of Audit Committee Oversight



Source: (Adapted from KPMG, 2003c:5, as quoted by Ferreira, 2007:62)

Figure 2.1 above shows a pyramid containing the elements of an audit committee's oversight function and its reporting relationship with the Board of Directors, as well as emphasising the need for continuous improvement in the performance of its function.

2.3.1 Composition and structure of the audit committee

Section 165 of the MFMA states that each local government must establish an internal audit functions as well as an audit committee. An audit committee must consist of at least three persons with appropriate audit experience and the majority of the audit committee members should be independent of local government, and preferably not be in the employment of the public service. The Act prohibits councillors from being appointed as members of an audit committee. The size of the committee is influenced by the nature and complexity of the operations of the local government, as well as the extent of the responsibilities as contained in the charter (National Treasury, 2012:3). An odd number is recommended in order to prevent a tie-vote when resolutions are to be made. One of the audit committee members must be appointed as a chairperson. The

role of the chairperson is critical in ensuring the overall effectiveness of audit committees, as well as the efficient planning and conducting of meetings. The person should also exhibit strong leadership and governance skills and be able to maintain good working relationships with other members, management, internal audit and external auditors (Deloitte, 2012a:3).

The members of the audit committee should come from a diverse background and their occupational experience should be as extensive as possible, in order to make the audit committee as effective as possible (Deloitte, 2012a:2). The appointed members, as a collective, should have experience in important areas that are relevant to an audit committee's functions, such as a financial reporting framework and related accounting practices, auditing, risk management, as well as an understanding of local government and its legislative requirements. The Internal Audit Framework developed by the National Treasury (2009:17) provides further guidelines on qualities that audit committee members should possess, which are listed below:

- The ability to carry out audit committee responsibilities in line with the strategic objectives of the overall corporate governance of the organisation;
- The ability to exercise an independent work ethos and to be proactively involved in issues which require the attention of management;
- The ability to interrogate management and evaluate the responses, and be able to probe for information to solicit conclusive answers;
- The ability to demonstrate professional and ethical behaviour, as well as commitment of time and effort; and
- The ability to engage with management in a fruitful manner, in order to achieve meaningful outcomes.

In terms of the MFMA, the audit committee members are appointed by council and the appointment period should be for at least two years. The guidelines provided by the National Treasury (2009:21) also indicate that the appointment tenure of office of the individual audit members should not be for more than two consecutive terms or exceed a period of six years. The guidelines also propose the rotation of members for purposes of maintaining their independence. In practice, there are instances where the period of appointment is aligned with the political office tenure or the municipal elections cycle.

The audit committee members are required to enter into a contract with the municipality which, inter alia, secures the fluent flow of audit activities.

2.3.2 Terms of reference of an audit committee

Terms of reference are used to describe the purpose, roles and structures of, among other things, committees. They are guidelines for the way in which a committee must function (VAADA Comorbidity, 2009). The primary role of an audit committee is to provide advice and assistance to the council and the management of a local government in relation to the following functional areas (National, 2004:1):

- Effective management and control of financial risks;
- Reliability of financial management and reporting;
- Compliance with policies, laws and regulations; and
- Maintenance of effective and efficient internal controls.

An audit committee must ensure that the local government has put in place effective systems that complement service delivery, safeguard municipal assets and ensure the proper maintenance of financial records. It also has to consider the financial affairs of the council and should provide oversight with regard to the internal audit function, liaise with the external auditors with regard to the annual audit of the financial statements, and ensure that the external auditors' recommendations are followed up and implemented by management. An audit committee may investigate any matters which are within the purview of their scope, and that may be referred to them by the council or municipal manager (National Treasury, 2004:1) Section 166(2) (d) of the MFMA makes provision for an audit committee to also be assigned legitimate functions outside their scope of work, which may be prescribed by council.

An audit committee can also serve as the performance management committee in cases where performance audit committees have not been established. Section 14(2)(c) of the Local Government Municipal Planning and Performance Management Regulations of 2001 states that local government may utilise any audit committee established in terms of applicable legislation as a performance audit committee.

2.3.3 Authority and powers of an audit committee

According to Section 166(2) of the MFMA, an audit committee is an advisory body to council and management, with no executive powers or authority to implement actions in areas over which council and management has jurisdiction. Importantly, it has to maintain its independence from council and management, in order to secure objectivity, which is an important feature of audit committees. The committee's delegated authority is limited to the scope of its terms of reference, as enlisted in the audit committee's charter (Spencer Picket, 2005:37). It is, however, imperative for the independence of the audit committee to be entrenched in all the areas provided in the audit committee charter (Marx, 2008:15).

The abovementioned audit committee charter outlines the mandate of the audit committee (and the audit function) and serves as the statement of purpose, authority and responsibility for the audit committee. The charter must be in writing and should address the following (National Treasury, 2012:3):

- The standards with which the audit committee should comply;
- The position of the audit committee in the local government;
- A description of assurance and the nature of the consulting services delivered by the audit committee;
- The appointment and dismissal of the chief audit executive; and
- The procedures for access to information, property and personnel.

The charter must be approved by the audit committee and accepted by the municipal manager. The committee can only make recommendations regarding their responsible audit areas and these recommendations must be implemented by the management of the local government (National Treasury, 2012:3).

2.3.4 Organisational requirements

An audit committee, in the execution of its responsibilities, is required to demonstrate leadership and the ability to promote effective working relationships with external and internal auditors, management and council (Umjindi Local Municipality, 2009:6). An audit committee, as well as its members, is required to have a thorough understanding

of their role, legal responsibilities and limitations, and be willing to learn about matters relating to an audit committee's functions through the attendance of courses or seminars (Marx, 2008:15). Most importantly, the members must dedicate sufficient time to performing their function, in order to maintain their effectiveness as a committee (National Treasury, 2009:23).

The audit committee members are required to maintain confidentiality in respect of information that is confidential in nature and to which they may be privy in the performance of their role, and should only disclose such information if required for the execution of their functions (Umjindi Local Municipality, 2009:7).

2.3.5 Reporting requirements

An audit committee reports, as mentioned earlier, directly to the Mayor and Executive Committee of the council. Written reports are supposed to be submitted to council for each meeting of the audit committee and should include an explanation of specific recommendations and the main expected outcomes. The chairperson of an audit committee is required to submit an annual report to council which describes the audit committee's activities for the year and the recommendations which were made (National Treasury, 2009:24).

An audit committee is required to provide comments in the annual report of the council of the local government on the effectiveness of internal control activities during the previous financial year. The following aspects should, inter alia, be included in the report:

- Any risk areas that have been identified in the functioning of the local government;
- The extent to which the local government complies with all relevant legislation and regulations;
- The results of significant investigations undertaken by the audit committee;
- The quality and efficiency of management activities in terms of the guidelines set out in the MFMA and the Division of Revenue Act (DoRA);
- The evaluation of the financial statements of the local municipality; and

- Information about the number of meetings held by the audit committee, as well as the attendance statistics of the members of the committee (National Treasury, 2009:24).

The audit committee is therefore an instrument to report immediately to the Executive Mayor any material findings or concerns discovered in the activities of the local municipality. A copy of the report must also be presented to the Municipal Manager (National Treasury, 2009:24).

2.3.6 Performance measurement and evaluation

The key performance areas of an audit committee are enshrined in an audit committee charter as part of the terms of reference. These include the provision of assurance with regard to timely financial reporting, effective internal control and risk management, compliance with legislative requirements, as well as follow-ups on the implementation of the auditor-general's recommendations (Umjindi Local Municipality, 2009:7). The assessment of the performance of an audit committee should be done periodically, and this includes the self-assessment of members, as well as assessment by council. The self-assessment process is considered to be one of the steps that enhance an audit committee's performance. An audit committee can assess individuals or all the members of an audit committee collectively (Deloitte, 2012b: 7).

2.4 THE PURPOSE AND FUNCTIONS OF AUDIT COMMITTEES

Local government has the responsibility to account for the public resources that are entrusted to them. An audit committee is a critical oversight mechanism in the process of accounting. It is also an imperative oversight mechanism during times of financial uncertainty, when the need for closer monitoring and scrutiny of financial performance is evident. More care should then be taken in ensuring that the committee is appropriately constituted and that committee members understand their roles and responsibilities, as well as the expectations of management regarding the scope of their function (National Treasury, 2012:8). In essence, an appropriately established and effective audit committee can assist the council to fulfil its governance duties and also provide

independent advice on financial accounting, reporting and controls (George, 2005: 43, as cited by Van Der Nest, 2006:178).

2.4.1 Purpose of an audit committee

The purpose of an audit committee is to function as a critical oversight mechanism in the process of accounting. The resultant increased focus on and elevated demand for audit committees have been stimulated by increasing public pressure for greater corporate accountability (Al-Lehaiden, 2006:10). In addressing key governance challenges, an audit committee has emerged as the main pillar that can positively contribute towards restoring integrity in local government accountability processes (Braiotta, 2004:xvi). Section 166(20) (a) of MFMA describes an audit committee as an independent advisory body to the municipal council and management, with the purpose of providing advice on local government matters and assisting the local government to perform efficiently. This is attested to by Marx (2008:1), when he declares that an audit committee can provide the acclaimed benefits only if it is appropriately constituted and its role is explicitly understood by all parties concerned.

2.4.2 Principles for establishing an ethical code for public sector organisations

An audit committee framework, which serves as a guide for the audit committee's work, comprises a combination of statutes, standards and guidelines, rules for listing, as well as professional bodies of codes of best practice (Al-Lehaiden, 2006:6). The foundation upon which the MFMA was promulgated was to entrench sound financial governance in local government. The Act also provides a framework for good governance and accountability, which was previously found to be ineffective and as a result threatened financial sustainability in local government (National Treasury, 2004:5). In the same vein, these principles are also entrenched in the audit committee's code of best practice.

In order for an audit committee to be effective, it needs to adopt appropriate procedures, work well as a team, demonstrate high levels of ethical behaviour and maintain good relationships with the organisation (Ferreira, 2007:36). The seven Nolan principles are recommended for establishing an ethical code for public sector organisations (Spencer

Pickett, 2005:15). The principles for good governance are the same principles highlighted in the King II Report, which forms the basis of good governance (SAICA, 2002):

- **Independence** which is the core principle underpinning the oversight responsibility. It basically requires an audit committee to ensure and demonstrate freedom from interference in decision making;
- **Openness and transparency** which is built on the free flow of information and related processes, and the need for such information to be accessible and understood by all people concerned with it. An audit committee needs to adopt an open communication policy and effectively consult with organisational members on significant changes to the organisation's services and policies;
- **Integrity** which represents straightforward dealings and completeness, and is based on honesty, selflessness and objectivity. It requires a high standard of probity and propriety by an audit committee in carrying out its responsibilities. The audit committee needs to uphold high ethical standards and to safeguard and promote the organisation's reputation;
- **Accountability**: As the oversight body, an audit committee needs to ensure that the organisation complies with all the applicable legal and regulatory frameworks and maintains good internal controls. An audit committee needs to review and identify the main risks to which the organisation is exposed and ensure that the organisation develops mitigation strategies;
- **Responsibility** which is essential in terms of the role of an audit committee. An effective audit committee provides good governance and leadership by understanding its role as collective and as individual members in relation to the audit standards and guidelines, statutes, and delegated powers and authority; and
- **Fairness** which represents equity and impartiality. An audit committee needs to be unbiased and exercise no prejudice or disfavour in its dealings with members of staff, management or the council.

These principles also have a wider role to play, which is the quality of consideration of the local government for the wider community and mindfulness of service requirements,

by ensuring that policies that are adopted are compatible with the environmental and human rights of such a community.

2.4.3 Attributes and characteristics of audit committees

There are several requirements and considerations that apply if a local government wishes to establish and maintain an effective audit committee (Fenwick & West LLP, 2002:4). This was attested to by the Deputy Minister of Finance, the honourable Member of Parliament, Nhlanhla Nene, in his address at the Annual Audit Committee Conference in October 2011. He referred to the credit crunch, which led to the global economic meltdown and had a devastating effect on good governance, and by implication audit functions. It is therefore essential for an audit committee and concerned parties to adhere to attributes such as the virtues of honesty, openness and meaningful dialogue, as well as effective communication (Marx, 2008:15).

Crosslin and Associates (2010:4) prescribe attributes which are specifically required to render an established audit committee of an organisation effective. In their guide for establishing and operating an effective audit committee, they identified eight attributes that are needed for an audit committee to function effectively, which are as follows:

- An audit committee needs to strive to have the right attitude at the top. It is incumbent upon an audit committee to ensure that the ethical and compliance requirements are well understood and communicated throughout the organisation. An audit committee must ensure accurate reporting and deal timeously with any misreporting if it occurs;
- The calibre of an audit committee must be such that members are able to ask probing questions about the organisation's affairs, and that it encourages the flow of information and reporting of bad news;
- An audit committee should encourage cooperation of employees with internal and external auditors by being truthful and upfront when providing the required information;
- The main advantage of the audit committee lies in its independence and expertise. The audit committee is required to be independent of management, in order to be able to exercise objectivity and guard against any attempts by management to compromise financial reporting;

- Audit committee members as a collective must possess a balanced mix of skills and expertise. The prescribed norm is that audit committees should at least consist of three members, one of which has accounting or financial management expertise. It is also required of the members to have an understanding of their organisation's operations, systems of internal control and the business risk and risk management processes which have been put in place;
- The chairperson of the audit committee must be an assertive person who can initiate discussions with management and the external auditors. He must also have a probing and analytical mind, and be able to identify issues in advance;
- Audit committee members are required to commit time and effort to carrying out their oversight role. This takes into consideration the fact that audit committee members are not appointed on a full-time basis. However, in order for audit committee members to be diligent and probing, this requires a significant amount of time and commitment. It is therefore incumbent upon an audit committee to ensure that it sets aside sufficient time to hold meetings to discuss scheduled matters, such as the quarterly financial reports and annual audit;
- It is a requirement for an audit committee to have an approved charter, which must be regularly reviewed. The charter includes the scope of an audit committee's responsibilities and delegated powers, as well as how it will execute those responsibilities. The scope of duties of an audit committee must be tailored to the organisation's circumstances, as it may differ considerably from one organisation to the other;
- An audit committee needs to plan the year's agenda. The agenda of audit committee meetings is dictated by the scope of duties and complexity of the organisation's operations. The recommended annual number of meetings that are to be held is four, but additional meetings may be scheduled to discuss any matters that may arise which need the auditor's attention;
- An audit committee's work is required to be presented in writing and be appropriately documented. An audit committee is required to keep records of minutes of their meetings and provide reports as required by legislation

and the charter. It is advisable to discuss sensitive issues with the board or council before they are documented; and

- Audit committee members must receive orientation and education when they assume their responsibilities. It is prudent for the audit committee members to receive ongoing education about the activities and operations of the organisation, as well as professional development.

The modern audit committee is also faced with challenges in terms of taking on more responsibilities in their oversight role. The King III report provides for the audit committee to also have an oversight responsibility with regard to sustainability reporting in the annual report (Marx, 2009a:9). As a result, the committee is expected to possess knowledge on sustainability reporting. An audit committee for local government is equally challenged, as the spectrum of stakeholders seeking assurance for accountability has widened over time. Local government should be accountable to rate-payers associations, labour representatives and national and provincial government, as well as parliament and legislators, as to how it runs its affairs (Ferreira, 2007:12).

2.4.4 Functions of an audit committee

The purpose of establishing audit committees is to increase confidence in the integrity of an organisation's processes and procedures in relation to internal controls and financial reporting. Audit committees in the private sector are established as a specialised subcommittee to be responsible for the oversight of the corporation's financial reporting processes (Spencer Pickett, 2005:38). In local government, the establishment of an audit committee provides a much-needed focus on accountability and fraud prevention, as well as ensuring the integrity of financial reporting. The audit committee must also ensure that the local government is in compliance with the laws and regulations regarding the use of public funds (AICPA, 2011a:2).

2.4.4.1 Oversight of financial reporting

An audit committee should, on a quarterly basis, review the financial reports of the organisation and regularly interact with the internal audit committee (National Treasury, 2009:16) and financial management team, in order to ascertain if they are discharging

their responsibilities appropriately. An audit committee is also responsible for recommending changes deemed necessary to the accounting principles and practices recommended by the internal and external auditors (National Treasury, 2009:17), as well as to assess their appropriateness to the organisation's financial processes (Braiotta, 1994:205). An audit committee should be able to embark on an investigation in instances where there are significant problems with accounting practices, or commission external consultants if necessary.

An audit committee has to provide an assurance that management is fulfilling its responsibilities regarding the preparation of annual financial statements and monitor the integrity and outcomes of reviews of financial performance (Braiotta, 1994:24, 204). The audit committee, in its review of the financial statements, needs to achieve the following objectives (National Treasury, 2012:10):

- To review significant accounting policies and disclosures to determine whether or not they are still relevant;
- To give assurance that the financial system which provides the figures for the financial statements is functioning optimally;
- To ensure that the quality of financial statements is of a high standard;
- To review the financial statements before the reporting phase;
- To review the complex accounting estimates and critical assumptions disclosed in the financial statements;
- To identify unusual or infrequent transactions that are outside the normal cause of business; and
- To manage and solve any dispute regarding financial information between management and the external auditors.

An audit committee is required to pay particular attention to the management and use of 'going concern' assumptions in the financial statements, as well as the liquidity risk (Braiotta, 2004:124).

2.4.4.2 Internal controls and risk management

The key responsibility of an audit committee is to oversee the internal controls and risk management (AICPA, 2011b:1). The main components of internal controls and risk management include the review and evaluation of the performance of internal and external auditors, inquiries by management and auditors about significant risks, and the steps taken to reduce such risks (National Treasury, 2009:14).

In the review of internal controls and risk management, an audit committee is required to provide advice on the scope, adequacy, efficiency and effectiveness of the local government's systems related to internal control measures (National Treasury, 2009:14), and as such, the audit committee must ensure that the internal audit annual plan encapsulates risks and controls strategies of the local government (Braiotta, 2004:249). In terms of internal financial controls, which may have an impact on financial loss, fraud or identified material errors, King III requires these to be reported to the board and stakeholders by the audit committee. King III also requires an audit committee to further conclude and report annually on the effectiveness of the internal financial controls (PricewaterhouseCoopers, 2009:3), hereafter referred to as PwC. An audit committee is also responsible for ensuring that the internal audit is well resourced in terms of skilled staff and a budget for effective functioning.

Management is required not only to provide an audit committee with reports on the effectiveness of risk management, but also on the control strategies they have developed (Van der Nest, 2008:176). An audit committee should consider whether or not these strategies are adequate and operating properly (National Treasury, 2009:14). In doing their assessment, it is important for the audit committee to have concrete knowledge of the control strategies of the organisation, so that they are able to identify the corresponding risks and prioritise the most relevant ones (Enhanced Disclosure, 2011:9). The audit committees, in their reports on risk management oversight, are required to disclose the following (National Treasury, 2009:24):

- The steps taken to ensure that the internal controls and risk management system are operating properly;
- The processes they have applied directly or through the relevant committee in reviewing the system; and

- The mitigating actions they have performed to remedy weaknesses identified from the review.

Inherently, risks can result from any activities, prevailing conditions or circumstances that could adversely affect the local government and prevent it from achieving its goals or objectives (AICPA, 2009:1). Therefore, the audit committee, in exercising its oversight role, must address all types of risks. The scope for assessment of risks should include the financial, operational and behavioural risks identified in the organisation (Enhanced Disclosure, 2011:9).

The accounting officers are required by Section 3.2.1 of the Treasury Regulation to ensure that a risk assessment is regularly conducted, in order to identify the emerging risks, and to ensure that risk management strategies, which include the fraud prevention plan, are used to direct the internal audit efforts in risk assessment. Section 165(2) (a) of the MFMA provides for the internal audit of municipalities to prepare a risk- based audit plan and internal audit programme for each financial year on how to address risk-related matters.

2.4.4.3 Compliance and the audit committee

Governance is about the management of the organisation, including taking environmental factors into account, as well as the strategies that have been adopted in this regard. Governance issues are therefore supposed to be integrated into the policy formulation processes of the local government, as well as the policy implementation activities (AICPA, 2011a:3). Governance includes ethical values and accountability practices. The non-compliance with governance issues can be detrimental to local government's credibility and reputation (Spencer Pickett, 2005:15). The internal and external auditors are required to report on these issues, in order to apprise the audit committee of the local government's compliance. The audit committee's responsibilities with regard to compliance issues are as follows (National Treasury, 2012:6):

- To ensure that financial reports and other financial information are distributed to relevant stakeholders, and that their dissemination is in compliance with the regulatory and legal framework of the country;

- To discuss litigation and regulatory compliance risks related to the local government's code of ethics with management;
- To review incidents of fraud, illegal acts, conflicts of interest and related parties' transactions;
- To establish procedures to be followed with regard to confidential or anonymous reporting by employees;
- To ensure that management implements the recommendations of the external auditors; and
- To obtain regular reports from management regarding compliance matters.

As part of compliance issues, an audit committee is also required to assess the adequacy and appropriateness of control strategies, which addresses areas such as risk management, code of ethics, anti- fraud and value for money arrangements, and anti-corruption, including whistle-blowing guidelines (CIPFA, 2005:16)

2.4.4.4 Oversight of the internal audit function

Section 165 of the MFMA provides for a local government to establish an internal audit function to advise the municipal manager and council on internal audit strategies (Spencer Pickett, 2005:39). Such an audit committee is functionally responsible for the work of the internal audit activities of the local government, and is therefore required to monitor and review the effectiveness of the function and to ensure its independence status. The audit committee must also report on how it is going to implement its internal auditing plan. The arrangement in terms of the reporting lines is critical, in order to allow the internal audit committee to remain independent and objective, and to ensure that weaknesses are acted upon by management (PwC, 2009:3).

The King III report outlines the responsibilities of internal auditing in relation to the internal financial controls, and these responsibilities include a formal, documented review of internal financial controls and to report on their effectiveness to the audit committee. The role of an audit committee in relation to the oversight function involves the following (National Treasury, 2009:15):

- To approve the overall strategy of the internal audit oversight function and to determine if it is in line with the overall strategic direction of the organisation;
- To approve the annual internal auditing plan and assess its scope for adequacy and appropriateness in relation to the identified key risk areas;
- To assess the internal audit unit's capacity and evaluate resources such as the budget, staffing, and the availability of the skills needed to provide an internal audit function;
- To provide inputs and opinions with regard to the appointment, replacement or dismissal of the Chief Audit Executive (CAE);
- To monitor progress against the annual internal auditing plan by reviewing significant findings and making recommendations to management ;
- To ensure the implementation of internal auditing recommendations by management; and
- To meet privately with the CAE to discuss any issues that the audit committee perceives to be important.

As an independent assurance agent, the internal auditing purpose is to enhance the oversight function of the local government by evaluating its effectiveness (QFinance, 2013a:2).

2.4.4.5 Oversight of the external audit function

The role of an audit committee in terms of its oversight of the external audit is to provide assurance with regard to the independence of the external auditors, which means that no conflicts of interest should exist which may have an impact on the external auditor's expression of opinion regarding financial statements (Braiotta, 2004:83). It is also incumbent upon the audit committee to evaluate the scope of the external audit, as well as the audit processes, with a view to ensuring that the audit results are in line with the standards set by the National Treasury (National Treasury, 2012:6).

PricewaterhouseCoopers (PwC) and the Institute of Internal Auditors Research Foundation (IIARF), formulated best practices with regard to the oversight role of an audit committee in relation to external auditors (PwC & IIARF, 2011:61):

- An audit committee needs to have an open and trusting relationship with the external auditors;
- An audit committee must preapprove all the audit services to be provided by the external auditors;
- An audit committee is responsible for recommending to the board or council the appointment, reappointment and removal of the external auditors, and for approving the remuneration fees as well as terms of engagement; and
- An audit committee is required to meet at least three times a year with the external auditors, in order to initially discuss the scope of the external audit before the commencement of the audit work, and then during the audit engagement, and finally, when the audit work is concluded, in order to discuss the audit findings.

The external auditors are also required to report to the audit committee on matters arising from the audit work, such as the external auditors' view on management's selection of financial reporting policies, any accounting adjustments arising from their audit work, significant disagreements with management pertaining to financial information provided, as well as fraud-related cases and illegal acts, and the extent to which these matters are impacting on the financial reporting process of local government ((PwC & IIARF, 2011:64).

To maintain an effective relationship with the external auditors, the audit committee is encouraged to have open, ongoing communication with them (PwC & IIARF, 2011:61). In their interaction with the external auditors, the audit committee is required to identify areas of concern they would like the external auditors to focus on and include in the scope of the audit work, as well as to seek further explanations on audit findings for a better understanding of the effect of the findings on financial reporting. The audit committee may also enquire about the concerns of the external auditors with regard to the local government's financial performance and reporting (National Treasury, 2012:7).

2.4.4.6 Performance Audit Committee

Section 14(2) (c) of the Local Government Municipal Planning and Performance Management Regulations makes provision for local government to establish a performance audit committee. The following are the functions of such a performance audit committee:

- To review the performance management activities of a local government and report on the effectiveness of the activities;
- To determine if the performance management system related to a local government reflects the purpose and objectives of the local government;
- To review the reliability of the performance measures; and
- To determine whether or not the performance reporting and information use appropriate targets and benchmarking.

The Local Government Municipal Planning and Performance Management Regulations of 2006, in section 27(4) (d), make provision for the chairperson of the audit committee to be a panel member of the committee evaluating the annual performance of the municipal manager and managers directly accountable to the municipal manager.

Against this background, attention will now be given to the legislative framework which governs the establishment and functioning of an audit committee at local government level.

2.5 LEGISLATIVE FRAMEWORK FOR AUDIT COMMITTEES AT LOCAL GOVERNMENT LEVEL

The transformation of local government in South Africa was brought about by the White Paper on Transformation of Local Government. The transformation introduced a host of other legislation on accountability and governance in local government. The establishment of an audit committee in government is one of the accountability instruments provided for by legislation (Van der Nest, 2006: 62). The Municipal Finance Management Act of 2003, in particular, pays attention to the functioning of audit committees. The Act is just one of the legislations which were promulgated post 1994, with a view to transforming local government systems including auditing, and strengthening their governance practices.

The discussion on legislation starts with the Constitution of 1996, which represents the supreme law in South Africa. All legislation finds its foundation in the Constitution. The legislation discussed after this has, in one way or the other, an influence on audit committees, either direct or indirect.

2.5.1 The Constitution of South Africa (RSA)

The Constitution of the Republic South Africa (1996), hereafter referred to as the Constitution, is the supreme law of the country, and its Chapter 1 emphasises its supremacy over all actions and laws of the country. The Constitution's founding principles are based on good governance and accountability. Section 1(d) of the Constitution recognises accountability, responsiveness and openness as the critical governance principles which are to be restored through the establishment of a democratic system of government. It further provides, in section 41(c), for all organs of state to “provide effective, accountable and coherent government for the Republic as a whole”.

The Constitution, in sections 43(c) and 151(2), establishes Legislative Authorities in the three spheres of government, including the establishment of municipal councils. The powers and functions of the municipal councils as an oversight governance structure are provided for in Chapter 7, section 156 (1). Chapter 7 of the Constitution sets out the framework for local government and provides for the establishment of the municipalities in the territory of South Africa. The chapter also sets out the powers and functions of the municipalities listed in schedules 4 and 5 of the Constitution.

As part of ensuring the suitability and effectiveness of local government, section 44 (iii) of the Constitution provides for both national and provincial government to support local government, by ensuring the effectiveness of local government in the performance of their functions, as listed in schedules 4 and 5, and to regulate the exercising of their powers, as provided for in section 156. In Section 139 of the Constitution, a provision has been made for provinces to intervene in local government in instances where municipalities cannot or do not fulfil executive obligations in terms of the Constitution or any related legislation. It also makes provision for processes that are to be followed by

the provincial executive when the intervention is done, and specifies how it must be completed. A provision is also made for the national government to be involved. In instances where national government has to intervene, the Constitution requires that it notifies the National Council of Provinces (NCPO).

The Constitution serves as a framework from which all the laws and legislation of the country is derived. In section 195 (1), it further promotes the basic values and principles governing public administration, which include, among others, a high standard of professional ethics, economic and effective use of resources, accountability and transparency in the public service. The principles are applicable to administration in every sphere of government, organs of state, as well as the public service. Although an audit committee is not directly mentioned in the Constitution, there are explicit and implicit requirements for good governance in local government entrenched in the Constitution. In the same vein, the founding principles of an audit committee as an oversight structure are therefore also enshrined by the Constitution.

An audit committee's key responsibility is to ensure that local government upholds the principle of good governance in the execution of its functions and is accountable to the local communities that it serves. Chapter 13 of the Constitution deals with overall public finance. It provides for the equitable distribution of national revenue to the provinces and municipalities. Section 215 (1) states that "national, provincial and municipalities budgets and budgetary processes must promote transparency, accountability and effective financial management of the economy, debt in the Public Sector". Section 216 established the National Treasury to oversee the budget process. One of the key oversight functions of an audit committee in local government is to safeguard integrity in financial reporting and compliance with the laws and regulations with regard to the use of public funds, which then addresses the Constitution's requirements for accountability and implementation of sound financial management by local government (AICPA, 2011b:2).

2.5.2 Local Government Transition Act, 1993 (LGTA)

The Local Government Transition Act of 1993 is regarded as a very important piece of legislation, as it provides for the transformation of local government and for a clearly

defined process for transition. The Act mapped out the following three phases of transition for local government in South Africa (White Paper, 2008:5):

- The pre-interim phase, which prescribed the establishment of temporary councils by the local forum, and lasted from 1993-1995;
- The interim phase, which commenced with the elections and ended when new local government systems were designed and legislated, and lasted from 1995- 1999; and
- The final phase, which led to the elections in local government, and took place in 2000.

The final transition phase of local government resulted in the enactment of the current Local Government Structure Act of 1998 (LGSA). Section 10 of the Local Government Transition Act which deals with the categorisation of municipalities has also been incorporated into the Local Government Municipal Structures Act of 2003.

The relevance of the LGTA to audit committees in local government is that it laid the foundation for the transformation of local government post-1994 up to the current governance structure in local government. The Act also provides for the categorisation of municipalities and, in terms of section 166(6) (a) of the Local Government Municipal Act, the establishment of audit committees is dependent on how the municipalities are categorised. Furthermore, it provides the option for a single audit committee to be established for a district municipality and the local municipalities within its jurisdiction.

2.5.3 White Paper on Local Government, 1998

The White Paper on Local Government (1998) came into being as a result of policy debates, interactive consultation and research which took place on the envisioned local government system. The White Paper spelled out the framework and programme for the transformation of the current local government system. This is the framework that has culminated in the current local government structure and the supporting systems of administration and financial management. Section G of the White Paper on Local Government sets out a framework which aims to address the following:

- The root causes of the financial problems which confronted the municipalities then;
- The establishment of strategies to address the imbalances of the past, eradication of poverty, job opportunities and promotion of economic growth; and
- The establishment of enablers for the empowerment of municipalities, in order for them to fulfil their constitutional mandate.

It is noted that the financial problems which were identified at that time, which were primarily attributable to policy shortcomings and inadequacies in financial management and service delivery, are not the same as the challenges that local government is currently facing, as highlighted by the AGSA (2012:107) in his report on Local Government Audit Outcomes for 2010/11, in which he indicated that financial sustainability was still a challenge in local government. Although an audit committee is not mentioned in the White Paper, its establishment is as a result of the interventions proposed in the White Paper, which had brought about a change in the legislative landscape of local government, which will be discussed in the ensuing paragraphs.

2.5.4 Local Government Municipal Structure Act, 1998

The Local Government Municipal Structures Act of 1998 provides for the establishment of municipalities, which is in accordance with the requirements relating to categories and types of municipalities, as well as appropriate division of functions and powers between categories of municipalities. The Act also regulates the internal systems, structures and office bearers of municipalities, and provides for appropriate electoral systems, as well as matters related to the electoral processes.

Although the Act does not make any reference to the oversight role of an audit committee, its relevance lies in the mandate of local government, and the audit committee will have to ensure compliance with this mandate by local government. Sections 44 and 83 are more relevant in terms of the oversight function of an audit committee. Section 44 establishes the functions and powers of the executive committee, whereas section 83 provides for the functions and powers of the

municipalities. Both these sections are pivotal in terms of the oversight role of the audit committee, as they have bestowed the council with the authority that they are exercising in terms of the establishment of audit committees for their municipalities.

2.5.5 Local Government Municipal Systems Act, 2000

The Local Government Municipal Systems Act of 2000 makes provision for core principles, mechanisms and processes that are necessary to enable local government municipalities to contribute to the economic empowerment of local communities, by making access to services affordable. This Act also establishes a framework for processes of planning, performance management, local public administration and human resource development for local government.

Section 4 (3) of the Act provides that municipal councils, in exercising their executive authority, must respect the rights of citizens and other persons protected by the Bill of Rights. Section 5 of the Act provides for the rights of local communities in relation to services provided by local municipalities. The Act also cites responsibilities of the local communities in relation to their rights of access to services provided by local government.

The duties of the municipality's administration, which are provided in section 6 (2) of the Act, are governed by the democratic values and principles enshrined in the Constitution. In executing their administrative duties, the municipality is required by the Act to ensure that, among others, they facilitate a culture of public service and accountability among the municipality staff, and take measures to prevent corruption. The audit committee, in exercising its oversight role with regard to governance, would have to ensure that the local government is in compliance with the provisions of the Act.

The Act also provides for the local government to establish a performance management system, which is provided in sections 40, 41, 42 and 43. Section 44 of the Act makes provision for the municipality to establish the performance indicators and performance targets for the performance management system, and section 45 provides for such performance measures to be audited. Audit committees can serve as performance audit committees where necessary, in order to evaluate the relevance of the set targets

and performance indicators. This is supported by the Local Government Municipal Planning and Performance Management Regulations of 2001, in section 14(2) (c), where provision is made for municipalities to utilise an audit committee established in terms of the MFMA to also serve as a performance audit committee.

In section 46, the Act makes provision for the municipality to prepare an annual report for each financial year. The annual report includes the financial statements, which are required to be prepared in accordance with the standards of generally recognised accounting practices, in reference to section 89 of the Public Finance Management Act No. 1 of 1991, and should also comply with any other reporting requirements, as dictated by other applicable legislation. The role of an audit committee, as dictated by the Local Government Municipal Finance Act no 56 of 2003, is to review the said financial statements and to subsequently provide council with an assurance of the credibility and level of compliance of the said financial statements (Braiotta, 1994:24, 204).

2.5.6 Local Government Municipal Finance Management Act, 2003

The Local Government Municipal Finance Act of 2003 (MFMA) aims to provide a framework for the promotion of the sustainable financial management of local government and its related institutions. The main reason for the promulgation of the Act was to promote sound financial governance, by clarifying roles as well as the accountability of all parties concerned. The Act also gives effect to the principles of transparency, as provided by sections 215 and 216 of the Constitution. These sections advocate for the adoption of principles of transparency and accountability in financial management in all spheres of government. The Act forms part of the broader framework for local government reform initiatives, as outlined in the White Paper.

As highlighted above, the Act aims to provide a sound financial governance framework for local government, and deals with various aspects relating to financial management, which are mostly included in the audit committee's scope of work. Chapter 14 of the Act focuses on Treasury matters, which constitute the governance and compliance issues, and Section 165 of this chapter provides for the municipalities to establish an internal audit function to advise the municipal manager and audit committee on the

implementation of its internal audit plan. The Act gives the municipality the option to outsource the internal audit function. In the same chapter, the Act provides for the minister responsible for local government to make regulations or issue guidelines applicable to the provisions of the Act, and all the regulations or guidelines should be adopted by the respective municipal councils in order to be enforceable. Sections 171 and 172 in the same chapter focus on the financial misconduct of municipal officials and municipal entities. The Act outlines the activities which constitute financial misconduct, as well as the criminal offences that apply to each activity, and the municipal obligations in terms of how to deal with such cases.

Section 166 of Chapter 14 makes provision for the establishment of audit committees in local government. The purpose of the audit committee is to serve as an independent body to advise the executive council and municipal management on the following matters:

- Advice on the effectiveness of internal financial controls, risk management and the internal audit function;
- Advice on financial reporting and related accounting policies, as well as accounting estimates and assumptions;
- Advice on performance management and evaluation of the municipalities' performance;
- Advice on the effectiveness of governance and compliance with the MFMA, Division of Revenue Act (DoRA) and all other applicable legislation;
- Advice on the independence of the external audit, the audit coverage plan and related audit fees; and
- Advice on any other matter which may be referred to an audit committee by municipalities or their entities.

The Act also requires the audit committee to review the annual financial statements of the local government and to express its view with regard to the financial internal controls and its efficiency and effectiveness. An audit committee is required by the Act to advise the council on matters raised in the audit report by the AGSA, and it is also obliged to commission investigations on matters relating to the financial affairs of the municipality. The audit committee is required by the Act to liaise with the internal audit in the

execution of its functions, and the AGSA with regard to the auditing of the annual financial statements.

It is stipulated in the Act that the members of the audit committee of local government are appointed by the council, and that the committee should comprise five or three members with the appropriate experience, of whom the majority are not supposed to be employees of the municipality. One of the members of the audit committee should be appointed as a chairperson. Councillors are excluded from being appointed as members of the audit committee. It is required that at least four audit committee meetings should be held each year. However, the audit committee is encouraged to meet as often as required to perform its functions effectively.

Chapter 12 of the Act provides the framework for financial reporting and auditing, and gives details in its various sections regarding the statutory requirements for annual reporting, including the preparation of financial statements. Section 122 requires municipalities to prepare annual financial statements which fairly present the state of affairs of the municipality, the management of revenue and expenditure, its performance against budget, its financial position as at the end of the financial year, as well as all the other information required for disclosure. Section 126 requires the municipal manager to submit, within two months after the end of the financial year, a set of financial statements to the AGSA for auditing. In section 127, the executive mayor is required, within seven months after the end of the financial year, to table the annual report to council and to the legislature of the province. In section 131, the municipality is required by the Act to address the issues on audit findings raised by the AGSA. The chapter also makes provision for steps to be taken in cases of non-compliance of the municipality in relation to some of the provisions on annual financial reporting.

Chapter 13 is the most important part of the Act, as it highlights the resolutions on interventions in cases of local governments which are in financial distress. The chapter commences by providing details on how the municipality can avoid finding itself in financial distress, and also articulates the actions to be performed by the municipal manager in cases where the municipality is confronted with financial difficulties, among which is for the municipality to determine if the situation requires intervention in terms

of section 139 of the Constitution. In addressing financial crises, section 141 of the Act makes provision for the municipality to secure services for the preparation of a financial recovery plan. The financial recovery plan must be approved by the MEC for Local Government and the MEC for Finance, depending on the nature of the intervention solicited by the municipality. Section 150 of the Act gives the Minister the power to intervene on behalf of the MEC if he or she fails to adequately exercise the powers bestowed upon him or her for the intervention. The audit committee is implicitly required, as part of the oversight of the financial affairs of the municipality, to monitor the implementation of the financial recovery plan.

Unlike the PMFA, which provides for the National Treasury to issue Treasury Regulations for the implementation of some of the provisions of the said Act, section 168 of Chapter 14 of the MFMA assigns the National Treasury, in concurrence with the Minister responsible for local government, with the powers to issue regulations or guidelines applicable to municipalities. It further provides for the said regulations or guidelines not to become binding to the municipality, unless they have been adopted and approved by the respective municipality councils. The National Treasury has only issued guidelines in the form of MFMA Circulars in instances where the Act is making provision for such guidelines to be issued.

There were no MFMA Circulars issued prior to 2012 which deal specifically with the functions of the audit committee for local government. However, the National Treasury subsequently issued Circular No. 65 in November 2012, which provides guidance for municipalities and their entities on how to improve the effective functioning of the internal audit and audit committee. Circular No. 32, issued in 2006 to provide the councillors with guidance on the financial governance framework to be used when dealing with the annual reports, makes reference to an audit committee as an advisory body to the council on the matter at hand.

2.5.7 Public Finance Management Act, 1999 and Treasury Regulations

The Public Finance Management Act of 1999 (as amended by Act no. 59 of 1999) (PMFA), like the MFMA, was promulgated to give effect to sections 215 and 219 of the Constitution of RSA for the national and provincial government. However, the relevance

of this Act to the financial management of local government lies in the fact that Chapter 9 gives the National Treasury the authority to issue Treasury Regulations and instructions in response to the implementation of the provisions of the PMFA for national and provincial government departments. Although some of the regulations are specific to national and provincial departments, some of them have been adopted by municipalities in cases where such regulations or instructions have not been issued in terms of the MFMA.

Sections 75 (4) (d) and 77 of the PFMA require national and provincial departments and their institutions to establish audit committees. Section 3.1 of the Treasury Regulations gives effect to these provisions by articulating the audit committee framework. The National Treasury also issued a user manual guide to measure compliance with the PFMA. The guide includes the normative standards for the establishment of audit committees, and has also been adopted by local government in the establishment of audit committees.

The National Treasury also issues, on an annual basis, a Reporting Framework for government departments. Chapter 2 of the guide provides a framework for the report of the audit committee, which is in line with the requirements of the Treasury Regulations in terms of PFMA implementation. The reporting format has also been adopted by audit committees in local government.

In addition, the National Treasury issued an Internal Audit Framework (IAF) in 2003 for the public service, in line with section 76(4) (b) of the PFMA and its regulations, as well as section 168(1) (h) of the MFMA. The purpose of the Internal Audit Framework is to establish guidelines for the development and operation of the internal audit in the public service. The guidelines are also applicable to the audit committee, as one of the primary functions of an audit committee is to provide an oversight role in the functions of internal audit, risk management and governance. The framework is also aligned with the following professional guides and code of ethics:

- Institute of Internal Auditors (IIA) code of ethics. The Institute of Internal Audit South Africa (IIASA) is part of an international network which supports and helps develop the internal audit profession. The IIASA is affiliated to the

international network, which observes the code of ethics, as well as the International Standards for the Professional Practice of Internal Auditing;

- The International Standards for the Professional Practice of Internal Auditing (ISPPIA), which provides the framework for performing and promoting value- added internal auditing; and
- The Commission of Sponsoring Organisations (COSO) Framework, which has been established to promote common definitions and standards for internal controls and risk management, enterprise risk, internal audit and fraud deterrence.

2.5.8 Local Government Municipal Planning and Performance Management Regulations

The Local Government Municipal Planning and Performance Management Regulations of 2001 and 2006 respectively were established in terms of section 120 of the Local Governments Systems Act No 32 of 2000. The Local Government Municipal Planning and Performance Management Regulations of 2001 provide a framework for the development of the integrated planning of municipalities, as well as the establishment of performance management systems, whereas the Local Government Municipal Planning and Performance Management Regulations of 2006 provide a framework for the monitoring and improvement of the municipal manager's performance and that of managers who are directly accountable to the municipal manager.

Section 14(2)(c) of the Local Government Municipal Planning and Performance Management Regulations of 2001 states that a municipality may utilise any audit committee established in terms of other applicable legislation as the performance audit committee. In that instance, an audit of performance management must be included as part of the audit committee's functions and be approved by council. It is required of an audit committee to hold separate meetings to that of the ordinary audit committee at least twice in a financial year, with one special meeting which may be called by any of the members of the audit committee. The audit committee is required to provide a report on performance management to the council. The role of the audit committee in relation to performance management systems is as follows:

- To advise council on the functionality of the performance management system;
- To provide advice regarding the compliance of the system with the legislative framework;
- To evaluate the performance measures' reliability in terms of measuring performance on indicators;
- To review the quarterly performance reports submitted by management; and
- In reviewing the performance management system, the performance audit committee is required to focus on economy, efficiency, effectiveness and impact in relation to the set performance targets.

The Regulations further provide for the performance audit committee to communicate directly with the municipal manager, internal audit, as well as the external auditors. The committee is also allowed to have access to the records of the municipality and to investigate any matters it deems necessary for the performance of its duties and exercise of its powers.

Section 27(4) (d) of the Local Government Municipal Planning and Performance Management Regulations of 2006 provide for the chairperson of the audit committee to be part of the panel evaluating the annual performance of the municipal manager and managers directly accountable to the municipal manager.

2.6 CONCLUSION

The audit committee framework for local government, which is provided by the MFMA, is underpinned by principles of good governance and accountability, which are mandatory for the audit committee in the conduct of their oversight responsibilities. An observation has been made in this chapter that audit committees cannot only rely on the rules and regulations as a means to provide assurance on good governance and accountability. An emphasis was placed on best practices and the prerequisite attributes and qualities of the audit committee members to improve the effectiveness of an audit committee. The regulatory agencies and bodies in the accountancy and audit

professions are continually evaluating financial reporting and patterns of governance in corporations, and use the trends to benchmark the audit committee's effectiveness. It is through this exercise that a need has been identified for the framework to be remodelled in order to suit different environments and circumstances.

It has been acknowledged that the MFMA, which is supplemented by the National Treasury Regulations on PFMA, has established a comprehensive audit committee framework for local government, which is also based on best practices and acclaimed governance principles. National Treasury only issued the MFMA Circular No. 65 in November 2012, which provides guidance for municipalities and their entities on how to improve the effective functioning of the internal audit and audit committees. In South Africa, before 2011, there were no independent professional regulatory agencies or forums established for government audit committees to evaluate the audit committee framework or even the relevance of current applicable legislations adopted by audit committees. The Public Sector Audit Committee Forum (PSACF) was then established by the Institute of Directors in Southern Africa (IoDSA) in November 2011, in collaboration with the National Treasury. The aim of the PSACF is to create a platform for education and mentoring of audit committees in government and to also publish related guidelines (IoDSA, 2013). However, the National Treasury is solely vested with powers to issue regulations, but according to the MFMA, these regulations cannot be binding if they are not adopted by the respective municipality councils.

The current legislation provides for the council to approve the audit committee charter, which should encapsulate all the aspects of the audit committee framework. However, unlike in the private sector, where the board, whose members have extensive knowledge regarding corporate governance issues, as well as varied expertise and knowledge of the operations of the business, the council members may often not have the required expertise or knowledge of the operations of the local government, as they may have been newly appointed. This is attested to by the AGSA (2012:39) in his report on Local Government Audit Outcomes for 2010/11, where he identified lack of leadership by councillors and mayors with regard to their overall understanding of their oversight role and inability to ensure that processes are put in place for the production of credible and reliable financial information. As the committee charter serves as a

blueprint for the audit committee's scope of work, it is imperative for the charters to be aligned to the operations and governance issues specific to the local government, particularly in reference to Westonaria Local Municipality.

In the next chapter, a discussion will be presented on the meaning of the concept of effectiveness. This discussion will also contextualise the concept in relation to the audit committee of Westonaria Local Municipality, with a focus on the functioning of the audit committee in relation to the municipality's operational and governance requirements. The discussion will also focus on measurements for effectiveness of the audit committee function in relation to characteristics that are consistent with audit committees' efficacy, and the leading best practices on audit committee's oversight role.

CHAPTER 3

AUDIT COMMITTEE EFFECTIVENESS

3.1 INTRODUCTION

The divergent objectives of shareholders and management in the private sector created a need for the establishment of a monitoring instrument to control investors' interests and to bridge the gap between them and management. This resulted in the development of audit committees (Al-Lehaidan, 2005:37). Audit committees are also an integral part of good corporate governance and their establishment strengthens government's credibility (Marx 2008:7). In the same vein, audit committees form an accountability structure in both government departments and local government, and are required by legislation to provide an assurance of accountability by public sector management (Van der Nest, 2008:176). They should also ensure transparent and credible financial reporting processes (Marx, 2009a:9).

Since the idea of audit committees was adopted, various standards and measures have been put in place to enhance the effective functioning of audit committees. This includes aspects such as the review of the regulatory framework, as well as auditing practices and standards (Waweru *et al.*, 2008:6). However, the literature reveals some scepticism about the benefits derived from the formation of audit committees. The perceptions or arguments are sometimes that audit committees' implementation is rather symbolic in nature and that their effectiveness is therefore in doubt (Sherer & Turley, 1997:78). Repeated business failures have resulted in audit committees' performance and the quality of their oversight function coming under scrutiny (Fenwick & West LLP, 2002:2). In view of this, the measure of the success of an audit committee is based on the extent of its effectiveness in terms of its oversight role (Marx, 2008:4). Audit committees should therefore not be merely constituted for compliance with legislative or regulatory requirements (Marx, 2009a:3).

This chapter is devoted to a discussion on audit committee effectiveness, with an in-depth description of effectiveness in the context of the local government system and accountability in South Africa. The description of effectiveness in the context of audit committees will be discussed in detail, as well as the characteristics which render an

audit committee effective in its oversight role. The chapter will also explore guidelines written by the National Treasury, PriceWaterhouseCoopers, King III report and the Institute of Internal Auditors on the effective functioning of audit committees and standards set by these institutions. The contents of this chapter will be utilised in the development of the questionnaire, which will be used to determine the effectiveness of the audit committee of the Westonaria Local Municipality.

3.2 DEFINING EFFECTIVENESS

Effectiveness can be defined as the capability of producing desired results. Although effectiveness can be used in different contexts as a measure of performance for the desired outcome or comparison to a standard of a given effect, it is mostly associated with quality or success (Reference for business, 2012). The relevant attributes for measuring quality invariably include, among others, “clarity, practicality, appropriateness, and fairness and cost effectiveness” (Tampieri, 2005:62). The eBusiness dictionary defines effectiveness as “the degrees to which the objective are achieved and the extent to which targeted problems are solved” (E-Business dictionary, 2012).

Mohiuddin and Karbhari (2010:109) perceive effectiveness as an indefinable concept, as it has a different meaning for different disciplines. In medicine, effectiveness is defined as a measure of a prescribed treatment in practice. In human and computer interaction, it is defined as the “accuracy and completeness of tasks” produced by the system. In the context of management, effectiveness relates to getting the right things done (E-Business dictionary, 2012).

In the field of public management and administration, effectiveness refers to “how well the government does what it is supposed to do, whether people in government are working hard and well, whether actions and procedures help achieve its mission” (Lee & Whitford, 2008:5). The effectiveness of government is about upholding good administration principles such as lawfulness, transparency, impartiality and accountability (Lukashenko, 2009:5). It also refers to the promotion of socio-

economic equity, societal wellbeing and a better life for communities (Sirayya, 2005: 18).

In light of the above definitions, it is necessary to establish a definition of effectiveness in line with the purpose of the study. The effectiveness of local government becomes evident when scarce resources are prudently utilised in the achievement of its set priorities (Mandl *et al.*, 2008:3). Effectiveness can also be described as a measure of how well local government is distributing resources equitably in the promotion of socio-economic development and equitable opportunities for its communities (Sirayya, 2005: ii). The basis for an effective local government entails the adoption of mechanisms which promote effective governance processes for the achievement of government priorities, as well as enhancing accountability (Lukashenko, 2009:5).

The establishment of audit committees as an accountability structure serves as a significant financial control mechanism for private as well as public sectors. This includes governance monitoring. Governance broadly entails mechanisms by which organisations are controlled, directed, made accountable and governed (Gregory & Simms, 1999:5). The effectiveness of good governance is derived from the organisation's prosperity and accountability (Cadbury Committee, 1992). According to Mohiuddin and Karbhari (2010:109), the literature on audit committees' effectiveness refers to the definition of the word as meaning the "carrying out or fulfilling of the committee-specific oversight responsibility or duties" which, among others, is to strengthen accountability and promote quality and prosperity. Effective governance also refers to the efficient use of all the resources of organisations (Gregory & Simms, 1999:4).

3.3 DIFFERENCES BETWEEN EFFECTIVENESS AND EFFICIENCY

The two concepts of effectiveness and efficiency are, in most instances, difficult to isolate and describe (Mandl *et al.*, 2008:3), as they are an integral part of the traditional "Triple E" (Economy, Efficiency and Effectiveness) performance indicator system (Tampieri, 2005:62). It is therefore prudent, for the purpose of the study, to

first describe the differences between the two concepts, as the focus in this study will only be on the concept “effectiveness” and its measurement in relation to how an audit committee performs its oversight role in local government. It is also important to make a distinction between measurements of effectiveness and those of efficiency, in order for the measurements of effectiveness to be isolated for inclusion in the questionnaire during the empirical study.

Although the two concepts may be closely related, they carry very different meanings when applied in the management context. The definition of efficiency provided by Lon Roberts (1994:19), as quoted in E-Business (2012), is the “degree of economy with which the process consumes resources giving example of time and money “, whereas he defines effectiveness as “how well the process actually accomplishes its intended purpose” (E-Business, 2012). In government, the economy is measured by the quality and quantity of resources and related costs, and in this context, efficiency is a measurement of the relationship between the inputs and outputs, whereas effectiveness is measured by the extent to which outputs meet set outcomes (National Treasury, 2003). The Online encyclopaedia (2012) refers to effectiveness as doing the right thing, and efficiency is defined as doing things in the right manner. Efficiency therefore involves processes, with the emphasis on means of getting things done, whereas effectiveness takes into account the processes to be addressed within the context of value-adding and quality.

The concept of efficiency originated from industrial engineering (Industrial Revolution) studies and was at that time adopted in management theories of efficiency in the production process. Therefore, efficiency is achieved if the level of output produced is greater than that of the given level of the input (Mandl *et al.*, 2008:3). The concepts are also commonly used in management when evaluating the activities of organisations (Online encyclopedia, 2012). The concept of effectiveness was adopted by businesses in America in the early 1980s to describe performance of Japanese electronic products, which were perceived to offer greater value and quality. It is, however, argued that efficiency can take place in the absence of effectiveness, whereas the opposite cannot be the case, which means that

effectiveness can be achieved in the absence of a greater degree of efficiency. (Online encyclopedia, 2012).

According to Gregory and Simms (1999:2), if the corporate governance system of an organisation is effective, if it promotes the efficient utilisation of resources within the organisation and the larger economy, and also assists in protecting scarce resources for service delivery. In local government, the aim of financial governance is “to manage limited financial resources with the purpose to ensure economy and efficiency of outputs required to achieve desired outcome (effectiveness) that will serve the needs of the community (appropriates)” (National Treasury, 2003).

Maintaining effectiveness requires processes that are capable of rapid adaptation and which are also flexible. However, the extent of effectiveness of any applied process needs to be measured if any improvements or adaptations are to be made (Online encyclopedia, 2012). To remain competitive, organisations such as municipalities have to continually establish effective and innovative strategies to meet the changing circumstances and to deliver quality services (Gregory & Simms, 1999: 4). The appropriateness of the adopted strategies in local government can be assessed by the extent to which service delivery priorities meet the real needs of the local community and their ability to adapt to meet those needs (National Treasury, 2003).

Therefore, there are distinctive traits, in terms of financial management, that a local government has to adopt in order to maintain its effectiveness, which are explained in the next section. In this regard, the relevance of effective functioning in local government will be emphasised, since local government (and its effectiveness) is the focus of this study.

3.4 EFFECTIVE LOCAL GOVERNMENT

The establishment of local government, which is enshrined in the Constitution, serves as the mechanism for the devolution of authority to local communities (De Mabior, 2006). In Chapter 7 of the Constitution, it is stated that local government

must offer a democratic and accountable sphere of government and that it should also establish mechanisms for sustainable service delivery for its local communities. This is further reiterated in Chapter 3 (on Cooperative Governance), which states that each sphere of government is required to provide for an effective, transparent, accountable and coherent government. Therefore, the Constitution provides the basis for an effective local government system for South African communities.

The fundamental principle of the existence of local government, as provided by legislation, is to support and build local communities and to attend to the delivery of effective services. It is through the local government's ability to translate communities' needs and expectations into actions that services can be delivered (Summers, 2009:100). Therefore, the effectiveness of local governance systems are important to deliver services to local communities (White Paper, 1998). The White Paper further stresses the fact that a developmental type of local government system must promote developmental objectives, with an emphasis on serving and creating a better life for all South African citizens (White Paper, 1998). By implication, this refers to effective service delivery.

A local government is defined in the White Paper of 1998 as a "local government committed to work with citizens and groups within the community to find suitable ways to meet social and economic and material needs and improves the quality of their lives". To establish the specific needs of local communities requires a viable governance system, as envisaged by the White Paper, which is capable of effectively serving and developing people, and which is also able to create an enabling environment for effective governance. An effective local governance system (and by implication a local government) promotes the effective utilisation of resources within the organisation and the economy at large, and also assists in protecting scarce resources for service delivery (Gregory & Simms, 1999:2).

In business, effective private organisations use the slogan "voice –from- customers" to identify the needs of their customers and align their products or services with those needs. This is done using business techniques that have been developed and tested over time (Summers, 2009:101). Local government, on the other hand, is

obliged by the Constitution to get involved in local communities with regard to service delivery issues. This is further emphasised by Chapter 4 of the Local Government Municipal Structures Act of 1998, which provides for the participation of organised local communities in local government activities through the establishment of, for instance, ward committees. This has been further entrenched by the provision in the Municipal Systems Act of 2000 which requires local government institutions to establish mechanisms for the engagement of local communities in, inter alia, effective planning processes, service delivery and performance administration.

To maintain a high level of effectiveness requires processes which can be quickly modified and which are also flexible (Online encyclopedia, 2012). In the same vein, in order for local government to remain competitive, it has to continually establish effective and innovative strategies to boost efficiency in the delivery of services, as well as to meet the changing circumstances in the government sector (Gregory & Simms, 1999:4).

The governance structure for local government, as discussed in the White Paper of 1998, is aligned with the current global emphasis on decentralisation, which promises greater government accountability and effectiveness. From the description provided, it is obvious that the effectiveness of a local government requires discipline and adherence to a code of good governance and ethics by those in charge of a local government and the governance thereof (Gregory & Simms, 1999:6). According to Al-Sa'eed and Al-Mahamid (2011:46), accountability theories suggest that individuals who are accountable are considered to be able to handle more information, think more deeply and engage more critically, and are less biased in their evaluation of decision choices. Most importantly, they base their decisions on the preferences of those to whom they are accountable. This will lead to the more effective performance of their functions.

It has been explained that audit committees, as an integral part of the accountability structure, contribute to the effectiveness of the governance system (Braiotta, 2004: xvi). Proponents of audit committees' establishment agree that audit committees'

existence has numerous benefits, provided that they are effective in the execution of their functions (Sherer & Turley, 1997:76).

The next section provides a description of an effective audit committee, as well as the elements that characterise audit committees' effectiveness.

3.5 EFFECTIVE AUDIT COMMITTEES IN LOCAL GOVERNMENT

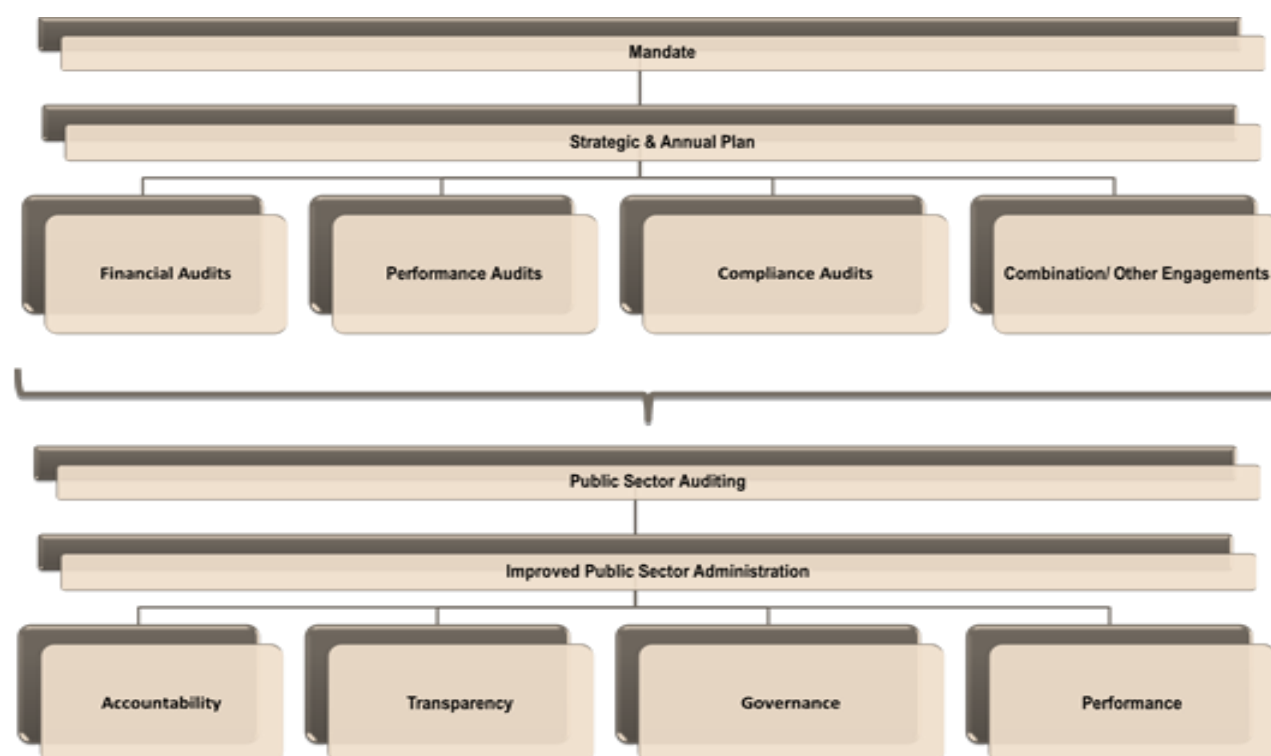
Audit committees have been accepted all over the world as oversight structures for the value and benefit of organisations, in that they provide an effective accountability mechanism to monitor activities in such organisations (Braiotta, 2004:xvi). Audit committees have also been adopted in local government, and MFMA emphasises the importance of these committees (Van der Nest, 2005:75). On the basis of the responsibilities conferred by the Act on audit committees, there is an expectation that these committees will bring visible improvements to the governance of local government. The Act stipulates the functions of audit committees, which were discussed in Chapter 2 of this study, but with the current accountability challenges confronting local government, the committee's oversight role has come under scrutiny, which has created an urgent need to understand the processes adopted by audit committees in their oversight role (Beasley *et al.*, 2009:67).

An effectively functioning local government is believed to improve service delivery, which can be achieved through effective utilisation of allocated public resources. The complexities of local government operations and an increasing need for effective management of its resources (SALGA, 2012) require local government to have an effective governance system in place to entrench accountability (Deloitte, 2010a:5). Therefore, the establishment of audit committees plays a significant role in realising the goals of local government (Mohiuddin & Karbhari, 2010:93). However, the overriding question in this regard is the following: What are the determinants or principles which render an audit committee effective as an accountability mechanism (Van der Nest *et al.*, 2008:553). These principles are very important in this study, as they will form a large part of the questionnaire.

3.5.1 Principles of effective auditing

Audit principles are essentially developed to enhance the credibility, quality and integrity of the audit function and to ensure that such a function is effectively implemented (Boynton *et al.*, 2001:17). It is recognised that the audit committee is required to interact with both internal and external auditors. Audit principles are thus applicable to both internal and external auditors in the execution of their audit work (Braiotta, 2004: xvi). Audit activities enhance efficacy and accountability, in order to protect the core values of local government through an evaluation of governance systems and compliance with ethics, policies and legislation by management (IIA, 2006:11). The principle framework for auditing in government is derived from the International Standards of Supreme Audit Institutions (ISSAIs), which are developed by the International Organisation of Supreme Institution (INTOSAI), of which South Africa is also a member. The founding principles of this supreme body are essentially to provide the prerequisites for the establishment of Auditing Standards Boards (ASB) of the subscribing member states, as well as fundamental auditing principles, guidelines on the conduct of auditing tasks, legal requirements, and description of best practices, including the code of corporate governance (INTOSAI, 2013:4).

Figure 3.1 Role of Supreme Audit Institutions (SAI) in improving public sector auditing



Source: Exposure Draft ISSAI 100- Fundamental Principles of Public Auditing

Figure 3.1 above denotes the role of the Supreme Audit Institutions (SAI) in relation to different types of public sector audits and the fundamental principles applicable in carrying out such audits, namely accountability, transparency, governance and lastly performance.

The aim of auditing principles is to foster independence, transparency, accountability and ethics, as well as quality control, in auditing. This is achieved by the establishment of statements on auditing standards which are consistent with the principles, as well as the procedures and operational guidelines, for various types of auditing. Auditing principles are reviewed from time to time to maintain their relevance, as well as for purposes of development and maintenance of effective auditing (Gray & Masion, 2000:78). However, it is noted by INTOSAI that the auditing principles, as guiding principles for the audit profession, are still superseded by laws and regulations (INTOSAI, 2013:6).

The auditing principles prescribed by the Supreme Audit Institution members comprise four areas which form an audit framework, namely: the basic principles; general principles; field standards and reporting standards. The framework is established as a basis for the development of effective procedures and practices. The basic principles consist of the assumption that logical principles are to be adopted in the formulation of an audit opinion and reporting, and therefore focus on the audit results. On the other hand, the general principles are applicable to the audit process for different stages of auditing (INTOSAI, 2013:4).

3.5.2 Discussion on general auditing principles

The general principles relevant to auditing will be discussed here in order to shed more light on the framework, which will help to determine whether or not the audit function in an organisation (such as a local government like Westonaria Local Municipality), is effective. This will also assist in the development of a questionnaire to determine whether or not a local government's audit committee is functioning effectively. The general auditing principles are as follows:

- **Professional ethics and independence** – It is expected from auditors to display good ethical behaviour in the conduct of an audit. The key principles of ethics are integrity, objectivity, professional competence and due care, confidentiality and professional behaviour (Marx *et al.*, 2006:107). The auditors have to be conscious of their duty to the people who are relying on their work, and are therefore required to be honest, reliable and truthful when conducting the audit (Gray & Manson, 2000:10, 59). Independence in the context of auditing is defined as “freedom from situation and relationship which could impair the auditor's objectivity which can also be an attitude of mind and appearance” (Independent Regulatory Board of Auditors, 2012:73), hereafter referred to as IRBA. Auditors' independence safeguards the impartiality and objectivity of the auditor's opinion and undue influence, which might affect their fairness and professional judgement. If professional ethics and independence can be mastered during audit activities, this will go a

long way towards the effective functioning of an audit committee (Marx *et al.*, 2006:40).

- **Quality control** – Auditors are required to comply with professional and technical standards on quality control when carrying out an audit activity (Marx *et al.*, 2006:38). Quality control as a principle in auditing encompasses areas such as the audit approach, documentation of the audit work, supervision and direction, reviewing of procedures, consulting with other professionals and soliciting assistance from people with other expertise, and exercising judgment and authority when confronted with contentious matters. Therefore, quality control of the audit work is essential for the ultimate conclusion that is drawn by the auditor when reporting on the audit results (Boynton *et al.*, 2001:30).
- **Audit team and management skills** - It is a prerequisite for the audit team to have the necessary skills and competences required for successful completion of audit activities, in order to ensure an effective audit. This includes understanding of financial reporting and the audit processes involved, relevant experience in relation to the type of audit to be undertaken (Gray & Manson, 2000:19), knowledge of the applicable auditing standards and legislation, as well as the ability to exercise professional judgement. All of these are important to effectively conducting audit activities (Boynton *et al.*, 2001:30). Qualified and skilled personnel should consistently be recruited to conduct audits, and there should also be continuous training and development of auditing personnel to enhance their skills. The availability of procedure manuals, guidelines and instructions on the conduct of an audit is of utmost importance. In order to maintain their professional competence, auditors need to participate in continuous professional development and training programmes, so as to improve their skills and those of the audit team (Deloitte, 2011:25).
- **Utilisation of internal auditors, other auditors or experts** - The auditor is also allowed to utilise the services of internal auditors or other auditors or experts in those instances where there is an overlap of the audit processes, as well as when the audit processes are part of the

audit scope. Before a decision is made to utilise the services of other auditors or experts, it is imperative for the auditor to first gather corroborative evidence regarding the competence and independence of the other auditors or experts (Marx *et al.*, 2006:41,159). On the other hand, the use of the services of internal auditors provides scope for coordination and cooperation between the external auditor and internal auditors, and this also eliminates the duplication of efforts (Marx *et al.*, 2006:160).

- **Auditors are required to exercise due professional care in the conduct of audits** – Auditors are required to exercise due care and diligence, and therefore refrain from actions or conducts which will discredit the audit work, by ensuring that they comply with professional standards, in order to ensure that the audit outcome is of the expected standard (Gray & Mansion, 2000:37). This can be achieved by ensuring that the audit team understands the audit assignment and that the audit is carried out in accordance with the audit plan, which is continuously monitored throughout the audit process (IRBA, 2012:74).
- **Auditors should manage the risk of providing an incorrect audit opinion, conclusion or recommendations** – In conducting the audit, the auditor should be mindful of the audit risk of issuing an inappropriate opinion, conclusion or recommendation. Undetected fraud or errors resulting from the complexity of political sensitivity of the underlying matter can have a negative impact on the audit conclusion (INTOSAI, 2013:15).
- **Materiality consideration throughout the audit process** - Auditors are required to consider materiality throughout the audit process. Materiality is “the expression of the relative significance or importance of a particular matter in the context of the financial statements” (Gray & Mansion, 2000:36). A matter is material if its omission would influence the decision of the financial statements’ users or the audit conclusion (Boynton *et al.*, 2001:171). Materiality can either be considered in terms of value or inherent nature, or groups of items may also be considered to be material (INTOSAI, 2013:15).

- **The auditor is required to maintain objectivity and appropriate behaviour** – Professional scepticism and professional judgement are essential throughout the audit engagement, based on the displayed professional and behavioural characteristics in the analysis and assessment of information obtained and explanations given in order to reach a conclusion (Gray & Manson, 2000:19). In exercising due diligence, the auditor must be able to maintain distance and openness, but also be receptive to views and arguments, as well as being alert and adopting a questioning attitude. Professional judgement is the application of collective knowledge, skills and experience in the audit (IIA, 2006:4).
- **Auditors are required to prepare audit documentation in sufficient detail, in order to provide a clear understating of the work performed, evidence and conclusions-** Audit documentation should include an audit programme, together with the audit strategy and plan which articulate the nature, timing and extent of the audit (Boynton *et al.*, 2001:211) A record of audit procedures followed should be kept for future reference, as well as the evidence obtained to support the communicated results of the audit. Deciding on significant audit matters which are to be kept on record requires the exercise of professional judgement. Audit documentation should be sufficient and organised in such a manner that it is easy to go through, even by an auditor who was not initially involved in a specific audit (INTOSAI, 2013:16).
- **Auditors should ensure good communication with the client** - Constant communication with the client fosters a constructive working relationship and also ensures that the client is continually updated on progress and matters relating to the audit. The communication may serve as a means by which the auditor can obtain the information required for the audit, as well as the communication of the audit findings throughout the audit, and the audit conclusion at the end of the audit process (IRBA, 2012:69) At the beginning of an audit, auditors determine the form, frequency and content of communication to the client in advance (INTOSAI, 2013:16). The auditor should also establish effective

communication with all the relevant stakeholders, including management. Effective lines of communication should be maintained throughout the audit.

3.5.2.1 Discussion on audit process principles

Like any other programme, the implementation of an audit project requires a detailed plan for effective execution of such a project (Boynton *et al.*, 2001:211). Auditors should ensure that the processes of the audit have been clearly established, which includes the scope and audit objective, activities in relation to how the audit evidence will be obtained, as well as the roles and responsibilities of all those responsible for the audit (IRBA, 2012:77). This is achieved by gaining an understanding of the nature and objectives of the entity that is audited, its operations, regulatory framework and internal controls, systems and business processes involved, as well as the appropriateness of a 'going concern' assumption in the preparation of the financial statements (Marx *et al.*, 2006:133,192). An audit process also involves the evaluation of audit evidence and communication of the results of audit findings in the form of an audit report (Boynton *et al.*, 2001:184). The audit report serves the purpose of communicating the audit findings or conclusion and recommendations. It is also utilised as a reference point when following up and determining progress on recommended corrective actions (INTOSAI, 2013:18).

In summary, although the abovementioned auditing principles relate directly to the internal auditors, they are also relevant to the individual audit committee members' effective functioning, as well as to their functioning as a collective in their oversight role. The aspect of ethics is entirely relevant to the audit committee, since it forms part of the governance actions.

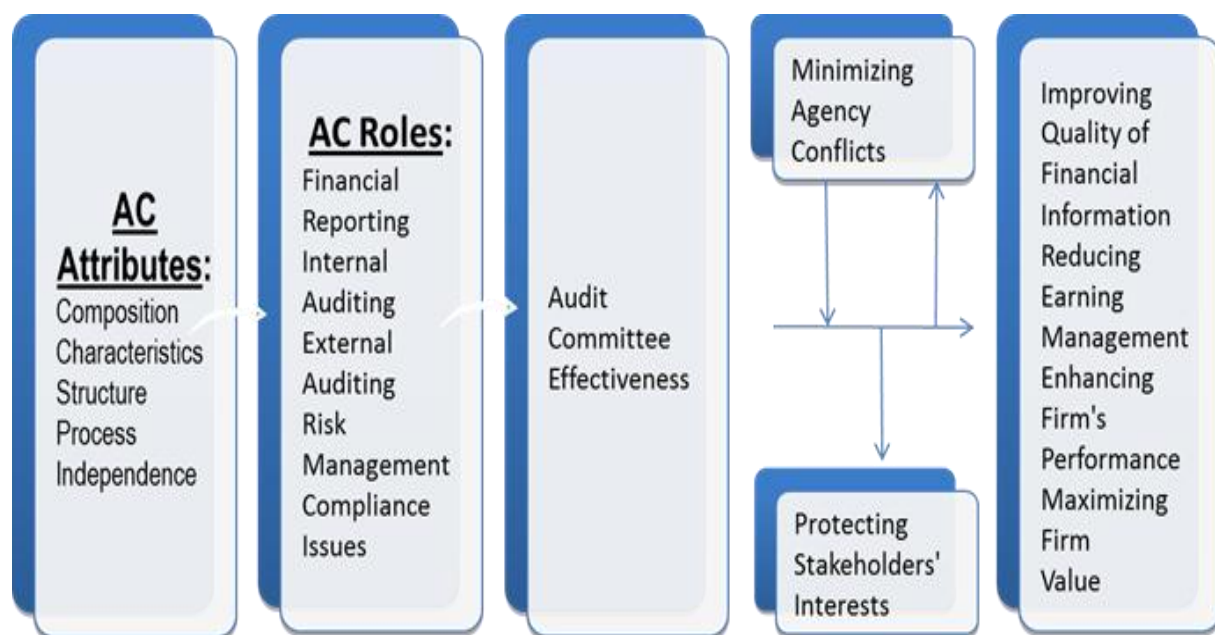
3.6 THE EFFECTIVE FUNCTIONING OF AUDIT COMMITTEES

The effective functioning of an audit committee (as the accountability mechanism) is paramount for the successful implementation of services from local government to its communities (Marx, 2009c:33). On its conceptualisation, the audit committee's main responsibility was to provide an oversight of the financial reporting of organisations.

This responsibility had rendered an audit committee its most distinct measure, namely to secure the effective functioning of an organisation such as a local government (IIA, 2006:3).

An audit committee's effectiveness, as described by Mohiuddin and Karbhari (2010:109), refers to its collective capability to fulfil its oversight objectives and for its members to have the "relevant qualification and experience with authority and resources to protect the 'shareholders' interests by ensuring reliable financial reporting, internal controls and risk management through diligent oversight efforts". This definition includes the traits, characteristics and authoritative resources required for audit committee members to maintain high performance standards (Braiotta, 2004, xv).

Figure: 3.2 Audit Committee's (AC) Effectiveness Model



Source: Adapted from Mohiuddin and Karbhari (2010:112)

Figure 3.2 above depicts the Audit Committee's Effectiveness Model, which indicates the key determinants for the measurement of an audit committee's effectiveness in relation to its functions.

The evaluation of audit committee effectiveness is associated with the key oversight roles of the audit committee (Braiotta, 2004:23), which include overseeing financial reporting; assessment of internal controls and risk environment; and governance and evaluation of the audit process (Van der Nest, 2008:178). Various empirical tests have been conducted which adopted various audit committees' attributes as measurements for effectiveness. However, each of these studies focused on areas which are of importance to the relevant local authority to which the audit committee is accountable (Mohiuddin & Karbhari, (2010:109). Therefore, for the purposes of this study, cognisance is taken of the fact that audit committees in local government report to council, which in turn is accountable to its local communities, and as such, the focus will be on those characteristics pertinent to the functioning of the audit committee in local government in terms of promoting effective governance and accountability. The characteristics identified in the literature which are associated with audit committee effectiveness are the following: (1) composition; (2) authority; (3) resources; (4) process (De Zoort *et al.*, 2002:40, as quoted by Van der Nest *et al.*, 2008:552; Al-Lehaidan, 2006:80). More details about these characteristics will be provided in the ensuing sections.

3.6.1 Audit committee composition

Audit committee composition refers to a composite of the requisite skills, expertise and qualities which ensures the objectivity and collective independence of members (Van der Nest *et al.*, 2008:552; Ferreira, 2007:63). Audit committees must comprise members with a diversity of qualifications and experience, in order for them to complement each other (Ferreira, 2007:64). What is also important is that members must have expertise in financial reporting and knowledge of the local government's operations, policies and applicable legislative framework (Braiotta, 2004:34; PwC & IIA, 2011:3). An audit committee's integrity and professional judgement are of paramount importance in fostering its independence and promoting the quality of the audit (Abbott *et al.*, 2003:20; Van der Nest *et al.*, 2008:552). Consideration must also be given with regard to opportunities for continuing education and professional development, as well as succession planning, as part of retaining the requisite committee composition (Ernst & Young, 2012a:3).

According to Mohiuddin and Karbhari (2010:110), an effective audit committee, which is independent of the local council and maintains its objectivity, is associated with improved financial reporting and a reduction of incidences of financial fraud, as well as the reduction of unqualified audit reports. In emphasising the significance of the audit committee's independence, Braiotta (2004:24) cites Carcello and Neal (2000), who stated that audit committees with a high percentage of affiliated members have a greater likelihood of the external auditors not issuing a "going concern" report.

Since the formation of the audit committee, its key responsibility has been to oversee the financial reporting of the organisation, and it therefore receives a large quantity of financial information in the review of the financial statements (PwC & IIA, 2011: 2). Therefore, the effectiveness of an audit committee is, to a larger extent, affected by the expertise of members in the fields of accounting and financial reporting, internal controls and auditing (Abbott *et al.*, 2004:74). The results of previous studies on audit committee effectiveness in relation to financial expertise confirm that audit committees with a high degree of financial literacy are likely to engage external auditors who are highly competent. These studies further confirm that as a result of their financial expertise, audit committees get more involved in the internal audit function and protect the external auditors from undue pressure from management, who may attempt to influence the audit outcome, thus safeguarding financial reporting transparency (Al-Lehaidan, 2006:47). Therefore, audit committee members with financial expertise have a better understanding of issues and associated risks, as well as the proposed procedures to address such risks (Abbott *et al.*, 2004: 72).

According to Gray and Manson (2000:534), audit committee members are required to carry out their oversight role with integrity, demonstrate independent judgement, be free from any bias and undue influence from management or council, and should not have a financial relationship with the organisation or council. They also emphasise that the existence of audit committees does not by default enhance the 'independent scrutiny' of management and the external auditors, but can only be

realised if management and the board or council enable such scrutiny to take place and allow it to be effective.

An audit committee as an oversight structure must, on a continuous basis, verify that the council and management are instilling the “right governance culture” across the organisation (KPMG, 2006). The council and management must permeate the culture of ethical behaviour throughout the organisation (PwC & IIARF, 2011:3). The “right tone” is about council, executive management and line management, as they must lead by example and reinforce a culture of making every one strive for effective governance principles and to do the right thing (KPMG, 2006). To achieve effectiveness, an audit committee needs to have a chairperson with strong leadership and facilitation skills to steer the committee in the right direction, as well as to promote effective relationships among committee members, management and the internal and external auditors (PwC & IIARF, 2011:86).

3.6.2 Audit committee authority

Understanding the parameters of their oversight role is paramount for the effective functioning of audit committees. Both the Cadbury Code of Best Practices on Corporate Governance (2000), hereafter referred to as the Combined Code, and the Treasury Regulations (1999) require an audit committee to operate in terms of written terms of reference which outline its responsibilities and the delegation of authority entrusted to them to influence management, council and auditors’ actions (Van der Nest, 2008:180). The audit committee’s charter should clearly outline its mission and emphasise its right to financial information and other related reports (Braiotta, 2004:45).

Gray and Mansion (2000:537) define audit committee authority as “the rights of the audit committee to seek information and make decisions so as to carry out prescribed duties”, which include the following: (1) overseeing **financial reporting** by ascertaining the accuracy and transparency of the accounting policies and procedures, and the extent of compliance with financial controls; (2) overseeing **the audit process** by reviewing the plans of the internal and external auditors and

evaluation of how their work is coordinated, and determining the adequacy of resources allocated to the internal audit for its effective functioning; (3) assessment of **internal controls** and **risk environment**; and (4) overseeing of **governance and compliance** matters.

The objective of the evaluation of **financial reporting** is to ensure that the financial statements presented by management are credible, reliable, accurate, timely and in compliance with the internal controls, accounting policies and principles (Gray & Mansion, 2000:538). Overseeing the **audit process** entails interaction by an audit committee with the internal auditors and a review of internal audit plans, in order to understand the internal audit activities and planned coverage, and, most importantly, to assess the adequacy of the internal audit resources required for executing its function (Ernst & Young, 2012a:9). The responsibility of the audit committee also involves an assessment of the independence of the external auditors and a discussion of the scope of the external auditors' work. Effective communication between the audit committee and the external auditor is paramount for the quality of the external audit process (Ernst & Young, 2012b:7). Audit committees are also responsible for assessment of the effectiveness of the **internal controls** and risk management, which entails monitoring the implementation of significant changes to internal controls and related mitigating risk controls (Ernst & Young, 2012a:6). In overseeing **governance and compliance matters**, an audit committee is required to determine whether or not the policies and practices of the organisation are aligned with good governance principles, and to ascertain if the compliance programme is periodically reviewed to maintain its effectiveness (PwC & IIA, 2011:40).

The benefit accruing from an effectively functioning audit committee is that it ensures a high standard of financial reporting. It also strengthens the governance and control environment (Van der Nest, 2008:180). Effective engagement between the audit committee and external auditors is beneficial to external auditors' professional scepticism in the conduct of the audit (Boynton *et al.*, 2001:51).

3.6.3 Audit committee resources

The development of an effective oversight framework requires the active involvement of an audit committee in the governance activities of the organisation (KPMG, 2006). The size of the committee and structured interaction with management are regarded as one of the main determinants of an effective audit committee (Al-Lehaidan, 2006: 58). An effective audit committee must have the right number of committee members, with a blend of skills pertinent to the organisation's operations, and the audit committee should also have unrestricted access to management and the internal and external auditors (Van der Nest, 2008:180). The Combined Code (2000) provides for an audit committee to formally establish procedures which are credible and transparent on how it will engage with management on issues relating to financial reporting and internal controls. With regard to communication with the external auditors, the audit committee must discuss the scope of the audit with the external auditors and invite them to discuss issues of concerns during their times of engagement. On completion of the audit, both parties should discuss the financial statements and the audit report that was issued (Boynton *et al.*, 2001:51).

The Code of Best Practices for audit committees provides for the committee to consist of a minimum of three members, of which the majority must be independent and not in the employment of the organisation or local government (MFMA, 2003). However, other studies have concluded that the prescribed "one size fits all" principle have proven to have a negative impact on the effectiveness of the audit committee (Klein, 2002 as cited by Braiotta, 2004). Therefore, the size of the committee as well as the mix of skills and experience of members must be based on the needs, as well as permeating dynamics and culture, of the organisation (KPMG, 2006).

Internal audit serves as the key resource for an audit committee (Ernst & Young, 2012a:9). However, audit committees require both administrative assistance and support from the finance department, internal audit, as well as the corporate secretariat, in order to assist with relevant reports and logistical arrangements for meetings (PwC & IIARF, 2011:107). In particular, the Chief Financial Officer must orientate and guide the audit committee on financial and accounting policies and

procedures, as well as financial liquidity and issues which involve a high degree of judgement (Braiotto, 2004:45). Audit committees may also seek additional external resources or persons for independent counsel in instances where they are confronted with sensitive or controversial issues (PwC & IARF, 2011:108).

3.6.4 Audit committee process

The prerequisite for effective implementation of an audit project, as discussed in a previous section (section 3.5.2), is that the audit project plan should outline the audit process, which includes the scope and audit objective, audit activities, and the roles and responsibilities of the audit team (Marx *et al.*, 2006:93). An audit process also involves the evaluation of audit evidence and communication of the results of audit findings in the form of an audit report (Boynton *et al.*, 2001:184). Similarly, the audit committee process provides a framework for the execution of an effective committee's activities in relation to the oversight function (PwC & IARF, 2011:109). The audit process, as outlined by PwC and IARF (2011), includes the following:

- The committee charter, which outlines the key responsibilities and authority of the audit committee. The charter should be tailor-made for the organisation's circumstances and should describe the committee's composition, as well as the mechanisms to be adopted by the committee to access resources required for the execution of its function (Deloitte, 2011:8). This is essential to ensuring that people who interact with audit committee members have a clear understanding of members' responsibilities, authority and needs (KPMG, 2012);
- A planned schedule of meetings, including specified agenda items, an outline of how such meetings are to be conducted, as well as the recording and documentation of discussions and recommendations. The audit committee must also provide details in its plan regarding how reports on its recommendations are going to be disseminated to management and council, the frequency of such reports and mechanisms for making follow-ups on its recommendations (Beasley *et al.*, 2009:68.) It is imperative for the agenda of meetings to be related to matters which are significant to the committee's oversight role. Regular

meetings scheduled with both the internal and external audit committee ensures that the audit committee keeps informed about audit issues (Abbott *et al.*, 2003:21);

- Other resources, such as the support of management and internal audit, which are needed by the audit committee to execute its oversight role, form an integral part of the audit committee process (Beasley *et al.*, 2009:69). Unlike external auditors' processes, which entail the gathering of supporting evidence for the information provided, the audit committee relies heavily on information provided by internal audit and management as their key resource (Ernst & Young, 2012a:9). It is therefore imperative for an audit committee to be able to apply the necessary skills, expertise and knowledge in the evaluation of the quality of the information provided (KPMG, 2012), as well as to have unrestricted access to both management and the internal audit whenever a need arises to ask questions or seek clarification;
- The audit committee's assessment by the board, council or external auditors, including self-assessment, and a review of the charter. The regular evaluation of the audit committee's performance is imperative for ensuring that it stays on course in terms of its oversight mandate (PwC & IIAF, 2011:106). The results of the assessment can also be utilised to effect the necessary changes to its processes, procedures and focus areas (Ernst & Young, 2012a:12). The annual review of the charter is recommended for all audit committees, in order to bring it in line with changes in the regulatory and legal framework (PwC & IIAF, 2011:105). The review of the charter may also be pre-empted and the modifications should form part of the audit committee's planned activities (Deloitte, 2011:8); and
- The chair of an audit committee's role with regard to its leadership and facilitation of meetings is fundamental to ensuring the effectiveness of the committee process (Beasley *et al.*, 2009:69). The chair of the committee also has to ensure that there is vigorous and constructive discussion on committee matters (PwC, 2010:3), and he/she must also take a lead in follow-ups subsequent to the meetings. In addition, the

chair of the audit committee must schedule private sessions with the internal audit and key finance personnel (PwC & IIARF, 2011:105). Lastly, the chair must serve as a link between the audit committee and the executive council of the municipality (National Treasury, 2012:8).

The above discussion indicates that an effective oversight process is made up of policies, people and procedures (KPMG, 2012) and must therefore involve “persistent listening, questioning of management, assessing of information provided and challenging responses provided on the part of an audit committee” (KPMG, 2006). It is also through an effective oversight process that the audit committee’s inputs, such as independence, expertise and diligence, can converge to produce the desired audit committee outcomes (Beasley *et al.*, 2009:69).

To this end, more focus has been placed on what characterises an effective audit committee as a collective. However, the primary asset of audit committees is their members, and their behaviours and approaches are equally important in achieving optimal performance in their oversight role. In the main, audit committees made up of a combination of members with diverse backgrounds and traits have an advantage, as their unique individual contributions can be complemented in pursuit of the committees’ optimal performance (Ferreira, 2007:81).

3.7 EFFECTIVE AUDIT COMMITTEE MEMBERS

The attributes and conduct of the members of audit committees play an important role in the effective performance of such committees. The key determinants of audit committee members’ effectiveness are (1) independence and (2) diligence (Boynton *et al.*, 2001:331). The results of previous studies have associated the independence and diligence of audit committee members with the demand for a high audit quality (Ananthanarayanan, 2011:53). There are, however other considerations which need to be acknowledged by audit committee members in order to carry out their responsibilities effectively (KPMG, 2006:2). These considerations will be discussed next.

3.7.1 Audit committee members' independence

Audit committee independence is regarded as one of the most important characteristics associated with the effective functioning of an audit committee (Baxter, 2007:20). The independence of members of an audit committee affords the members the courage and willpower to challenge management on pertinent governance issues (KMPG, 2006; INTOSAI, 2013:13). The independence of audit committee members ensures their impartiality and objectivity, which will in turn positively affect their fairness and professional judgement. As a result, independent audit committee members are better equipped to maintain the integrity of financial statements (Marx *et al.*, 2006:40).

The independence of audit committee members should set them free from any influence by management and therefore enhance the committee's objectivity when dealing with management (Abbott *et al.*, 2004:70). This is also emphasised by the MFMA (2003), as it requires local government audit committee members to not be in the employment of the local government. According to Van der Nest (2006:176), independent committee members must display the following personality traits:

- They must be able to act independently and be pro-active in advising the council and management;
- They must have the skills to probe for additional information when responses by management are either inappropriate or unsatisfactory;
- They must have an independent approach to their tasks, with a probing mind;
- They should display courage when complex decisions are to be made by the committee; and
- They must strive to achieve high ethical standards and behaviour when interacting with management and council members, to encourage openness and transparency.

Al-Lehaidan (2006:43) provides the example of the study conducted by Carcello and Neal (2000), which suggested that audit committee members should be entirely

independent, as this will reduce the likelihood of financial statements being misstated.

3.7.2 Audit committee members' diligence

Diligence is regarded as one of the most significant characteristics associated with the effectiveness of audit committee members (Ferreira, 2007:63). It is considered to be a virtue for the effective functioning of an audit committee. Diligence is defined as the conscientiousness of audit committee members in performing their oversight role (TheFreeDictionary, 2012). It is referred to by Al-Lehaidan (2006:49) as the degree of painstakingness of the audit committee members in addressing their responsibilities and duties. He has further noted that unlike all other audit committee characteristics, diligence cannot be directly measured, and various studies have therefore resorted to the measurement of diligence by using the number of meetings as a proxy for diligence, since meetings are considered to be observable.

Although prior studies had adopted frequency and size of meetings as proxies for diligence, the argument was that the quality of the meetings, activities and the level of engagements on those activities by the members are paramount to exercising care and diligence (Al-Lehaidan, 2006:51). Abbott *et al.* (2003:31) suggest that audit committee members who meet more frequently get to know more about audit issues and exercise diligence in discharging their oversight function. They also get to know more about the scope of the audit process and this reduces the likelihood of the financial statements being misstated. Audit committee members are also required to ask probing questions in their engagement with management and have to be informed at all times in terms of any developments in the organisation. The members also need to ask questions beyond what is provided by management in their reports and gain an understanding beyond the financial information provided (KPMG, 2006).

Diligence is also about time and commitment. Audit committee members are required to make time and show commitment through preparations for meetings and the interactions of each member during meetings (Deloitte, 2011:8). In order for audit committees to diligently prepare for meetings, they should be provided with meeting materials and presentations with details pertinent to agenda items. The

meetings' agendas and reports should be send out to members well in advance, in order to afford them sufficient time to prepare for meetings (Deloitte, 2012b:5).

3.7.3 Personal qualities associated with effective audit committee members

In addition to the abovementioned considerations to which audit committee members are required to adhere, there are also certain personal qualities which can enhance their effectiveness (Ferreira, 2007:93; KPMG, 2006:2), which are cited as the following:

- Be emotionally intelligent and have interactive skills and the ability to deal with conflicts;
- Be vigilant and informed, willing to ask management probing questions and persistent in the pursuit of correct answers;
- Be aware of the financial reporting risks;
- Have an analytical mind and a willingness to obtain more understanding about the functioning of organisations and the interrelationships of its operations; and
- Be committed to the organisation and willing to devote sufficient time to the cause of the organisation.

From the above, it is clear that the attributes for effective functioning of audit committee members are characterised by a balanced approach with regard to how they are required to carry out their audit function. They must strive to achieve desirable behaviours and conduct in their engagement on matters of significance to the committee. As explained by Drucker (1966), as quoted in in E-Business dictionary (2012), effectiveness can be viewed as a discipline which, like other disciplines, can be learned and earned (Harvard Business Review, 2004:7). In essence, audit committee members as individuals can also develop and learn all the above mentioned attributes and behaviours, if they do not have them already, in order to enhance their effectiveness for optimisation of the performance of the audit committee as a collective (Ferreira, 2007:90).

From the time of its formation, the audit committee functions in a framework comprising both regulations and best practices. Professional agencies from time to time issue publications on best practices, as well as guidelines on the implementation and amendment of standards. The premise is that functions of audit committees are relatively generic. This is attested to by KPMG (2012:1), which states that “those seeking to strengthen corporate governance and enhance audit committee oversight often look for leading and best practices and with good reason; they suggest processes, policies that work, yet best practices for one organisation may not be ideal for another”. Currently, the National Treasury is the sole regulatory body which governs public sector audit committees, but it also recognises the inputs by professional agencies on audit committee principles in the formulation of the regulatory framework.

The focus in the next section will therefore be on selected publications on standards and guidelines. The reason for discussing these publications on standards and guidelines is that they provide a wider perspective or framework regarding what it entails for an audit committee to be effective (PwC & IIA RF, 2011:ix). The publications that will be analysed here are the PricewaterhouseCoopers Audit Report (2012) on standards for effective functioning of an audit committee, the National Treasury Guidelines, the King III Report on Corporate Governance, and the Internal Audit Standards. The discussion commences with the PwC Audit Report (2012), which describes the standards for the effectiveness of audit committees.

3.8 PRICEWATERHOUSECOOPERS AUDIT REPORT ON STANDARDS FOR EFFECTIVENESS OF AUDIT COMMITTEES (2012)

In response to the emerging challenges and immense responsibilities faced by audit committees during the world economic crisis in 2008, PricewaterhouseCoopers published the 4th edition of their landmark book in 2011, entitled “Audit Effectiveness-What Works Best”. This book was produced in collaboration with the Institute of Internal Auditors Research Foundation (IIARF), which is supplemented from time to time by PwC guidelines on key questions regarding the effective functioning of audit committees. The principles and procedures described in the book only represent suggestions for enhancing the overall performance of audit committees. Therefore,

audit committees are still required to take into account their own circumstances when applying the suggested principles (PwC & IARF, 2011:ix).

It is thus acknowledged by PwC that corporate culture, financial reporting risks and governance needs can vary from organisation to organisation (KPMG, 2012:1). In the same vein, audit committees for local government are also supposed to take into consideration the prevailing factors and circumstances in local government, in order to apply those principles which will “work” best. One of the factors which are a concern in local government is the revenue baseline, which has been negatively affected by the recent economic meltdown and therefore has an impact on projects for service delivery (SALGA, 2012).

The most recent PwC guidelines are the May 2012 edition on the functioning of effective audit committees. This publication also outlines leading practices which enhance effective audit and financial reporting and thus ensure quality in the activities of local government (PwC, 2012). The preceding sections of this chapter (3.6 and 3.7) described how audit committees’ inputs, such as independence, expertise and diligence, impact on audit committees’ outcomes (Beasley *et al.*, 2009:67). An audit committee outcome relates to how the committee carries out its oversight function (PwC & IARF, 2011:109). Key areas of emphasis highlighted in the PwC guidelines regarding the enhancement of audit committee effectiveness are (1) enhancement of communication with external auditors; (2) promotion of financial reporting quality; (3) achievement of quality audit outcomes; and (4) enhancement of effectiveness through continuous learning (PwC & IARF, 2011:111). These key areas will be discussed below (PwC, 2012).

3.8.1 Enhancement of communication with external auditors

The relationship between an audit committee and external auditors was referred to in the previous section as one of the resource requirements in the discharge of the audit committee’s oversight role with regard to the external auditors’ process (section 3.6.2). According to PwC (2012), one of the recent developments regarding audit committees is the provision of a regulatory framework by the Public Accounting Oversight Board. This Board has issued a proposed auditing standard on

Communication with Audit Committees. The aspect of communication with external auditors is one of the key determinants of the effective functioning of an audit committee (see also section 3.6.2). In their guidelines, PwC (2012) is advocating for the ‘spirit’ of ‘good’ communication, which should be open and honest and include the following: (PwC, 2012):

- Audit committees should have a clear understanding of the organisation’s reporting requirements, which can be used as a basis for their engagement with both management and external auditors;
- Audit committee members should have frequent informal discussions with external auditors throughout the year. It is believed that these informal discussions can bring about a “deeper mutual understanding” of the organisation’s operations and financial reporting requirements; and
- Audit committees should be encouraged to schedule private sessions with management and external auditors, and ensure that management and external auditors respect and maintain the privacy and confidentiality of these discussions. This will ensure that the public and officials will trust audit committees, which will help in future discussions.

The above key issues are not only re-emphasising the importance of communication between an audit committee and the external auditors, but also provide further details on how such communication can be enhanced for a better audit process outcome (Ernst & Young, 2012b:7).

3.8.2 Promotion of financial reporting quality and transparency

One of the key responsibilities of an audit committee is to oversee the financial reporting of the organisation, with a view to enhancing the quality and transparency of financial statements. PwC (2012) promotes new approaches to enhancing an audit committee’s financial reporting, which emphasise the following:

- Audit committees should always have a robust discussion with management about the risks associated with financial reporting. These must entail focusing on risk areas which involve the exercise of judgement by management, including any significant issues such as

accounting estimates and policies adopted for reporting and disclosure. The critical outcome of the discussion on these aspects of reporting is to ensure a mutual understanding of the basis for those judgements and their effect on financial reporting;

- Audit committees should evaluate the effects of any disclosure in the financial statements and must ensure that any ambiguities are further clarified, by including additional disclosures in the financial statements and using simple language that can be understood by non-financial people; and
- Audit committees should ensure that management and auditors consider the compatibility and relevance of historical reporting policies, practices and disclosure.

3.8.3 Achievement of audit quality and process transparency

As part of the audit process, audit committees are required to evaluate the work of the external auditors, with a view to ensuring audit quality (Van Der Nest, 2006:161). Quality control is the principle issue in auditing, and it refers to procedures applied in order to ensure that outputs from an audit process are in line with standards (Gray & Manson, 2000:37). It is on this basis that the aspect of audit risk becomes an important element in an evaluation of the audit quality. An audit risk refers to “the risk that external auditors may give an inappropriate audit opinion on the financial statements” (Gray & Manson, 2000:118). In their guidelines, PwC (2012) encourages audit committee discussions with external auditors on the details of the audit risks, in order to achieve audit quality and establish process transparency. In this regard, the guidelines of PwC (2012) state the following in terms of audit quality and process transparency:

- Audit committees, in evaluating the audit process, must have a clear understanding of the audit plan. This includes knowledge of how to address material risks arising from changes in the organisation’s strategies, management initiatives and current operating environment. The basis for evaluation should be the information provided by the external auditors to the audit committee on the key audit risks, internal

controls and environment of the organisation, the audit approach, as well as a summary of how they have reached their conclusion regarding any contentious matters; and

- Audit committees should establish the criteria, as well as standards, for the evaluation of the external audit process. This should take place at the beginning of the audit, as this will enable the audit committee to assess the quality of the audit with reference to the standards. An audit committee should also stipulate its expectations in terms of the key professional behaviours of the external auditors in relation to their objectivity and professional conduct.

These aspects will assist an audit committee to ensure quality in audit activities and the transparency of the process.

3.8.4 Enhancement of effectiveness through continuous learning with regard to audit committee matters

Audit committees are encouraged to be involved in continuous learning, in order to stay on top of their craft (PwC, 2012). Continuous learning sharpens audit committees' approaches and also provides the committee with information on leading practices. There are continuous learning practices that are highlighted in the guidelines by PwC (2012:6) and PwC and IIARF (2011:110), which include the following:

- External learning programmes, which can be followed by audit committee members to learn about new leading practices on auditing matters in governance;
- Benchmarking with audit committees of other organisations to obtain and implement peer audit programmes which are of a high quality;
- Interactions with audit committees of other organisations can provide audit committees with new perspectives which include aspects related to the effectiveness of the exchange of ideas on audit matters; and
- Self-evaluation to improve the effectiveness of audit committees and to identify specific areas where improvements are necessary.

In order for audit committees to effectively deal with governance challenges confronting local government, they have to continually develop themselves by ensuring that they stay up to date with new developments in local government. As such, the latest knowledge in the fields of financial reporting and auditing needs to be utilised (PwC, 2012).

Because this study is examining the extent of the audit committee's effectiveness in the execution of its auditing role in local government, it is important to look at the audit committee framework presented by the National Treasury. The National Treasury, as a governance body, is responsible for the establishment of a regulatory framework for audit committees in South Africa. It has also developed guidelines on the audit committee process and best practices, which are described in the Framework on Normative Measures that is discussed in the next section.

3.9 NATIONAL TREASURY GUIDELINES

The Audit Committee Framework developed by the National Treasury is incorporated into the Framework on Normative Measures for financial management (National Treasury, 2003). This framework defines the scope, responsibilities and delegated authority of audit committees for government departments. The framework is also applicable to audit committees in local government, as there are currently no other government guidelines for audit committees in local government. There is also a Framework Guide on Departmental Financial Reporting (National Treasury, 2011), which is issued by the National Treasury on an annual basis. The guide comprises various chapters, and Chapter 2 of the guide provides a framework for the reports of audit committees for inclusion in the Annual Report of government departments, as well as local government (National Treasury, 2012:11). It describes the following: (1) audit committee responsibilities; (2) delegated authority; (3) how to evaluate annual financial statements (AFS); and (4) the enhancement of an audit committee's effectiveness (National Treasury, 2012:4). The premise for the guide is to ensure that an audit committee has a good understanding of its role, embraces its vested responsibilities, and recognises what is necessary to perform its audit tasks effectively (KPMG, 2006:12, as cited by Van der Nest *et al.*, 2008:549).

3.9.1 Audit committee's responsibilities

The responsibilities of an audit committee are outlined in the Framework Guide on Departmental Financial Reporting, as well as the Framework on Normative Measures, both published by the National Treasury. These responsibilities focus to a large extent on the functioning of an effective audit committee and require an audit committee to review the following:

- the effectiveness of the internal control systems of local government;
- the risk environment associated with the local government's operations included in the audit activities of internal and external auditors;
- the integrity, reliability and accuracy of the financial information included in the financial statements;
- any accounting and auditing concerns raised by the internal and external auditors during audit engagements;
- compliance with legal and regulatory provisions, local government code of ethics and policies established by management; and
- the activities of the internal audit function, which includes the annual operational programme and any significant investigations conducted, including management responses to the recommendations made.

The above responsibilities are also included in the audit committee's charter.

3.9.2 Audit committee's authority and reporting requirements

Audit committees have the explicit authority to investigate matters which are within the scope of their terms of reference, and they must also be provided by the municipality with the resources and information required to undertake such investigations. An audit committee is accountable to the council and must therefore report and make recommendations to the municipal manager and council. The municipal manager is responsible for the implementation of the recommendations made by audit committees (National Treasury, 2012:8).

The chairperson of the audit committee is required to report to the executive authority of the relevant local authority on any incidences of fraud, corruption or

gross negligence which implicate the municipal manager and employees of the municipality. The audit committee is required to provide a report for inclusion in the annual report of the municipality, which provides comments on the following (MFMA, 2003; National Treasury, 2012:10):

- the effectiveness of internal control measures in the local government;
- the evaluation of the financial statements; and
- the effectiveness of the internal audit functions, especially in relation to coverage of risks that are pertinent to local government.

Commenting on these documents is another means of ensuring effectiveness in local government.

3.9.3 Audit committee's evaluation of annual financial statements

Overseeing financial reporting is one of the key responsibilities of audit committees, and the objective is mainly to enhance the quality and transparency of financial statements (PwC, 2012). To effectively perform this role, an audit committee is required to understand various accounting and legal requirements in financial reporting for local government (Abbott *et al.*, 2004:71). The National Treasury guidelines identify salient areas on which audit committees have to focus in their review of the annual financial statements. These areas are the following (National Treasury, 2011:6):

- any significant or abnormal financial transactions disclosed in the financial statements which are inconstant with previous years' reporting;
- any proposed new legislation which may have a material impact on municipal policies and financial reporting;
- any significant variations in the annual financial statements when compared to the appropriated budget and financial figures of previous years;
- any significant matters of judgement in the annual financial statements which include accounting estimates;

- any outstanding litigation, contingencies and claims disclosed in the annual financial statements which are required to be validated by management;
- any changes in the accounting policies and the reasons for these changes, as well as whether or not the changes are in line with applicable accounting standards. If there are deviations from the applicable accounting standards, the audit committee should ascertain if approval has been granted by the National Treasury for the deviation; and
- any impending or disputed issues in financial reporting between management and the external auditors.

The guidelines require an audit committee to review the previous years' recommendations on the findings by external auditors and to understand how the findings were derived. Audit committees are further required to assess the adequacy of the corrective action plan proposed by management to address the external audit findings (National Treasury, 2011:6). Since the introduction of the MFMA, the majority of municipalities have repeatedly obtained adverse audit reports. The report on local government audit outcomes (AGSA, 2011:2) revealed that only seven out of 237 municipalities had received financially unqualified audit reports, with 110 (67%) out of 163 of the municipalities that obtained qualified audit reports having failed to address all 2008/09 audit findings. Therefore, audit committees in local government can play a critical role in improving the audit outcomes of municipalities (AGSA, 2012:86).

3.9.4 Enhancement of audit effectiveness in audit committees

The National Treasury guidelines on the reporting of audit committees (National Treasury, 2011:7) recognises the importance of an audit committee as an accountability structure, hence the highlighting of areas which need improvement (National Treasury, 2011:7). One of the areas emphasised in the guidelines is effective communication between the audit committee, management and internal and external auditors. The significance of an effective relationship between the audit committee and external auditors was discussed in the previous section, in which this

was referred to as one of the resource requirements in overseeing the audit process (Section 3.6.2). This aspect was also discussed in the previous sections (3.8.1 and 3.8.3), which dealt with the report by PwC (2012). The PwC (2012) provided an update on recent developments with regard to the proposed auditing standard on Communication with Audit Committees issued by the Public Accounting Oversight Board, which in essence is supporting the process towards quality audit outcomes (PwC, 2012). With the aforesaid in mind, in order to achieve quality audit outcomes, the National Treasury (2011:7) recommends the involvement of the audit committee in the following audit activities:

- To support the audit investigations by discussing the details with management in terms of the course and impact of the findings. The committee is also required to maintain a log sheet of audit recommendations, which should be used to follow up on the implementation of the recommendations;
- To have a separate meeting with external auditors prior to its meetings, in order to discuss progress on issues raised in the preceding meetings, which can be used to inform the agenda of the upcoming meeting;
- To have regular interaction with management (usually the chairperson) to discuss areas of the agenda and related documents or management reports essential for such agenda items; and
- To optimise the effectiveness of meetings by prioritising agenda items and drawing up an annual plan for audit committee meetings to coincide with the timing of key events or issues related to financial reporting and the audit process.

The importance of the guidelines provided by the National Treasury on effective audit committee processes illustrates the convergence of recommended best practices with legislative requirements for the audit committee's oversight role in government. The guidelines (National Treasury, 2011) also highlight the similarities between private and public sectors in terms of audit committee functions, as well as the common areas for improvement, which in turn promotes audit committee effectiveness.

The discussion in the next section will focus on the King Report on Governance for South Africa (2009) and the King Code of Governance Principles (2009), which together are referred to as “King III” (PwC, 2009:1). The relevance of King III to this study is that it is applicable to all entities, regardless of the form of incorporation or establishment, which in essence will also be applicable to local government.

3.10 KING III ON AUDIT COMMITTEE EFFICACY

As mentioned above, “King III” comprises of the King Code of Governance Principles (2009) and the Report on Governance for South Africa (2009) (PwC, 2009:1), hereafter to be referred to as the Code and the Report respectively. The Report sets out recommendations on best practices, whereas the Code focuses on principles of governance. King III is preceded by the second King Report on Corporate Governance for South Africa (2002), which is referred to as “King II”, and its issuance was necessitated by the promulgation of the new Companies Act of South Africa, as well as the global changes on governance trends. King III is regarded as the embodiment of good governance in South Africa. In contrast to King I and King II, King III applies to all entities, regardless of the legal form or establishment, and whether in the private or public sector (IoDSA, 2009:16). Its applicability to government has been demonstrated by the National Treasury in its report to the Standing Committee on Public Accounts (SCOPA) on “Audit Committee and Compliance with the Regulations” (National Treasury, 2011:7), which made reference to King III in terms of the audit committee’s oversight in relation to integrated reporting.

King III highlights issues pertaining to audit committee formation, such as audit committee composition, authority and required resources, as well as the responsibilities of audit committees, which are all in line with the leading practices discussed in the previous sections. The responsibilities of an independent audit committee, as outlined in King III, include integrity of integrated reporting and internal financial controls, oversight of combined assurance, and identification and management of risks. There are other governance elements in both the Code and the Report of King III, which have been added as either new concepts or oversight

approaches, with a view to enhancing audit committees' oversight and, most importantly, enabling audit committees to effectively deal with emerging governance challenges (IoDSA, 2009:9). These new approaches and concepts are discussed below.

3.10.1 Key risks and reporting implications

King III adopts a wide approach to the audit committee's responsibilities for financial risk and reporting, which incorporate the following areas:

- **Assurance on integrity of integrated reporting** - integrated reporting encapsulates economic, social and environmental performance (referred to as the triple bottom line), which in essence also includes sustainability issues. King III requires statutory financial information and sustainably information to be included in the "integrated report" and to be prepared annually (PwC, 2009:2). Therefore, in reviewing sustainability reporting, an audit committee is required to ensure that the information provided is reliable and not in conflict with the financial results.
- **Combined assurance with regard to risks** - combined assurance effectively co-ordinates the efforts of management and those of internal and external assurance, and enhances their collaboration, as well as facilitating a common and holistic view of the organisation's risk profile. The audit committee is required by King III to monitor the appropriateness of the organisation's combined assurance model, and to ensure that significant risks are adequately addressed (PwC, 2009:2).
- **Annual review of internal financial controls**- King III requires the audit committee to determine the nature and extent of an annual review of internal financial controls and to conclude and report annually, as well as to include, in the "Annual Report", a report outlining the effectiveness of the internal financial controls. The report should include the extent of any material weakness in financial controls which might have resulted in actual material financial losses, fraud and any material errors identified (PwC, 2009:2).

- **Risk-based internal audit** – King III emphasises the fact that internal audit should adopt a risk-based approach in the development of its audit plan. Rather than being compliance-based, the internal audit plan should be aligned with the organisation’s risk assessment process and take into consideration the control environment, as well as the risks and opportunities identified by management. The role of the audit committee is to ensure that internal audit is adequately resourced and that it has the required skills to carry out its functions. The internal audit should also functionally report to the audit committee chairperson, so as to remain independent and objective.
- **IT governance** - King III requires an audit committee to operate with IT governance in mind in the execution of its oversight function. The review of IT governance should entail the assessment of its alignment with the performance and sustainability objectives of the organisation, optimisation of expenditure and value-adding to IT infrastructure, protection and management of information, and risk management which addresses the safeguarding of IT assets, disaster recovery and continuity plan. The consideration of IT by the audit committee is based on the fact that IT has a bearing on financial reporting and ‘going concern’ assumptions.

3.10.2 Other concepts introduced

Although most of the new concepts introduced are more suited to companies in the private sector, their relevance to local government operations is also undisputed. Therefore, the adoption of the recommendations as a whole will also enhance the effective functioning of audit committees in local government (IoDSA, 2013:2). These recommendations are as follows:

- King III recommends the evaluation of the performance of the audit committee to be done in-house or conducted professionally by independent service providers, as long as it is still in line with the legislative requirements.

- There is also provision made for an organisation's rescue, which recommends that the board or council commences with local government rescue proceedings as soon as it is financially distressed. This provision is consistent with Chapter 13 of the MFMA (2003) discussed in Chapter 2 of this study, which provides a list of interventions for local governments which are in financial distress. The role of audit committees in this instance is to monitor progress on implementation of the financial recovery plans of the local government.

King III also promotes principles of good governance. The holistic application of principles and recommendations in King III can therefore result in any audit committee practising good governance becoming effective in its oversight role (PwC, 2009:2). The King III governance framework follows an "apply and explain" approach, which means that when the Code and recommendations in the Report are applied, statements to this effect should be made to stakeholders, and in instances where only certain principles are applied, this should also be explained to the stakeholders (IoDSA, 2009:6). King III acknowledges that governance principles are evolving and that they are dynamic, and therefore places an emphasis on aspects such as effective audit performance. Against this background, it is also important to discuss the Internal Audit Standards to determine their applicability to audit committees' effectiveness.

3.11 INTERNAL AUDIT STANDARDS

Internal audit standards refer to a set of principles which provides a framework for performing the internal audit function. The standards are mandatory requirements, which consist of statements of requirements for the profession of internal auditing and for the evaluation of the effectiveness of its performance, as well as interpretations which clarify terms and concepts in the statements. The purpose of the standards is to promote consistency in the internal auditing approach, as the internal audit activities are carried out in diverse environment with different cultures, rules and regulations, which may affect the practices of internal audit in each environment (IIA, 2010:1).

Section 165 Of the MFMA (2003) provides for local government and its entities to establish an internal auditing function. The establishment of internal auditing in local government is a necessary process for the improvement of its operations, as it promotes an effective financial control environment. A systematic and disciplined approach adopted by internal audit is essential for the evaluation and improvement of the effectiveness of the risk management, controls and governance processes in local government (Protiviti, 2009:3). As attested to by IIA (2006), the goals and objectives of the audit committee and internal audit function are essentially interrelated (Abbott *et al.*, 2004:73). The reason for this is that one of the key responsibilities of internal audit is to assess the risk management processes and related system of control of the local government, while the audit committee has to oversee the function (Protiviti, 2009:56). An audit committee has to safeguard the independence of the internal auditors from management, as well as ensuring that the unit is adequately resourced in terms of funding, skills and required competences (Brink & Witt, 1982:758). Internal audit is also playing an important role as a support service for an audit committee in fulfilling its oversight role (Brink & Witt, 1982:757).

The Internal Auditing Standards are part of the Professional Practices Framework approved by the Institute of Internal Auditors (IIA) in 1999. The Framework comprises the definition of Internal Auditing; Code of Ethics; Standards and other guidelines (IIA, 2001:2). The IIA is responsible for the promulgation of the standards and the practices. The advisory bodies, together with the Internal Auditing Standards Board (IASB), are responsible for updating and revising the IIA standards (Protiviti, 2009:3). It must be noted that compliance with the Standards is essential for the effectiveness of the internal audit function (IIA, 2001:1).

The internal audit is required to apply the IIA standards in the performance of its duties, which include planned audits, consultancy or advisory services, investigations and training. The standards are divided into three categories, namely (i) attributes standards, (ii) performance standards, and (iii) implementation standards (IIA, 2010). Unlike the implementation standards, the attribute and performance standards are applicable to all services of the internal audit, and therefore, for the purpose of this

study, the focus will only be on attribute and performance standards, which are discussed below (Protiviti, 2009:61).

3.11.1 Attribute standards

Attribute standards refer to the characteristic powers and authority of organisations and individual internal audit services (Protiviti, 2009:61). For effective functioning of the internal audit, the standards require the purpose, authority and responsibility to be formally defined in an internal audit charter, in line with the Definition of Internal Audit, the Code and the Standards, and to be periodically reviewed (IIA, 2010:3). The attribute standards address the following attributes for effective functioning of the internal audit unit (IIA, 2010:3):

- **Recognition of the mandatory nature** of the Definition of Internal Auditing and the Code of Ethics in the internal audit charter. It is also critical for management and the board or council to understand the internal audit framework, as stipulated in the charter.
- **Independence and objectivity** - The internal audit must strive for independent functioning and the internal auditor must be objective in performing his or her work. The internal audit unit must carry out its responsibilities in an unbiased manner. Internal audit independence can be achieved through dual reporting to both management and the audit committee. To maintain objectivity, the individual internal auditor must have an impartial, unbiased attitude and avoid any conflict of interest.
- **Proficiency and professional due care** - Internal auditors must possess knowledge, skills and relevant competences to effectively carry out their professional responsibilities. The internal auditors are also required to enhance their skills and competences through continuous professional development. In exercising professional due care, internal auditors must be aware of any significant risks that might affect its engagement objectives, operations or resources negatively.
- **Quality assurance and improvement programme** - The chief audit executive must develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit.

The programme is used for assessment of the effectiveness of the internal audit function, and should identify any problems within the audit function and recommend improvements. The assessment of the internal audit function is an ongoing process which monitors the performance of the internal audit function on a regular basis. This is extended through periodic performance reviews conducted by means of self-assessment or external assessments by a qualified independent reviewer or a team from outside the organisation. A report on the quality assurance programme must be made available to both management and the audit committee. This report must highlight areas which have an impact on the overall operations of the internal audit function. This is consistent with King III's recommendation regarding disclosure and reporting with regard to the effectiveness of the internal financial controls.

3.11.2 Performance standards

Performance standards provide a framework for internal audit planning processes, as well as the management of internal audit activities (Protiviti, 2009:62). The purpose of performance standards is to provide a description of the type of activities performed by the internal audit function and the criteria for evaluation of its performance. The effectiveness of the internal audit function is achieved if it provides objective and relevant assurance and contributes to the effectiveness of the governance, risk management and control processes of local government (IIA, 2010:9). The performance standards address the following activities relating to the effective functioning of the internal audit unit (IIA, 2010:9):

- **Nature of work** – The internal audit function is required to evaluate and contribute to the improvement of governance, risk management and control processes using a systematic and disciplined approach. The internal audit function is required to assess and make appropriate recommendations with regard to the promotion of appropriate ethics and values within the local government, effectiveness of the operations and compliance with the policies and regulations.

- **Engagement planning** - The internal auditor is required to develop a plan for each audit engagement, which includes the objectives, scope, timing and resource allocation. The internal audit plan must be aligned with the local government's risk management framework and if this does not exist, the internal auditor is required to use his or her own judgement to ascertain the extent of the risk exposures after consultation with management and the audit committee. The internal audit engagement plan must be approved by management and the audit committee.
- **Performing the engagement** - The internal auditor is required to identify, analyse, evaluate and document information in line with the engagement objectives. In developing the engagement objectives, the internal auditor must consider the probability of significant errors, fraud, non-compliance and other exposures.
- **Communicating results** - The internal auditor is required to communicate the engagement results to management. The communication of engagement results must include the engagement objectives, as well as the applicable conclusions being drawn, recommendations and an action plan for the way forward. Reporting of the results must be timely and address critical risk issues for local government.
- **Monitoring progress** - The chief audit executive of the internal audit is required to establish and monitor the disposition of results communicated to management, by establishing a follow-up plan and ensuring effective implementation of recommendations by management.
- **Resolution of management acceptance risks** - In instances where the chief audit executive believes that management has accepted a level of the residual risk that may be unacceptable to the organisation, the chief audit executive is required to discuss the matter with management. If the matter regarding the residual risk is not resolved, then the chief audit executive is required to report the matter to the audit committee.

Figure 3.3 The IIA Effective Governance Model



Source: The Institute of Internal Auditors – Professional Guidance (s.a.)

Figure 3.3 above presents the IIA Corporate Governance Model, which promotes effective governance through the audit committee, with management and the internal and external audit as assurance structures.

The goal of internal auditing, as defined by IIA (2009), is to “assist the organisation to accomplish its objectives by bringing a systematic, discipline approach to establish and improve the effectiveness of risk management control and governance processes”. In the same vein, the establishment of an independent internal audit in local government is essential for the promotion of effective governance and accountability, with a view to providing good value for its local communities. However, to add value to the governance processes, the internal audit function is obliged to implement IIA standards and guidelines and be mindful of the risk environment in which it operates. It is therefore incumbent upon an audit committee to ensure that the internal audit processes are “supported by the effective risk intelligence which provides a continuous feed of relevant information about the threads” for the achievement of local government objectives (QFinance, 2013a:7).

Although the purpose of this chapter is to seek the most appropriate measures which can be applied to secure the effectiveness of an audit committee in local government, periodic evaluation of an audit committee's performance is imperative for redirecting audit committees' activities and processes towards local government objectives (PwC & IARF, 2011:106). The periodic evaluation of the audit committee's function encompasses an assessment of general effectiveness in the execution of its roles and relationships with management, internal and external auditors. It also includes the audit committee's understanding of local government operations and risks profile, as well as determining the extent of communication proficiency necessary for proper oversight, the details of which are discussed in the next section (AICPA, 2009:2).

3.12 EVALUATION OF AN AUDIT COMMITTEE'S FUNCTION

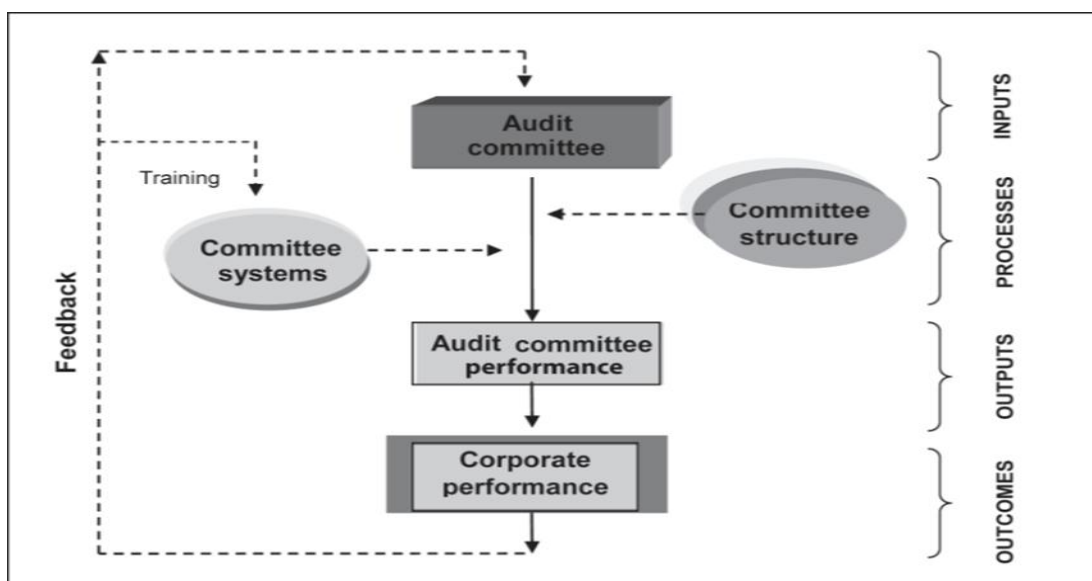
Audit committees are required to continuously review their oversight role in an effort to maintain their effectiveness (Van der Nest, 2006:183). The audit committee charter provides for audit committees' performance to be evaluated on an annual basis and for such evaluation to include self-assessment, and evaluation by management and internal and external auditors (Ernst & Young, 2012b:12). The evaluation of audit committees' function needs to be done to determine if it is discharging its role in line with its terms of reference in the charter (Deloitte, 2011:48). Feedback from the evaluation is very important, as it can identify areas which need improvement by audit committees and ensures adequate alignment with the charter. The charter refers to a formal document that defines audit committee's activities, purpose, authority and responsibility (NSW Government, 2010: 49).

There are several considerations when deciding on the best process for evaluating the audit committee's effectiveness (Deloitte, 2011:49). This evaluation can be based on a comparison of its activities with leading best practices, as this can assist the committee to understand alternative approaches and ways that can work better in the discharge of its role. Discussions on the performance of an audit committee among committee members, as well as management, in order to obtain views regarding what works best and what could be improved, can also serve as another

approach for the evaluation of an audit committee's performance (PwC & IIARF, 2011:106).

The evaluation of an audit committee's performance can also be led by management and the internal and external auditors, whereas King III recommends the evaluation to be done in-house or be conducted professionally by an independent service provider (PwC, 2009:2) A combination of these is recommended, as it may prove to be most effective if the two processes are alternated by engaging the external service provider every three years and facilitating the process internally in-between the three year period (Deloitte, 2011.49). Periodic self-evaluation by audit committees can identify ways of improving their effectiveness, as long as it provides for a programme of action with specific time lines and details regarding how the identified deficiencies are going to be addressed (BDO, 2012:2).

Figure 3.4 Determinants of an audit committee's performance



Source: (Adapted from Epstein et al., 2002: 6, as cited by Ferreira, 2007:51)

Figure 3.4 above illustrates the interrelationship between the process for the assessment of the audit committee's performance and that of the organisation's

performance, as well as indicating how the results identify the training needs of both the committee and the organisation.

According to Ernst and Young (2012a:12), an effective audit committee evaluation can yield the following benefits:

- prioritisation of meeting agendas and restructuring of meetings to focus on critical issues;
- reengineering of audit committee processes for alignment with the organisation's current and future activities, so that future challenges can be addressed effectively;
- creating an opportunity to revisit the timing, level of detail and quality of materials provided by management; and
- Identification of areas for continuing development to improve effective functioning of the committee.

There are many tools and resources developed by professional and regulatory agencies which are available as a guide to assist in the evaluation of an audit committee's function. Most of them are designed to address areas which have been identified to have an impact on the effective functioning of the committee, such as the audit committee's composition, activities, meeting agendas, qualifications and relationships with internal and external auditors (PwC & IIARF.2011:106). However, it is incumbent upon the audit committee, in collaboration with management, to decide on the most appropriate instrument to be adopted for evaluation of an audit committee's performance (Deloitte, 2011:49).

Consideration must also be given in terms of the format for evaluation of the audit committee's function (PwC & IIARF, 2011:106). For self-evaluation, audit committees may utilise a questionnaire which can be completed individually or as a collective. The format for assessment by management and internal and external auditors may consist of an evaluation form or interviews with individuals who have significant interaction with the audit committee (Deloitte, 2011:49). The evaluation process adopted may be reviewed from time to time to align it with the current governance dynamics. However, it is also important to consider the level of documentation of the

evaluation in terms of its appropriateness and ease of retrieval for future reference (PwC & IIARF, 2011:106).

On the basis of the discussion in this chapter, it is apparent that the complexities of the local government operations and an increasing need for effective leadership for management of its resources requires local government to have an effective governance system in place to ensure accountability (Deloitte, 2010:5). Therefore, it is essential for audit committees in local government to take cognisance of their unique oversight challenges resulting from the peculiarities of local government operations, and to demonstrate the “worth” of their oversight function (QFinance, 2013b:1).

3.13 CONCLUSION

In conclusion, this chapter has described the characteristics of an effective audit committee in local government in an attempt to determine the appropriate measurements to apply in the evaluation of its function. The discussion commenced with a definition of effectiveness as a concept, which in the management field relates to getting the right things done. The discussion further elaborated on the differences between the concepts of effectiveness and efficiency, due to the fact that these two concepts are closely related when applied in the management context. The importance of highlighting the differences was also to isolate the measures for effectiveness from those of efficiency, so that the measurement variable for effectiveness can be understood and subsequently applied in the development of the questionnaire for this study.

An in-depth discussion was also presented on the description of an effective local governance system and the significance of public sector auditing in the enhancement of accountability and transparency, as well as appropriate use of public funds. Public sector external auditors are obligated to observe the Fundamental Auditing Principles in the execution of the audit function, and the audit committee must also be conversant with these principles. The discussion on characteristics of an effective audit committee in local government was based on areas which have an impact on the effective functioning of these committees, such

as the audit committee's composition, authority, resources, processes and members' independence and diligence.

The complexity of local government operations and evolving governance standards have necessitated the development of new approaches and leading practices to enhance an audit committee's effectiveness. It is on this basis that a description of recent publications by professional and regulatory agencies was included in the discussion in this chapter. These publications provide guidelines on standards and leading practices for the effectiveness of audit committees. The publications included in the discussion were the guidelines by PwC (2012), National Treasury, and King III (2009) on King Code of Governance Principles and Report on Governance for South Africa. These guidelines suggest common processes and policies that work best for the enhancement of an audit committee's effectiveness. The King III approach of "apply and explain" in terms of execution of principles recommends the exercise of discretion in the application of the principles, with a provision that the ultimate objective is to achieve the overarching good governance principles of fairness, accountability, responsibility and transparency. With this in mind, it is therefore incumbent upon each organisation to adopt those practices which are ideal for its environment.

Due to the close association between the internal audit function and that of the audit committee, authoritative internal audit standards for the conduct of an effective internal audit function were also discussed in this chapter. The concepts adopted in the development of internal audit standards are found to be consistent with the fundamental auditing principles relevant to external auditing. A number of commonalities in terms of standards and recommended leading practices were also highlighted in this discussion. The discussion ended by providing a description of the general evaluation of an audit committee's function, including the various evaluation processes and formats. Some of the formats mentioned, such as the questionnaire, will be adopted in the empirical study.

In the following chapter, attention will be given to the empirical study, which aims to evaluate the effectiveness of the audit committee of Westonaria Local Municipality.

Taking cognisance of the challenges faced by local municipalities, it is hoped that the results of the study will provide useful knowledge that can be applied to other local municipalities or prompt further studies to be conducted to enhance the existing body of knowledge on the effectiveness of audit committees.

CHAPTER 4

EMPIRICAL FINDINGS ON THE EFFECTIVENESS OF THE AUDIT COMMITTEE OF THE WESTONARIA LOCAL MUNICIPALITY

4.1 INTRODUCTION

In the preceding chapters, an explanation was provided of the orientation of the study and the theoretical literature on the principles for an effective auditing function, as well as the characteristics that exist for the effective functioning of an audit committee. To fulfil the objective of the study, the criteria for the measurement of an audit committee's effectiveness were identified in this regard.

In this chapter, the researcher seeks to validate the perception regarding the effectiveness of the audit committee of the Westonaria Local Municipality. In order to achieve this, the discussion in this chapter will focus on the research design and methodology adopted in the empirical study. This entails a description of the target population and sample, as well as the methods and procedures for the collection of data. The chapter further presents a discussion on the interpretation of the findings from the empirical study, which will be presented in the form of charts and tables.

The data and information gathered for the study were analysed and interpreted through the use of quantitative research methodology. The questionnaire that was developed for this study was distributed to the target population, which consisted of people who are closely related to the audit function and activities in the Westonaria Local Municipality. In the following sections, the empirical study, utilisation of a questionnaire, research methodology, selection of the sample population and procedures followed in the collection and analysis of data will be discussed.

4.2 FOCUS ON EMPIRICAL RESEARCH

Empirical research can be defined as research based on investigation and observation (evidence). Empirical research is a valuable means for testing a hypothesis. The word 'empirical' means information gained by experience, involvement, observation or experiment (investigation) (Dictionary online, 2013). The central notion is that all evidence or information must be empirical, which means

that it is based on exploration. In essence, empirical refers to the testing of a hypothesis using experiments and observations (Explorable, 2013).

The following are the objectives of empirical research (Explorable, 2013):

- It goes beyond the simple reporting of information or the analysis of a phenomenon. It refers to the in-depth exploration of a phenomenon to establish the core business of that phenomenon.
- It promotes an environment for the improvement of understanding of a phenomenon.
- It combines extensive research with a detailed analysis of a phenomenon.
- It assists in the process of proving the relevancy of an approach or theory.

In this study, this goes beyond the simple obtaining of data on a specific aspect, namely the effectiveness of the audit committee of the Westonaria Local Municipality, in that it also combines extensive research with a detailed analysis of the phenomenon. The data is then interpreted and specific recommendations are made.

4.3 RESEARCH METHODOLOGY

The appropriateness of the research methodology is pivotal for any study to be successfully undertaken (Thomas & Smith, 2003:57). Therefore, the research methodology that has been selected for this study is suited to an examination of the effectiveness of the audit committee of the Westonaria Local Municipality. The research methodology includes aspects such as the tools and procedures to be employed for the selection of the population and sample, as well as data collection and analysis techniques (Mouton, 2012:56). For this study, a case study approach and a quantitative research methodology have been employed, as mentioned in Chapter 1, with the questionnaire as an instrument for collecting data.

4.3.1 Population

According to Babbie (2010:193), it is appropriate to select a sample on the basis of knowledge of a population, its elements and the purpose of the study. Therefore, the population for this study was purposely selected in consideration of its

appropriateness for the fulfilment of the objective of the study, which is to determine the perceptions of the management team who interact with the audit committee of the WLM regarding the effectiveness of its audit committee.

The population selected by the researcher consisted of all the officials in the WLM who were linked to the audit function. This was, however, a moderate number, and the study population therefore constituted 100% of the total population. This is called a total study, where every unit of the population who is relevant or related to the study is actually measured or recorded. This is possible only if the population is not too large and if all the respondents are available for the study. The researcher must also be comfortable with the fact that the population, who is actually selected non-randomly, will provide relevant information for the study (Burger & Silima, 2006: 656).

The researcher distributed the questionnaires electronically and then physically collected the outstanding questionnaires from those respondents, with their consent, who did not send them back in time. The population comprised ten respondents, who represent the senior management of the municipality at executive director and managerial levels.

4.3.2 Data collection

The gathering of information was accomplished by means of survey research. Surveys include the utilisation of a questionnaire, and a questionnaire is an instrument specifically developed to elicit information that will be useful for analysis (Babbie, 2010:255). The questionnaires were, as mentioned in Chapter 1, electronically distributed to the respondents, accompanied by a letter of consent. The letter of consent served as an introductory note in which the importance of the research was emphasised, and it also provided an explanation regarding the purpose of the research. The letter made provision for the respondents to acknowledge their voluntary participation in the study. An assurance of the confidentiality of the information obtained through the questionnaire and the anonymity of the respondents were guaranteed.

The respondents in this study were, as previously mentioned, and requested to submit the completed questionnaires electronically. A follow-up exercise was subsequently conducted by the researcher to physically collect the outstanding questionnaires from those respondents, with their consent, who did not send them back to the researcher in time. This is an indication that a study is useful and that the results are valid (Edwards *et al.*, 2002:21).

Attention will now be focused on the questionnaire that was developed and utilised as a research tool in this study. It will give the reader a better idea of the scope of data collection in this study.

4.3.3 The questionnaire as a research tool

A close-ended questionnaire was designed as a tool to collect valid and reliable information to test the hypothesis scientifically in this study, as mentioned in Chapter one. This research instrument makes it possible to measure people's knowledge, skills, likes and dislikes, attitudes and perceptions (Gravetter & Forzano, 2009:360). The questions in the questionnaire were based on the theory discussed in chapters two and three.

In this study, the researcher used the questionnaire to determine the perceptions of senior management in the Westonaria Local Municipality regarding the effectiveness of the audit function in these institutions. The most significant aspect of this type of data collection is that the questionnaire is the primary means of communication between the respondents and the researcher (Struwig & Stead, 2001). With such information available, the researcher could also make logical recommendations on the subject matter, as questionnaires may be used to obtain, *inter alia*, the following kinds of information from respondents (Huyseman, 1994:128):

- Their background information and procedures for completion of the questionnaires;
- Their behaviour towards a specific phenomenon (such as the audit function in the Westonaria Local Municipality);
- Their opinions and beliefs, as well as their convictions, regarding a specific occurrence; and

- Their attitude towards the functioning of a specific entity (the audit committee of the Westonaria Local Municipality).

There are advantages and disadvantages associated with this technique, which the researcher took note of during the gathering of data.

4.3.3.1 Advantages and disadvantages of questionnaires

The following **advantages** of questionnaires can be identified (Best, 1977:166):

- Questionnaires are one of the more prominent instruments that a researcher can utilise to collect data quickly;
- A questionnaire is relatively inexpensive, provided that it is compiled in such a way that respondents are able to interpret the contents of the questionnaire correctly;
- Administration is relatively easy;
- Questionnaires are an economical instrument to utilise. This includes the 'economy of time';
- A high proportion of responses can be achieved by the researcher in a short period of time;
- The data obtained when using questionnaires is normally without any bias because respondents are usually not known to the researcher;
- The interpretation and analysis of data can be done scientifically through the use of statistical techniques which increase the validity of the results; and
- The analysis of the data can be 'outsourced' to a specialist entity (such as the Statistical Services of the North West University).

The utilisation of a questionnaire proved to be a valuable instrument for collecting data in this study.

The following **disadvantages** associated with the utilisation of questionnaires can, however, be noted (Best, 1997:137):

- Respondents often fail to return the completed questionnaires or to complete them at all. An important reason for this is that they are suspicious of the reasons for the research and see it as a threat in some way or another. Others may see it as a waste of time and some simply do not understand the questions being asked. This is of big concern in a total study;
- Inaccurate completion of questionnaires creates problems. Some respondents may not supply accurate answers, as they may lack the ability to articulate their thoughts;
- Respondents who are reluctant to reveal information may ignore certain questions or even falsify their answers;
- A further limitation of conducting questionnaires is the problem of getting respondents to think of and come up with original responses, rather than responses that are merely pleasing to the researcher; and
- Close-ended questionnaires are rigid and do not provide the flexibility that the researcher may seek, and comments cannot be further explored or probed.

The researcher found, to a certain extent that more open-ended questions could have been asked in order to gain more insight into the topic. This notion was, however, rejected when the researcher determined that enough data had been obtained through the close-ended questions.

4.3.3.2 Development of the questionnaire for this study

The questionnaire for this study was developed with the purpose of finding out what the respondents' perceptions were regarding the effectiveness of the audit function in Westonaria Local Municipality. The respondents were assured of the confidentiality of the information provided to the researcher, which hopefully encouraged more sincere and truthful responses. The preparation of the

questionnaire followed theoretical guidelines, and took the following into account (Best, 1997:137):

- Long complex sentences were avoided, so that questions were clearer to respondents;
- Leading statements were minimised; and
- The wording of questions was clearly presented, with attention focused on directness and simplicity.

This approach helped to ensure that the questionnaire was compiled as scientifically as possible, in order to ensure a better understanding by all who completed it, so as to obtain accurate information. The statistics processed from the information gathered from the questionnaire can thus be regarded as truthful, and the study is therefore valid.

To measure respondents' perceptions regarding the effectiveness of the audit committee, a 5-Point Likert scale was utilised. It is one of the most popular (and reliable) instruments to obtain data. A Likert scale asks questions that range from one extreme to another, for instance from 'agree strongly' to 'disagree strongly', with three other alternatives in between. Unlike simple 'yes/no' questions, a 5-point-Likert scale allows the respondent to make specific choices from 1-5 (SurveyMonkey, 2013).

When compiling the questions for a Likert-scale type questionnaire, the following aspects must be taken into account:

- Avoid double-barrelled questions. Such questions give the respondents two or three options for the same question, which is confusing and leads to incorrect answers;
- Avoid quantitative statements in the questions. It is the intention of the Likert Scale to capture the extent or degree of the respondent's perceptions regarding a statement through an indication of their agreement or disagreement; and
- Avoid leading questions. Questions must be asked from a neutral standpoint, which means that leading statements towards a particular answer should be avoided (uOttawa, 2010).

In compiling the questions for this questionnaire, complex questions and quantitative statements were avoided and the researcher was also careful not to lead the respondents in a specific direction because she wanted to determine the respondents' individual opinions, attitudes, perceptions and beliefs.

4.3.3.3 Structure and content of the questionnaire for this study

The questionnaire designed for this study was divided into three main sections. The senior management of the Westonaria Local Municipality were asked to take part in this study and to complete this questionnaire. This protocol was followed to secure data of a high quality and to make this study a success.

- i) **Section A:** This section consisted of eight questions, which focused on the principles associated with the effective functioning of the audit committee of the Westonaria Local Municipality.
- ii) **Section B:** This section included six questions to determine the key qualities and characteristics associated with effective audit committee members.
- iii) **Section C:** This section also comprised six questions, with the purpose of determining the extent to which the audit committee of Westonaria Local Municipality observes best practices associated with the effectiveness of audit committees.

All the questions were, as previously mentioned, structured based on the theoretical discussion presented in Chapters 2 and 3 of this study. The data that was gathered was utilised to test the following:

- Whether the hypothesis, as stated in Chapter 1, is true or false.
- Whether the establishment of the audit committee for Westonaria Local Municipality was done in accordance with the prescribed legislative framework. The theoretical literature was discussed in Chapter 2.
- Whether the members of the audit committee of the Westonaria Local Municipality exercise caution and diligence in the execution of their audit function. The related theoretical literature was discussed in Chapter 3.

- Whether or not the best practices related to committees' effective functioning have been implemented .Both chapters two and three formed the basis for these questions.

4.3.3.4 Questions formulated for the questionnaire (Appendix 7.2)

The following questions were formulated for the questionnaire:

SECTION A OF THE QUESTIONNAIRE: QUESTIONS ON THE PRINCIPLES CONSISTENT WITH THE EFFECTIVE FUNCTIONING OF THE AUDIT COMMITTEE OF THE WESTONARIA LOCAL MUNICIPALITY:

Question A.1: The audit committee charter gives sufficient authority to the audit committee, which is in line with its assigned audit function.

Question A.2: The audit committee comprises members with relevant qualifications.

Question A.3: The audit committee members have sufficient experience in financial reporting to serve on such a committee.

Question A.4: The audit committee holds a sufficient number of meetings.

Question A.5: The audit committee receives appropriate agendas, quality reports and documentation on time, in order to review them before meetings.

Question A.6: The audit committee discusses the scope of the internal and external audit regularly.

Question A.7: The audit committee maintains productive relationships with management.

Question A.8: The audit committee has open lines of communication with management.

SECTION B OF THE QUESTIONNAIRE: QUESTIONS ON THE QUALITIES AND CHARACTERISTICS OF EFFECTIVE AUDIT COMMITTEE MEMBERS:

Question B.1: The audit committee members act independently, without any undue influence from management in the discharge of their oversight function.

Question B.2: The audit committee members act impartially.

Question B.3: The audit committee members probe for more information from management when provided with inappropriate or unsatisfactory responses.

Question B.4: The audit committee asks questions beyond the financial information and reports provided by management.

Question B.5: The audit committee members are well informed of developments in local government.

Question B.6: The audit committee members attend meetings regularly.

SECTION C OF THE QUESTIONNAIRE: QUESTIONS ON STANDARDS ASSOCIATED WITH THE EFFECTIVENESS OF THE AUDIT COMMITTEE:

Question C.1: The audit committee meets informally with the internal and external auditors throughout the year.

Question C.2: The audit committee probes for more explanation on financial risks associated with areas of management's judgement.

Question C.3: The audit committee receives appropriate training on existing and emerging risks in local government.

Question C.4: The audit committee is provided with sufficient administrative assistance and support for logistical arrangements for their meetings and reporting.

Question C.5: Management has developed a continuous learning programme for audit committee members.

Question C.6: The audit committee evaluates its own performance to identify areas for improvement.

The questionnaire was, according to the respondents, clearly understood, and the researcher found it easy to administer. The responses from the participants were positive, as they indicated that they did not experience difficulty in completing the questionnaire. Its validity and reliability were thus evident. This means that the questionnaire was, as a data collection instrument, consistent, dependable (reliable) and valid. Therefore, it will measure what it intended to measure (uOttawa, 2010).

4.4 DATA ANALYSIS AND INTERPRETATION

Following the data collection phase is the analysis and interpretation phase of the information collected, with a view to drawing a conclusion (Mouton, 2012:108). The data was analysed by the researcher with reference to the results of the questionnaires, and was then processed and evaluated using descriptive analysis. Such quantitative data analysis, using numbers to discover and describe patterns in the data, is one of the most commonly used techniques in the field of social sciences. The data was then prepared in a format suitable for computer entry (Sage, 2010). The data collected from the individual responses was coded and transferred into a MS Windows Excel spreadsheet for analysis (Spreadsheet.about.com, 2013).

The results from the analysis are graphically presented in the form of tables and graphs. There are many forms of tables and graphs available to the researcher to present data to the reader. In this study, the majority of the information is, however, presented in the form of pie charts. A pie chart is used to chart only one variable at a time in the form of a percentage of the whole. The chart is divided into slices representing a total of 100% (Spreadsheet.about.com, 2013). The overall results for each section, that is Sections A, B and C, are summarised and presented in the form

of bar charts. A bar chart contains solid vertical bars separated by space, and summarises more than one variable at one time (Spreadsheet.about.com, 2013).

4.5 RESEARCH FINDINGS AND ANALYSIS

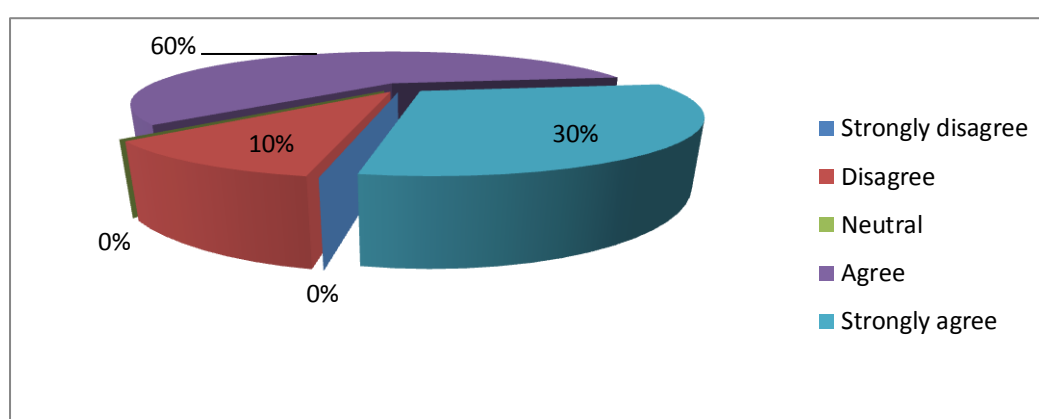
This section details the results obtained from the data analysis explained in the previous sections. The main objective of a study is to present the findings systematically and clearly (Thomas & Smith, 2003:18).

4.5.1 Section A of the questionnaire: Effective functioning of audit committees

There are eight questions in Section A, which focuses on the principles associated with the effective functioning of the audit committee. The questions are formulated to determine if the audit committee has sufficient authority to fulfil its objectives and whether or not it operates independently from management, in order to foster transparency and accountability. The results of the analysis of each question are presented below in the form of pie-charts, and the final presentation of data for this section can be found at the end of Section A in the form of a bar chart.

- Question A 1: The audit committee charter gives the audit committee sufficient authority, which is in line with its assigned audit function.

Table 4.1: Audit committee authority provided by the charter



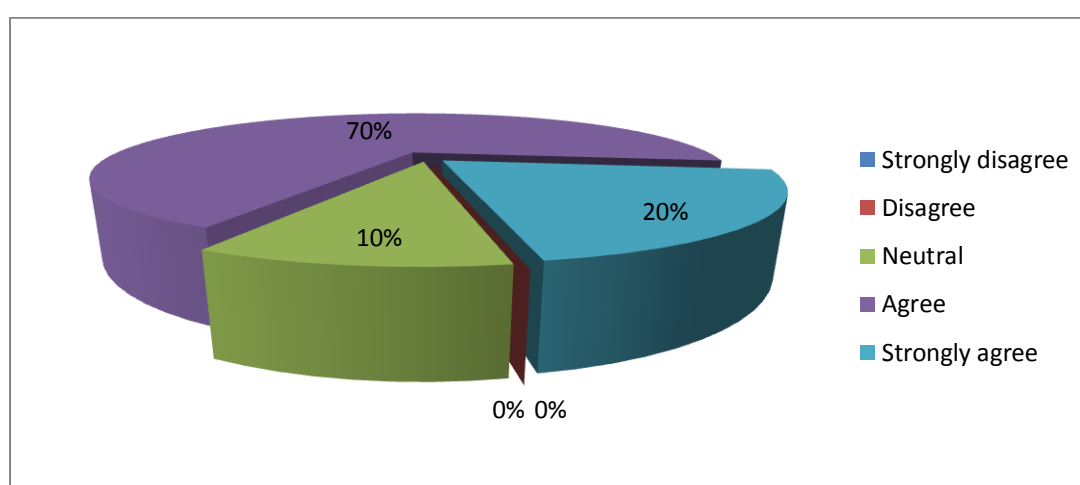
Source: Drawn from the MS Windows Excel spreadsheet analysis

In theory, understanding the parameters of their audit role is paramount for the effective functioning of audit committees. Both the Cadbury Code of Best Practices on Corporate Governance (2000) and the Normative Measures for Financial Management developed by the National Treasury (2003) require an audit committee to operate within written terms of reference, which outline its responsibilities and authority (Van der Nest, 2006:180). An audit committee's charter should also outline its mission and right to financial information and other related reports (Braiotta, 2004: 45).

Table 4.1 above indicates that 6 of the respondents agreed that the audit committee charter provides the audit committee with sufficient authority, which is in line with its assigned responsibility. This represents 60% of the total number of respondents, whereas 30% indicated that they strongly agreed with the statement and one respondent disagreed. This suggests that the majority of the respondents agree that the audit committee of the Westonaria Local Municipality is vested with adequate authority to carry out its function. The authority entrusted to the audit committee gives them the right to seek information from management and make decisions pertaining to their duties.

- Question A.2: The audit committee comprises members with relevant qualifications.

Table 4.2: Relevance of audit committee members' qualifications



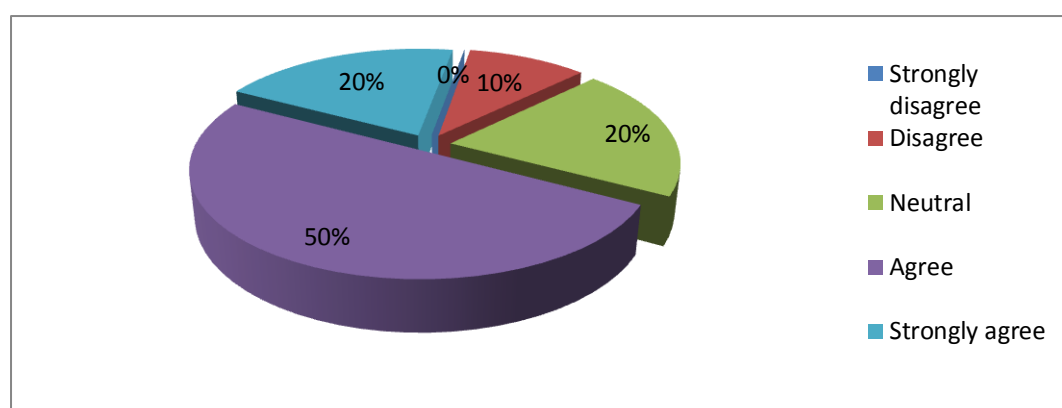
Source: Drawn from the MS Windows Excel spreadsheet analysis

The prescribed principle framework for auditing in government is derived from the ISSAI, which was developed by the INTOSAI, of which South Africa is also a member. This framework requires that the audit team has the necessary skills and competences for the successful completion of the audit activities (INTOSAI, 2013:14). In the same vein, the norms and standards for the formation of audit committees, as outlined in Normative Measures for Financial Management, which was published by the National Treasury (2003), require the audit committee's membership to have a varied composition in terms of qualifications, skills, expertise and qualities. This is reiterated by the MFMA (2003), which provides for the audit committee to comprise members with the appropriate experience.

Table 4.2 above presents the responses in terms of the relevance and applicability of the audit committee's qualifications. The results illustrate that 70% of the respondents agreed with the statement, with 20% strongly agreeing, whereas one respondent was neutral about the statement. Therefore, the results illustrate that the majority of the respondents (90%) believe that the audit committee is properly constituted of members with the applicable qualifications. The audit committee for the municipalities must be composed of members who have a blend of qualifications and skills relevant to the implementation of local government operations, such as financial reporting and the audit function.

- Question A.3: The audit committee members have sufficient experience in financial reporting to serve on such a committee.

Table 4.3: Audit committee members' experience in financial reporting



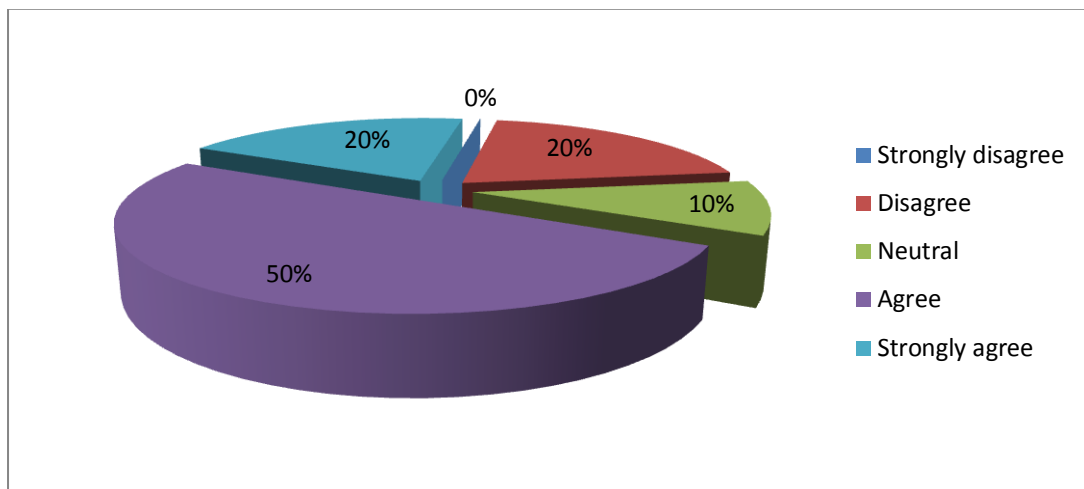
Source: Drawn from the MS Windows Excel spreadsheet analysis

The primary responsibility of an audit committee, from its origin, has been to oversee the financial reporting of organisations, with a view to safeguarding the integrity of the financial statements and pronouncements relating to financial performance (PwC & IIARF, 2011: 2). Audit committee members, in reviewing the financial statements, should be concerned with their completeness, accuracy and focus on critical disclosure requirements, trends and fundamental uncertainties that may occur, including factors that may cause doubt about the “going concern” ability (Braiotta, 2004:124). It is on this basis that audit committees are seen as the “financial watchdog” for stakeholders and communities (Marx, 2008:2).

Table 4.3 above illustrates that half of the respondents agreed that the audit committee members have sufficient experience in financial reporting to serve on the audit committee. The percentage of respondents who strongly agreed and those who were neutral to the statement was 20% in each case. One respondent disagreed with the statement. In essence, two-thirds of the respondents are in support of the statement that audit committee members possess sufficient experience in financial reporting to serve on the committee. The findings raise concerns, however, in terms of the responsibility to oversee financial reporting, as the extent of the audit committee’s financial expertise should in no case be disputed. For the review of financial information, the audit committee members may receive large quantities of financial information, which they must understand and analyse when reviewing the financial statements.

- Question A.4: The audit committee holds a sufficient number of meetings.

Table 4.4: Sufficient number of audit committee meetings held



Source: Drawn from the MS Windows Excel spreadsheet analysis

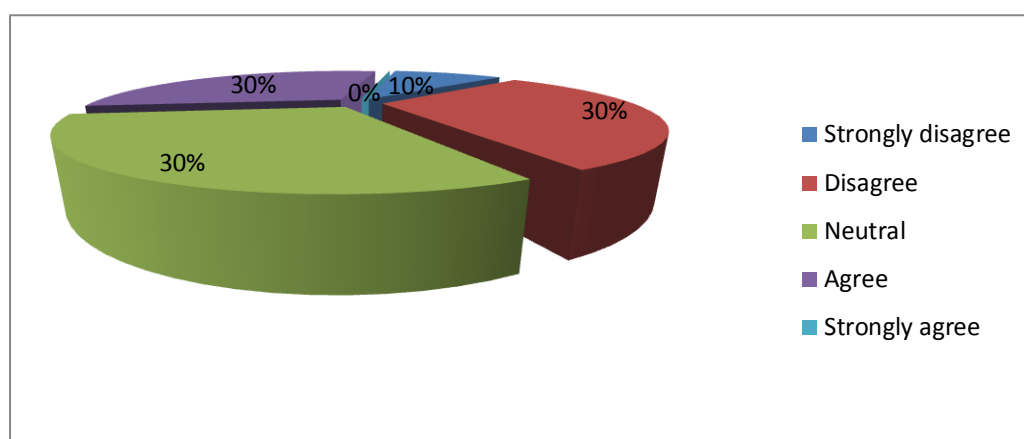
The prerequisite for effective implementation of an audit project, as provided by INTOSAI (2013), is that the audit project plan should outline the audit process, which includes the scope and audit objectives, audit activities and roles and responsibilities. Similarly, the Normative Measures for Financial Management, published by the National Treasury (2003), require audit committees to hold adequately planned meetings at least four times a year. The audit committee framework for the execution of the committees' activities, which is provided by PwC and IIARF (2011), requires an audit committee to develop a planned schedule of meetings. In this plan, the audit committee must provide details regarding how such meetings are to be conducted, as well as the recording and documentation of their discussions and recommendations.

Table 4.4 above indicates that 50% of the respondents agreed with the statement that the audit committee holds sufficient meetings, and 20% strongly agreed with the statement. The other 20% disagreed with the statement and the remaining 10% were neutral to the statement. In essence, the majority of the respondents are in agreement with the statement. It is expected that an audit committee must meet as often as it is required to carry out its oversight role, and most importantly, to

optimise the effectiveness of meetings by prioritising the agenda and scheduling meetings to coincide with the timing of key issues on financial reporting and the audit process.

- Question A.5: The audit committee receives appropriate agendas, quality reports and documentation on time, in order to review them before meetings.

Table 4.5: Timely receipt of meeting agendas and related documents and reports



Source: Drawn from the MS Windows Excel Spreadsheet analysis

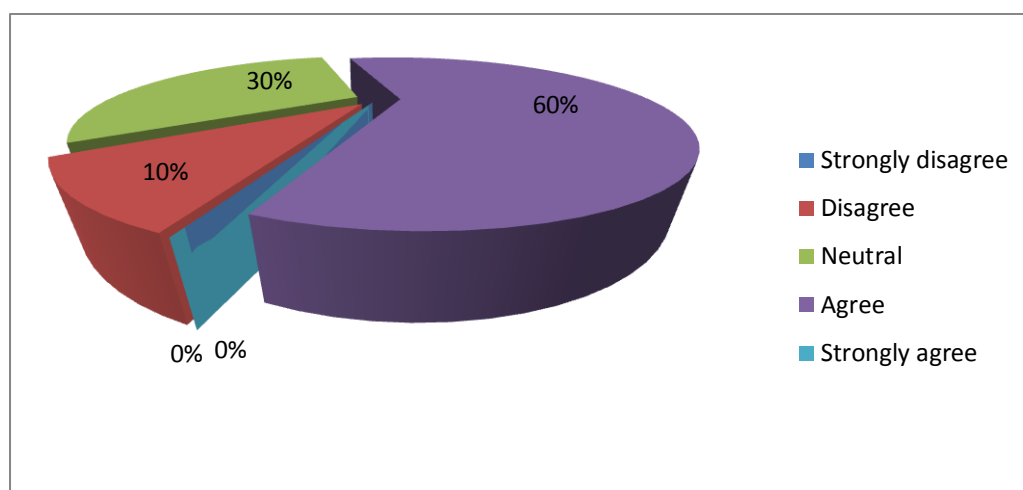
As is the case with the planning of audit committees' meetings, audit committees need to plan ahead for the year's agenda, which relates to matters that are significant to audit committees' oversight role. Audit committees need to be provided with the agenda and supporting reports and documentations ahead of each meeting in order to adequately prepare for the meetings. Unlike the external auditors' process, which entails the gathering of supporting evidence for the information provided, audit committees rely heavily on information provided by management (Ernst & Young, 2012a:9). Therefore, the quality of reports and documentation supporting the agenda not only optimises the effectiveness of meetings, but is also paramount to the credibility of decisions and validity of recommendations which audit committees ultimately have to make to management and the council.

The results presented in Table 4.5 above illustrate that 30% of the respondents were in agreement with the statement that the audit committee receives appropriate

agendas, quality reports and documentation in sufficient time to review them before meetings, whereas 30% were neutral to the statement and another 30% disagreed. The remaining 10% totally disagreed with the statement. The results suggest that the audit committee does not adequately prepare for meetings, as the members do not get the agenda and all other related reports and documents in sufficient time to prepare for meetings. The agenda and reports for the meetings must be distributed beforehand to enable the committee to adequately evaluate them and prepare for meetings. This is because the meeting agenda and reports must relate to matters which are significant to the committee's oversight role and which is now not the case. This should be a reason for concern for the Westonaria Local Municipality, and this matter should be attended to urgently. Recommendations in this regard will be made in the next chapter.

- Question A.6: The audit committee discusses the scope of the internal and external audit.

Table 4.6: Audit committee's discussions with internal and external auditors on their scope



Source: Drawn from the MS Windows Excel spreadsheet analysis

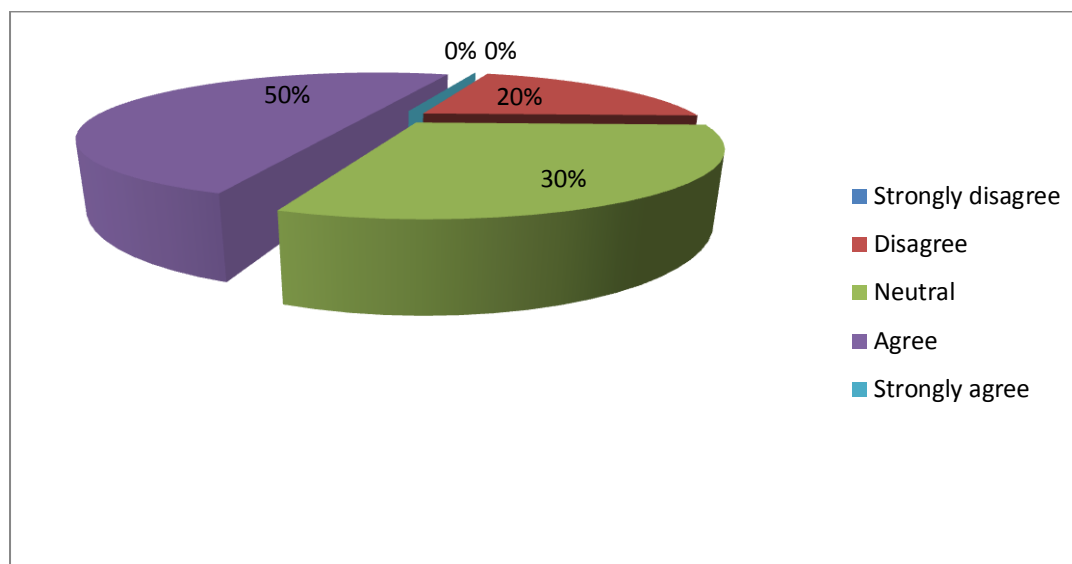
Effective communication between audit committees and internal and external auditors is essential for the quality of the audit outcomes. As part of its oversight of the audit process, the audit committee should discuss the scope and issues of

concerns raised during the audit engagement and on conclusion of the audit process. Both the Cadbury Code of Practices (2000) and Financial Reporting Framework Guide by the National Treasury (2011) provide for the audit committee to discuss the scope of the audit with the external auditors, including issues of concern raised during the audit engagement and the audit report on completion of the audit process. Audit committees are also required to monitor progress on implementation of the external auditor's recommendations.

Table 4.6 above indicates that 60% of the respondents agreed that the audit committee discusses the scope of the internal and external audit regularly, including issues of concerns raised during the audit engagement, financial statements and the 'management letter' on completion of the external audit. The statement also suggests that the audit committee reviews management responses to the audit findings. 30% of the respondents neither agreed nor disagreed, and were therefore neutral to the statement, with the remaining 10% indicating that they disagreed with the statement. As part of their oversight function, the audit committee must discuss the scope of the audit with the external auditors and invite them to discuss issues of concern during the audit engagement. Regular meetings with the internal and external auditors help the audit committee to stay informed on audit matters. Furthermore, the audit committee is supposed to ensure that management addresses the identified weaknesses raised by the internal and external auditors, as this can result in an improvement in the quality of the audit outcomes, which on the basis of the AGSA's recent reports, is currently an area of concern in local government.

- Question A.7: The audit committee maintains productive relationships with management.

Table 4.7: Maintenance of productive relationships with management



Source: Drawn from the MS Windows Excel spreadsheet analysis

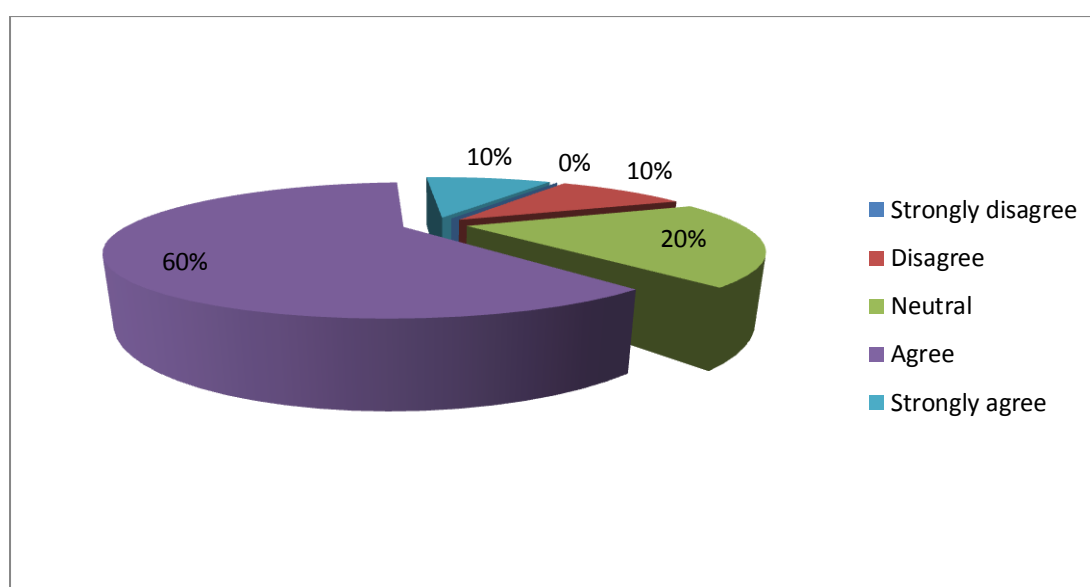
An audit committee, in the execution of its function, is required to demonstrate leadership and the ability to promote effective working relationships with management. Both the Cadbury Code of Practices (2000) and Financial Reporting Framework Guide by the National Treasury (2011) provide for an audit committee to establish procedures which are credible and transparent in terms of how it will engage with management on issues related to their oversight function, and to further develop procedures for how reports on its recommendations are to be disseminated to management.

The results presented in Table 4.7 above indicate that half of the respondents agreed that the audit committee maintains a productive relationship with management, whereas 30% neither disagreed nor agreed, with the remaining 20% disagreeing with the statement. In essence, this illustrates that there is an equal split between the respondents in terms of those who disagreed with the statement and those who did not. The lack of a majority support for the statement suggests that there is not a productive relationship between the audit committee and management,

which raises concerns, as the audit committee relies on management for support in carrying out its oversight function. This should also be a reason for concern for the Westonaria Local Municipality, and the situation should be attended to as a matter of urgency. Recommendations in this regard will be made in the next chapter.

- Question A.8: The audit committee has open lines of communication with management.

Table 4.8: Maintenance of effective communication with management



Source: Drawn from the MS Windows Excel spreadsheet analysis

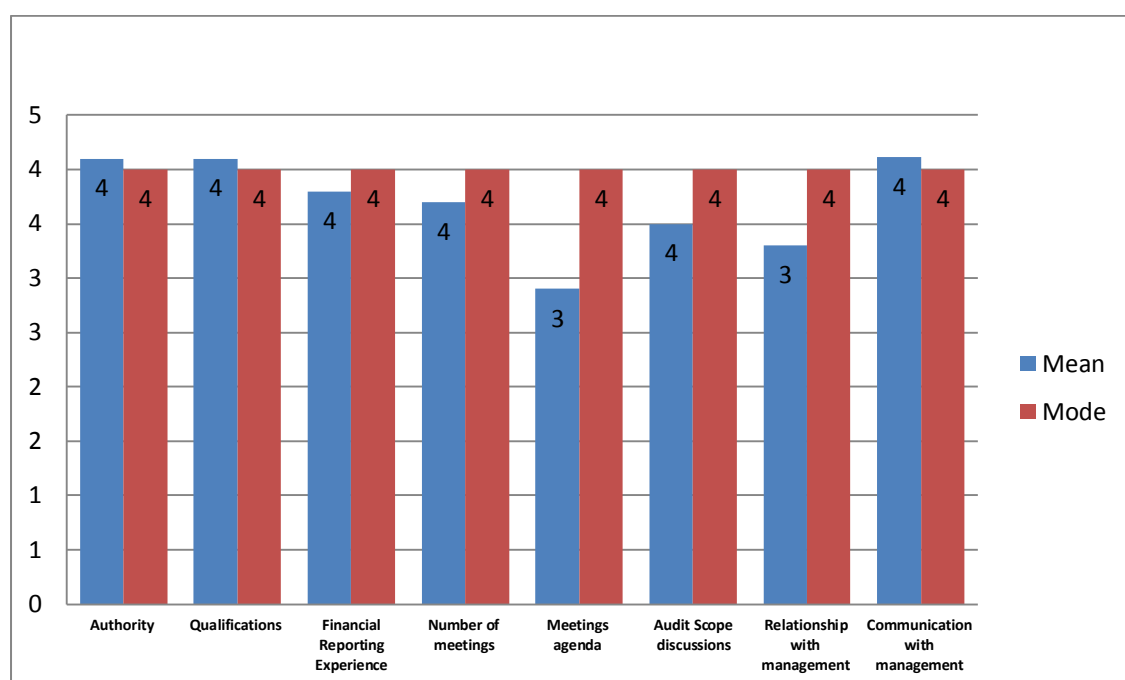
The fundamental principles on auditing prescribed by INTOSAI (2013) require the external auditors to maintain good communication with their clients, which is believed to foster a constructive working relationship, and communication serves as a means by which the auditor can obtain information required for the audit. Similarly, management serves as the key resource for obtaining information needed by the audit committee in the execution of its oversight function, and audit committees should therefore have unrestricted access to management and the internal audit whenever the need arises for clarification of issues.

Table 4.8 above shows that 60% of the respondents agreed that the audit committee has open lines of communication with management. There were 20% who were neutral to the statement and 10% who strongly agreed, while the remaining 10% of respondents disagreed. The results indicate that the majority of the respondents are in agreement with the statement. However, it is concerning that 30% of the respondents are not in agreement with the statement. The audit committee is required to formally establish procedures which are credible and transparent with regard to how it will engage with management on issues relating to its oversight function, and the existence of such procedures must therefore be known and communicated to the entire management.

4.5.2 Overall analysis of Section A: Effective functioning of audit committees

The aim of providing the overall picture is to illustrate the central tendencies in the measurements of all the statements in Section A.

Table 4.9: Overall perspective regarding the effectiveness of the audit committee



Source: Drawn from the discussions in Section A

The aim of the questions in Section A was to assess the effective functioning of the audit committee as a collective, which is based on the determinants identified in the audit committee literature, namely composition, authority, resources and the audit committee process. Table 4.9 above presents the average ratings by the respondents for each question, which were measured in Section A (Tables 1 to 8). The results indicate that there is overall agreement that the Westonaria Local Municipality is functioning effectively.

The following questions in section A indicated that a positive response was noted by the respondents (Average of 4 out of 5), which suggests that the audit committee of the Westonaria Local Municipality is in general an effective unit when it comes to the performance of its functions:

- That it has sufficient authority, which is in line with its assigned oversight function;
- That it comprises members with relevant qualifications;
- That the audit committee members have sufficient experience in financial reporting to serve on such a committee;
- That the audit committee holds a sufficient number of meetings;
- That the audit committee discusses the scope of the internal and external audit regularly; and
- That the audit committee has open lines of communication with management.

There is, however, a concern that the audit committee is not provided with the agenda and reports on time, as the average score for this question was 3. Another problem that came to the fore is that there are some challenges with the relationship between the audit committee and the management of the municipality. The average score in this case was also 3. As can be seen in Table 4.9 above, the average for the other questions was 4 out of the standard of 5.

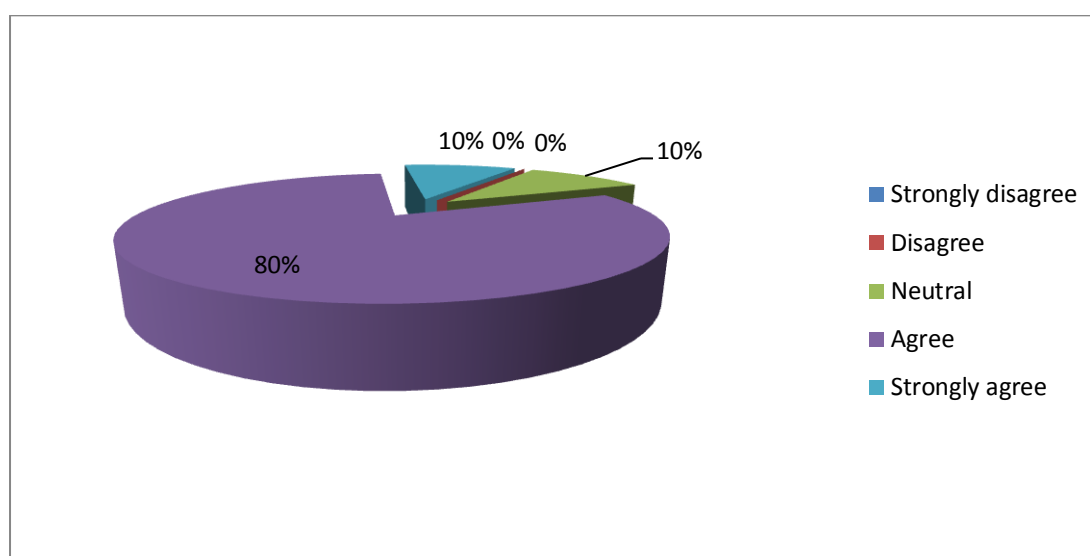
As mentioned previously, recommendations in this regard will be made in Chapter five.

4.5.3 Section B of the questionnaire: Effectiveness of audit committee members

The purpose of Section B is to determine if audit committee members in the Westonaria Local Municipality have the key qualities and characteristics associated with the effective functioning of such a committee. The assessment of audit committee members' attributes is based on their independence in terms of their actions and how they engage with management, as well as the extent to which they exercise diligence in the conduct of their oversight function. The results of the analysis of each question, including the overall analysis of Section B, are presented below:

- Question B.1: The audit committee members act independently without any undue influence from management in the discharge of their oversight function.

Table 4.10: Audit committee members' independence



Source: Drawn from the MS Windows Excel spreadsheet analysis

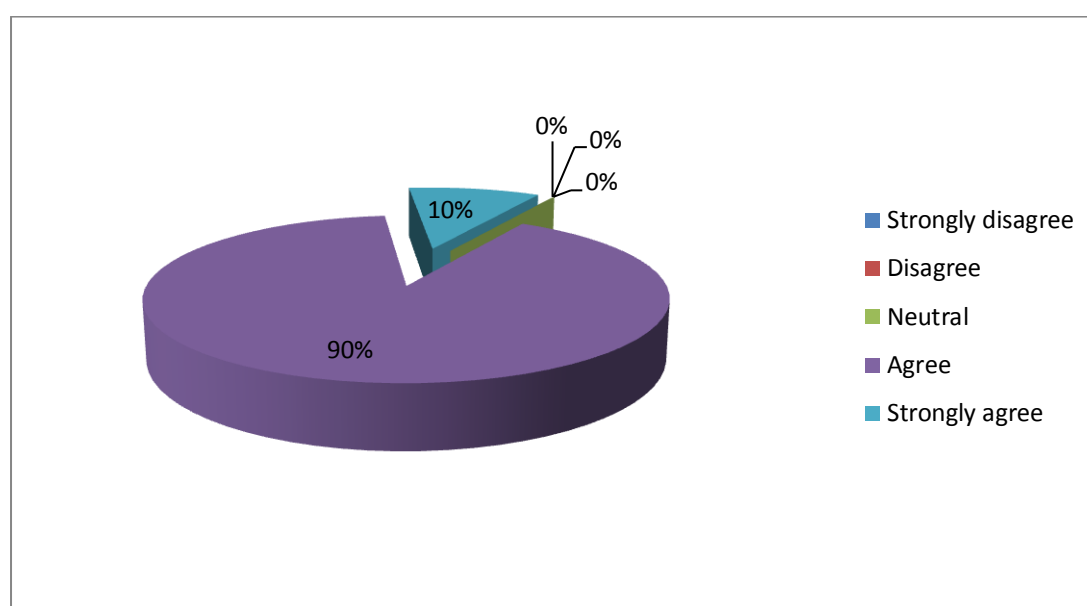
In theory, independence is the core principle underpinning the oversight responsibility. The independence of audit committee members sets them free from any influence by management, which could impair their objectivity (Abbott *et al.*, 2003:31). Independence basically requires the audit committee to ensure and

demonstrate freedom from interference in their decision making, and therefore enhances their objectivity when dealing with management (INTOSAI, 2013:13).

Table 4.10 above illustrates that 80% of the respondents agreed that the audit committee members act independently without any undue influence from management in the discharge of their oversight function, with 10% of the respondents strongly agreeing with the statement and 10% being neutral to the statement. The independence of audit committee members is thus ensured in the Westonaria Local Municipality. This is a critical input characterising the effective functioning of audit committee members, as it affords members the courage and willpower to challenge management on issues relating to financial reporting and the audit process.

- Question B.2: The audit committee members act impartially.

Table 4.11: Audit committee members' impartiality



Source: Drawn from the MS Windows Excel spreadsheet analysis

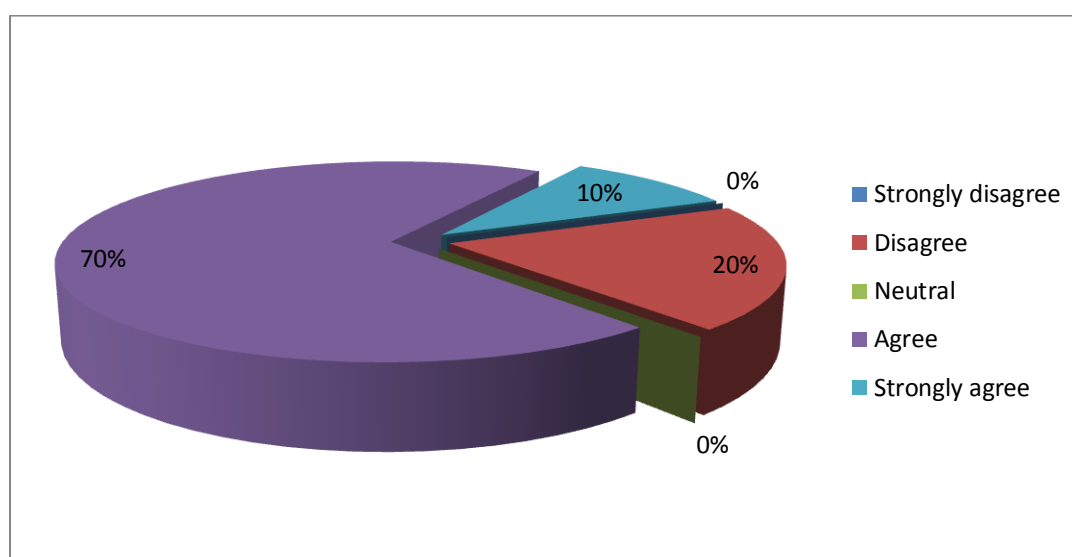
Fairness is one of the principles underlying good governance. In exercising impartiality, audit committee members must be free of bias, prejudice and disfavour in their dealings with management, as well as internal and external auditors. Audit

committee members must be able to maintain a distance but also be receptive to views and arguments in their discussions (INTOSAI, 2013:15).

Table 4.11 above indicates that the majority of respondents, representing 90%, agreed with the statement that the audit committee members act impartially. The remaining 10% strongly agreed with the statement, which means that all respondents (100%) were in agreement with the statement. The independence of members ensures their impartiality and objectivity, as well as undue influence from management. The audit committee, without any fear or favour, should be able to have a robust discussion with management about all aspects of governance, particularly the aspect of risks associated with financial reporting. Their independent status enables them to maintain the integrity of the financial statements.

- Question B.3: The audit committee members probe for more information from management when provided with inappropriate or unsatisfactory responses.

Table 4.12: Probing of details from management when responses are not satisfactory



Source: Drawn from the MS Windows Excel spreadsheet analysis

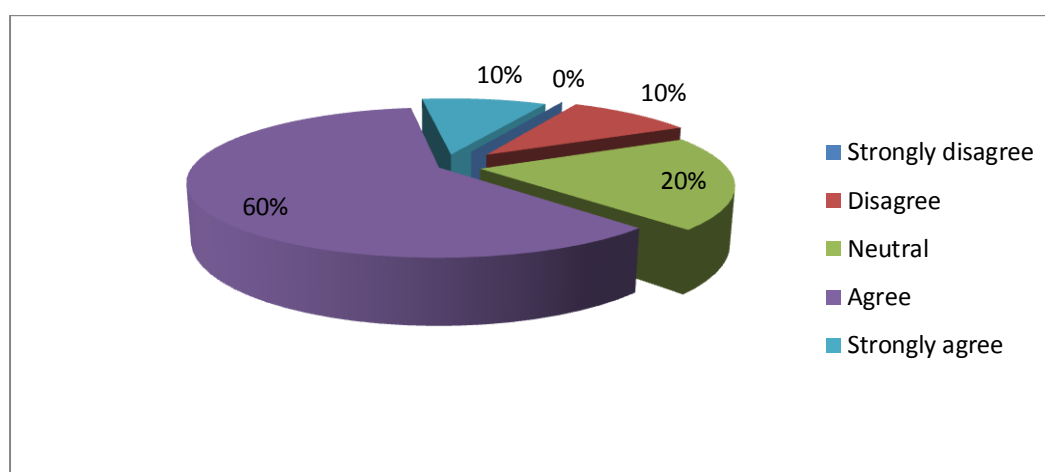
In exercising impartiality, audit committees must be alert and adopt a questioning attitude, as well as exercising judgement and authority. Most importantly, they must

remain vigilant and be well informed. They must be willing to ask management probing questions and be persistent in the pursuit of correct answers and a better understanding of the risks associated with local government operations and financial reporting (Abbott *et al.*, 2003:31).

Table 4.12 above indicates that 70% of the respondents agreed with the statement that the audit committee members probe for more information from management when provided with inappropriate or unsatisfactory responses, and 10% strongly agreed with the statement, whereas 20% disagreed. The results indicate that the majority of the respondents are in agreement with the statement. Attributes for the effective functioning of audit committee members is characterised by their approach and conduct, as well as desirable behaviours when dealing with matters that are significant to their oversight function.

- Question B.4: The audit committee members ask questions beyond the financial information and reports provided by management.

Table 4.13: Extensive questions beyond financial information are being asked by the audit committee



Source: Drawn from the MS Windows Excel spreadsheet analysis

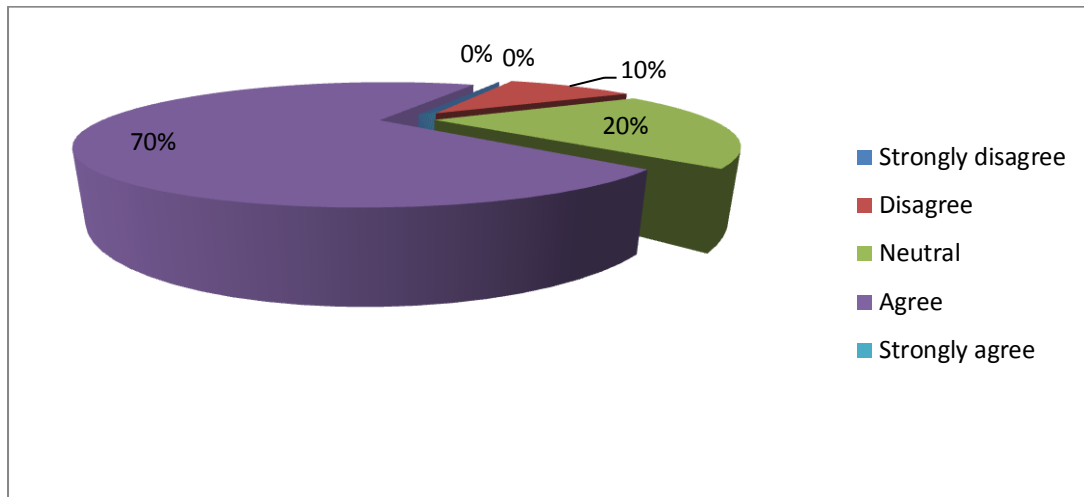
One of the primary functions of the audit committee is to oversee the financial reporting of the organisation. To achieve this, audit committee members are required to exercise due care and diligence in the review of financial information, so as to

ensure the completeness, accuracy and integrity of the financial statements. Diligence is defined as the consciousness of the audit committee members of the need to pay a high degree of care in their oversight role. Therefore, this necessitates the audit committee members asking questions beyond what is provided by management in their reports, in order to obtain an understanding beyond the financial information provided (KPMG, 2006).

The results presented in Table 4.13 above indicate that 60% of the respondents agreed with the statement that the audit committee members ask questions beyond the financial information and reports provided by management, and 20% were neutral to the statement. The remaining respondents, constituting 10%, strongly agreed with the statement, whereas the other 10% disagreed with it. Financial information includes matters which involve the exercise of management's judgement and which are significant to financial reporting, including accounting policies and estimates adopted in the disclosure in financial statements. The evaluation of risks associated with financial reporting seeks to obtain an in-depth understanding of the basis for those judgements and the impact this has on financial reporting. These are therefore areas which require the audit committee to probe continually for more information until they are satisfied with the explanations provided by management (Abbott *et al.*, 2003:31). In essence, the audit committee should strive to probe the management of Westonaria Local Municipality on an ongoing basis with regard to financial matters. The 70% of the respondents who agreed with the statement mentioned above should thus become a part of the vision of the municipality to expand knowledge beyond the boundaries of the audit committee.

- Question B.5: The audit committee members are well informed of developments in local government.

Table 4.14: Audit committee's familiarity with developments in local government



Source: Drawn from the MS Windows Excel spreadsheet analysis

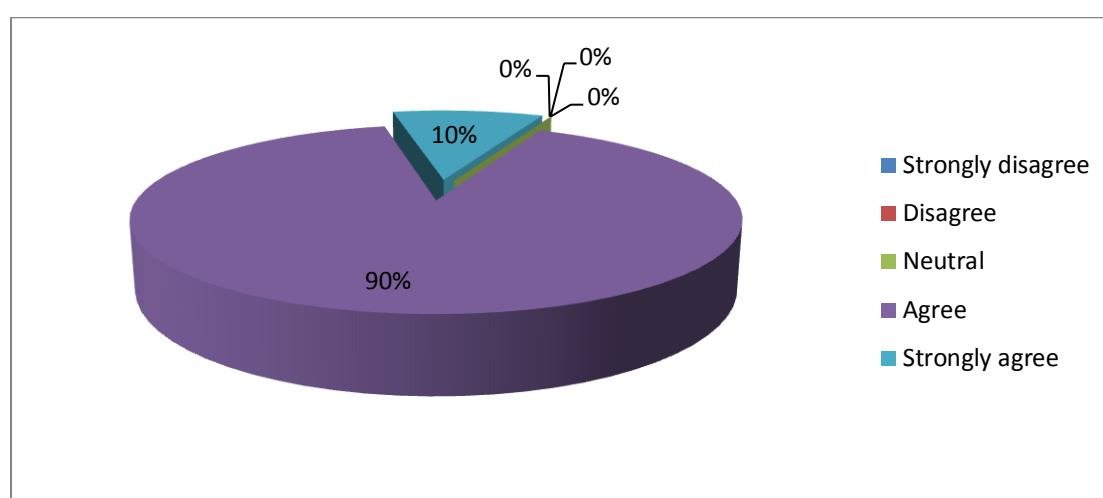
The establishment of audit committees in local government aims to provide mechanisms through which an independent oversight can be factored into the local governance process, in order to deal particularly with challenges posed by the emerging emphasis on accountability. An audit committee, as well as its members, is required to have a thorough understanding of their role, legal responsibilities and limitations, and be willing to learn about matters relating to local government operations (Marx 2008:15). It is on these bases that there is an expectation of the audit committee's function resulting in visible improvements in the governance of local government (Marx, 2008:15).

Table 4.14 above indicates that 70% of the respondents agreed with the statement that the audit committee members are well informed of developments in local government, and 20% were neutral to the statement, whereas 10% disagreed. In order to diligently fulfil their oversight role, audit committee members have to stay abreast of new developments in local government. The complexities of local government operations and an increasing need for effective management of

resources require local government to entrench accountability. To achieve this, the audit committee must have concrete knowledge of the operations of the municipality, so that it will be able to identify the corresponding risks and their interrelationship with the operations, as well as to evaluate the effectiveness of the control strategies adopted by management (Marx, 2008:15).

- Question B.6: The audit committee members consistently attend meetings.

Table 4.15: Audit committee members' consistency in attending meetings



Source: Drawn from the MS Windows Excel spreadsheet analysis

Previous studies on audit committee effectiveness resorted to the measurement of diligence by using the frequency and size of meetings as a proxy, since meetings are considered to be visible. However, it is the quality of meetings and activities and the level of engagement on those activities by members which is paramount to the degree of care and diligence. Diligence is also about time and commitment. Audit committee members are required to make time and show commitment through preparation for meetings and input by each member during meetings (Marx, 2008:25).

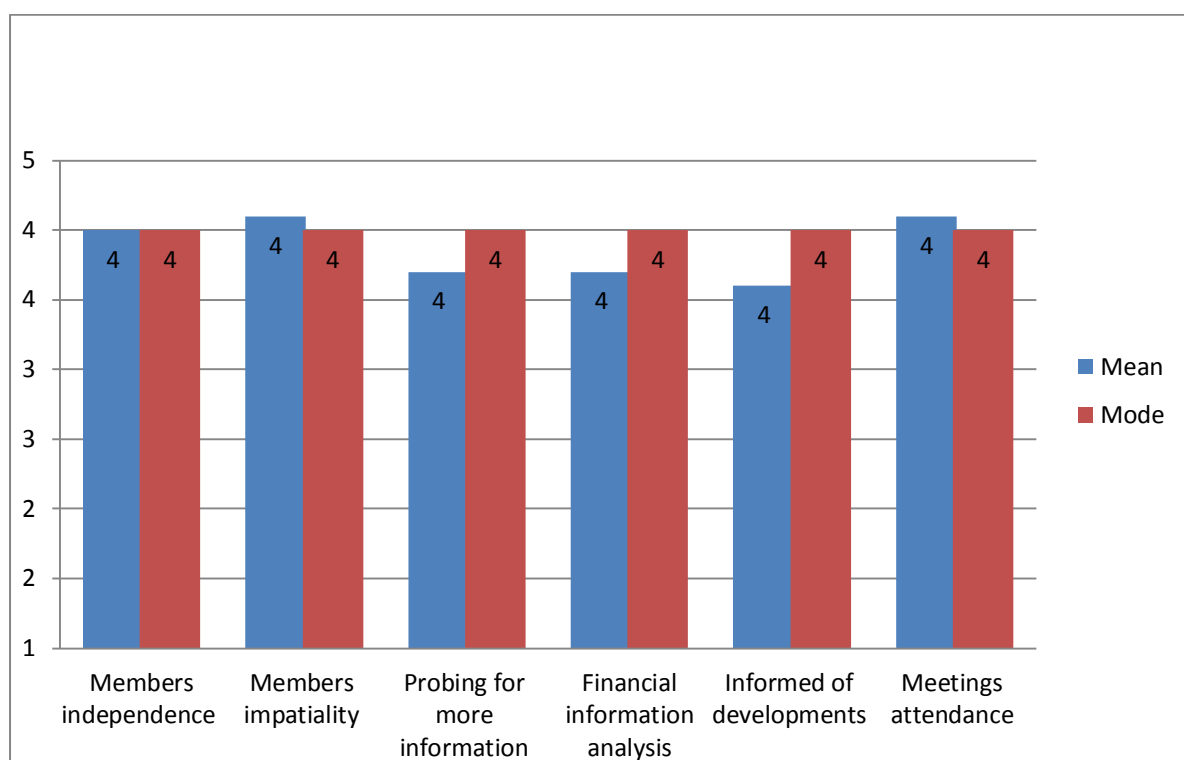
Table 4.15 above illustrates that 90% of the respondents agreed with the statement that the audit committee members consistently attend meetings, and 10% strongly

agreed with the statement. Therefore, the results reveal that the respondents are all (100%) in support of the statement. Audit committees' diligence is measured by the frequency of meetings held. Therefore, audit committee members who make time to attend meetings get to know more about issues pertinent to their oversight responsibilities, such as audit coverage, which can result in the improvement of the quality of the audit outcomes.

4.5.4 Overall analysis of Section B: Effectiveness of audit committee members

The overall analysis for all the questions asked in Section B is presented in Table 4.16 below, and a discussion in this regard is then presented.

Table 4.16: Overall perspective regarding the effectiveness of audit committee members



Source: Drawn from the discussions in Section B

The questions in Section B were designed to assess the effectiveness of the audit committee members on the basis of the characteristics identified in the audit

committee literature, namely the extent of their independence and degree of diligence. Table 4.16 above shows the average score for each question, presented as the value of the mean and the mode. All the statements had an average score of 4 at varying levels. The overall results presented in Table 4.16 indicate consistency in terms of the rating of the six questions by the respondents, which illustrates the positive response of the respondents to all the questions.

The analyses of the results for Section B indicate the following (Deducted from the results of the questionnaire):

- The members of the audit committee act independently and are to a large extent not negatively influenced by the other functions in the municipality;
- The members of the audit committee are impartial and free of bias, prejudice and disfavour in their dealings with management, as well as the internal and external auditors;
- The audit committee members probe for more information from management in pursuit of correct answers when provided with inappropriate or unsatisfactory responses;
- The audit committee members ask questions beyond financial information and reports provided by management, in order to gain a better understanding of risks associated with financial reporting;
- The audit committee members are well informed of developments in local government, so that they can gain an understanding of the interrelationship between these developments and its operations, service delivery imperatives and financial reporting requirements; and
- The audit committee makes time to attend meetings, and members are therefore in a better position to know more about issues pertinent to their oversight responsibilities, such as the audit function and financial reporting requirements.

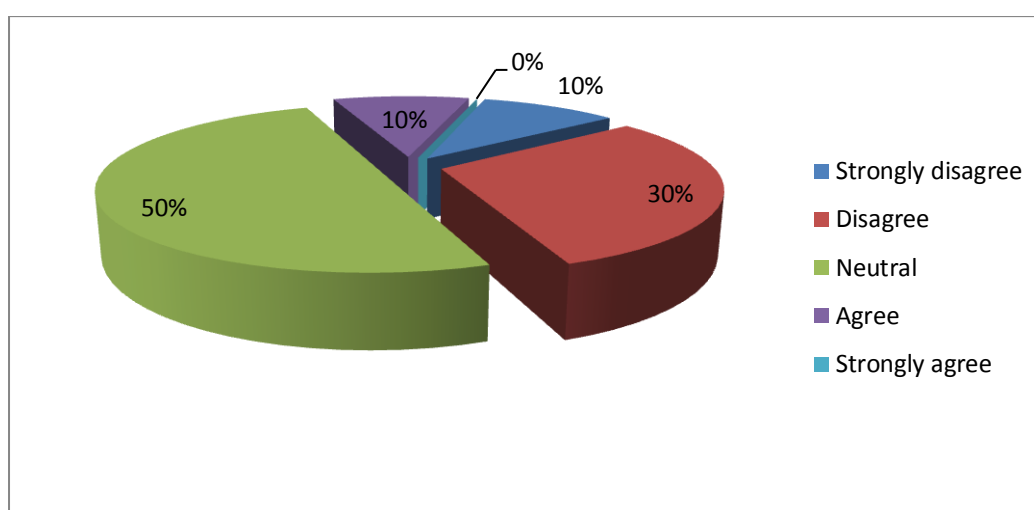
With an average of 4 out of 5, no recommendations are needed to be made in Chapter five for this section.

4.5.5 Section C: Standards for the effectiveness of audit committees

Section C comprises six questions. The section aims to assess the extent to which the audit committee observes the leading practices which are regarded to enhance the performance of audit committees in their oversight function. The questions focus on specific leading practices which are enhancing communication with internal and external auditors, promoting quality and transparency in financial reporting, as well as the audit quality process, and lastly, the training initiatives for the development of the audit committee with regard to governance issues. The results of the analysis are detailed below, with the overall results being presented at the end of the narrative:

- Question C.1: The audit committee meets informally with the internal and external auditors throughout the year.

Table 4.17: Frequency of informal engagements with internal and external auditors



Source: Drawn from the MS Windows Excel spreadsheet analysis

Both the Cadbury Code of Practices (2000) and Financial Reporting Framework Guide published by the National Treasury (2011) advocate for an audit committee to develop a direct and open relationship with both the internal and external auditors, independently of management. This can be achieved by also having informal discussions during the year, as it is believed that informal discussions can result in

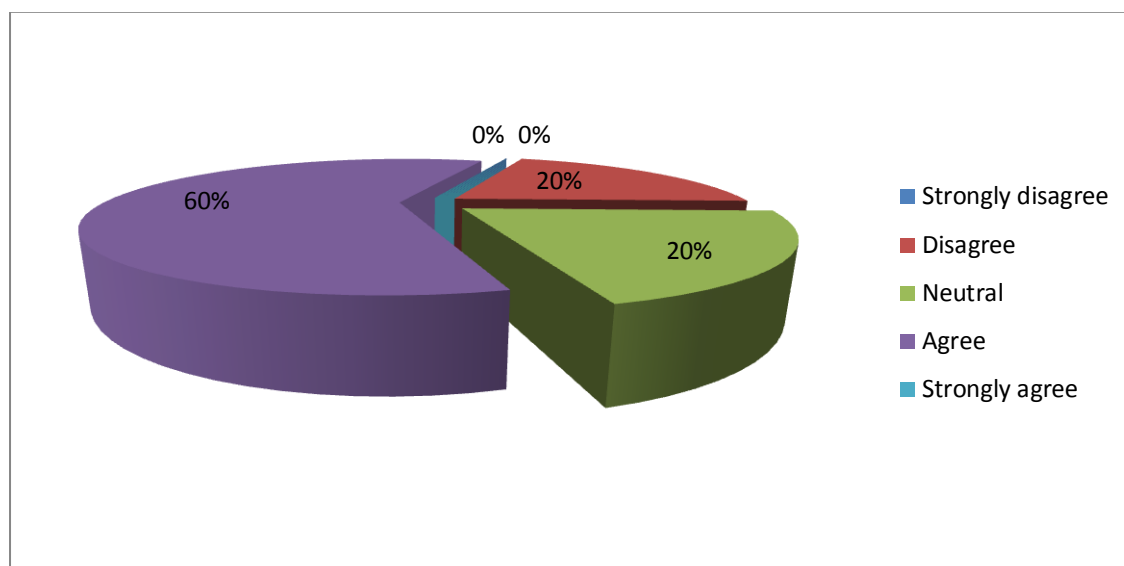
an insightful and mutual understanding of the organisation's operations and financial requirements.

Table 4.17 above indicates that 10 % of the respondents agreed with the statement that the audit committee meets with the internal and external auditors throughout the year, and 50% of the respondents neither agreed nor disagreed (neutral) with the statement, whereas 30% of the respondents disagreed with the statement and the remaining 10% strongly disagreed with it. The aspect of constant communication with the internal and external auditors is critical for effective functioning of an audit committee. The informal discussions with the external auditors contribute towards forging a mutual understanding between the audit committee and the external auditors on matters relating to the operations of the municipality and the financial reporting requirements.

The fact that 50% of the respondents indicated that they felt neutral towards the question and that 10% indicated that the audit committee did not meet with the internal and external auditors is problematic. This can be interpreted to mean that 90% of the respondents are not comfortable with the notion that the audit committee of the Westonaria Local Municipality is not constantly communicating with the internal and external auditors. This aspect will be discussed in Chapter five and recommendations will be made in this regard.

- Question C.2: The audit committee probes for more explanation on financial risks associated with areas of management judgement.

Table 4.18: Probe for explanations on financial risks associated with areas of management judgement



Source: Drawn from the MS Windows Excel spreadsheet analysis

The oversight of financial reporting by the audit committee enhances the quality and transparency of the financial statements of the organisation. The guidelines by the National Treasury (2011) and PwC and IARF (2011) provide for audit committees to engage in a robust discussion with management on financial reporting risks associated with areas which involve the exercise of judgement by management, including accounting estimates and policies adopted in reporting and disclosure. Management is required to ensure that any ambiguities in relation to elements of such judgement are explicitly clarified, in order to gain a better understanding of the users of the financial statements and to use a simple language which can be understood by non-financial people.

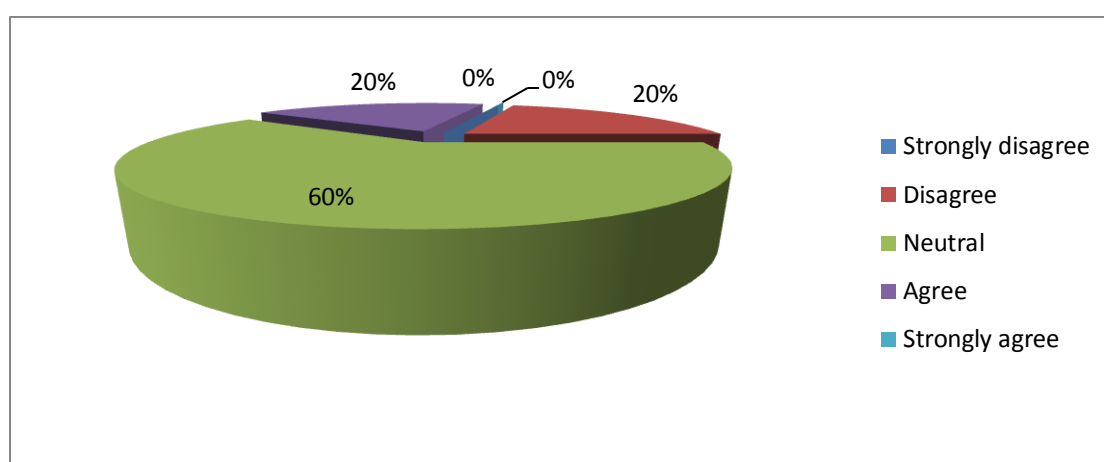
It is shown in Table 4.18 above that 60% of the respondents agreed with the statement that the audit committee probes for more explanation on financial risks associated with areas of management judgement, which include significant accounting accruals, estimates, provisions and policies adopted in reporting and

disclosure. On the other hand, 20% were neutral to the statement, whereas the other 20% disagreed with it. It is critical for the audit committee to engage management on the financial risks areas associated with management judgements. The objective of such discussions is to eliminate any ambiguities by establishing a mutual understanding regarding the basis for those judgements and their effects on financial reporting.

The fact that, 20% of the respondents disagreed with the question and that 20% were uncertain, means that in effect, 40% of the respondents are in the dark about the question. A percentage of 40% in the negative indicates that this area needs attention by the audit committee when analysing the financial information provided.

- Question C.3: The audit committee receives appropriate training on existing and emerging risks in local government.

Table 4.19: Provision of appropriate training on existing and emerging risks in local government



Source: Drawn from the MS Windows Excel spreadsheet analysis

The internal audit function is obliged to observe IIA standards and guidelines, and be mindful of the risk environment in which it operates, and it is important for audit committees to ensure that the internal audit has the required skills to carry out this function. Both the Guidelines by National Treasury (2012) and the Code and Report on King III (IoDSA: 2009) place emphasis on the internal audit adopting a risk-based approach in the development of the internal audit plan, which is supported by

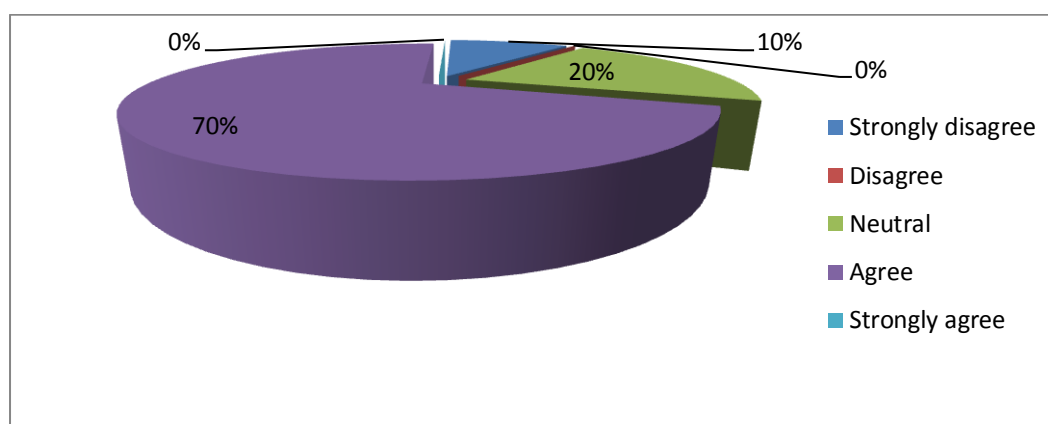
effective risk assessment mechanisms which allow the internal audit plan to be continuously updated with relevant information on the risks and opportunities identified by management (QFinance, 2013a:7).

Table 4.19 above indicates that 20% of the respondents agreed with the statement that the audit committee receives appropriate training on existing and emerging risks in local government, whereas 60% neither agreed nor disagreed, and the remaining 20% disagreed with the statement. Therefore, the results indicate that the majority of the respondents (80%) are not in support of the statement. Local government, like any enterprise, is confronted with new operational challenges and associated risks, which may have an impact on its operations and financial reporting. Therefore, knowledge of the risks associated with the new developments enables audit committees to identify and prioritise the most relevant risks and proficiently monitor the effectiveness of mitigating strategies.

With an 80% negative count regarding the training of audit committee members, there is cause for concern for the municipality as a whole, as well for the audit committee members. Training is one of the basic principles for effective functioning of entities, and recommendations in this regard will also be made in Chapter five.

- Question C.4: The audit committee is provided with sufficient administrative assistance and support.

Table 4.20: Provision of sufficient assistance and support for meetings and reporting



Source: Drawn from the MS Windows Excel spreadsheet analysis

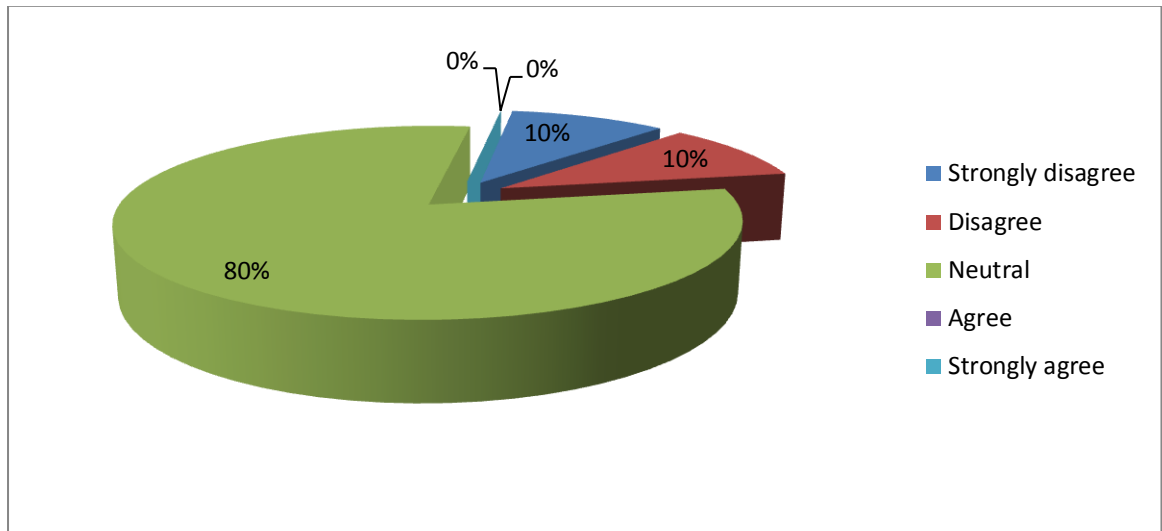
Internal audit serves as the key resource for the audit committee in executing its oversight role, and it forms an integral part of the audit process. In addition, an audit committee requires both administrative assistance and support from the finance department to provide the committee with financial information and reports and for the corporate secretariat to assist with the recording and documentation of the minutes of meetings, as well as the distribution of other relevant reports, including logistical arrangements for meetings (PwC & IIARF, 2011:107).

Table 4.20 above indicates that 70% of the respondents agreed with the statement that the audit committee is provided with sufficient administrative assistance and support by internal audit and finance departments for logistical arrangements, while 20% neither agreed nor disagreed, and 10% disagreed with the statement. The audit committee relies heavily on information and the administrative support provided by management and the internal audit, as key resources for it to effectively perform its oversight function.

With a 70% positive count for this question, there is no reason for the municipality and audit committee to take urgent steps to improve the situation. Problems in this regard can be addressed on an ad hoc basis.

- Question C.5: Management has developed a continuous learning programme for audit committee members.

Table 4.21: Developed programme on continuous learning for audit committee members



Source: Drawn from the MS Windows Excel spreadsheet analysis

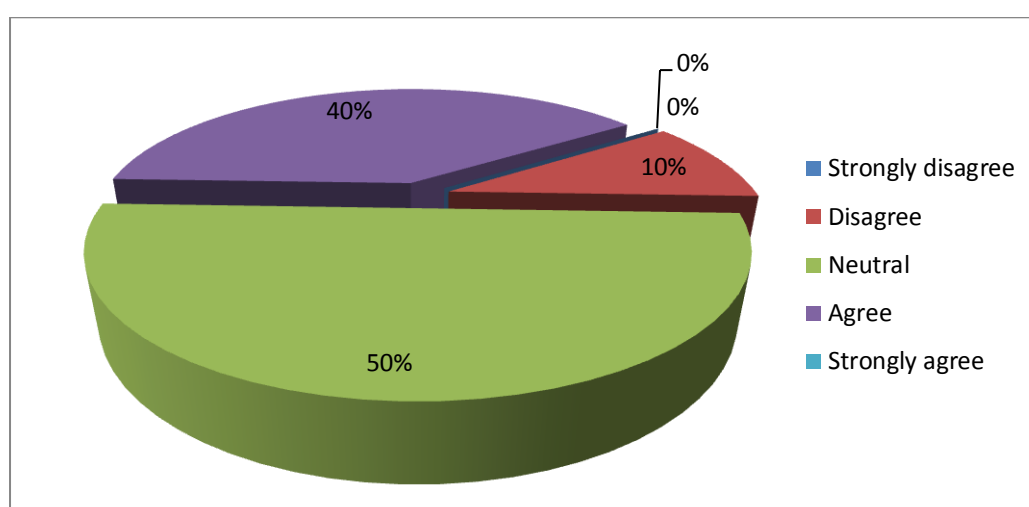
In order to maintain the requisite competences, members of the audit committee need to participate in continuous training and development programmes to improve the committee's effectiveness (INTOSAI, 2013:14). Continuous learning provides members with new perspectives and information on leading practices in corporate governance. However, it is advisable for the ongoing learning programme to have periodic targets and goals for each aspect of their development (INTOSAI, 2013:14).

As expected, the results for this question were negative in nature. As shown in Table 4.21 above, 80% of the respondents neither agreed nor disagreed with the statement that management has developed a continuous learning programme for audit committee members, and of the remaining respondents, 10% disagreed, while the other 10% strongly disagreed with the statement. It is evident that none of the respondents (-100%) are in support of the statement. This suggests that there is no programme designed to provide continuous learning for the audit committee, which would have been able to provide them with information on leading practices in corporate governance and the audit process.

The municipality and its management should take this as a serious threat and should address the issue on the highest level of discussion. Learning should form part and parcel of the development of audit committee members, in order to ensure that members stay abreast of current audit practices in the country. Recommendations in this regard will also be presented in the next chapter.

- Question C.6: The audit committee evaluates its own performance to identify areas for improvement.

Table 4.22: Audit committee's self-evaluation



Source: Drawn from the MS Windows Excel spreadsheet analysis

Self-evaluation by audit committees is regarded as a means to improve their effectiveness. Self-evaluation is a process through which the audit committee reflects on its current practices, in order to determine their effectiveness and acknowledge achievements, as well as to identify possible improvement areas. The results from the self-evaluation process can be used to inform the development of the audit committee's future learning programme.

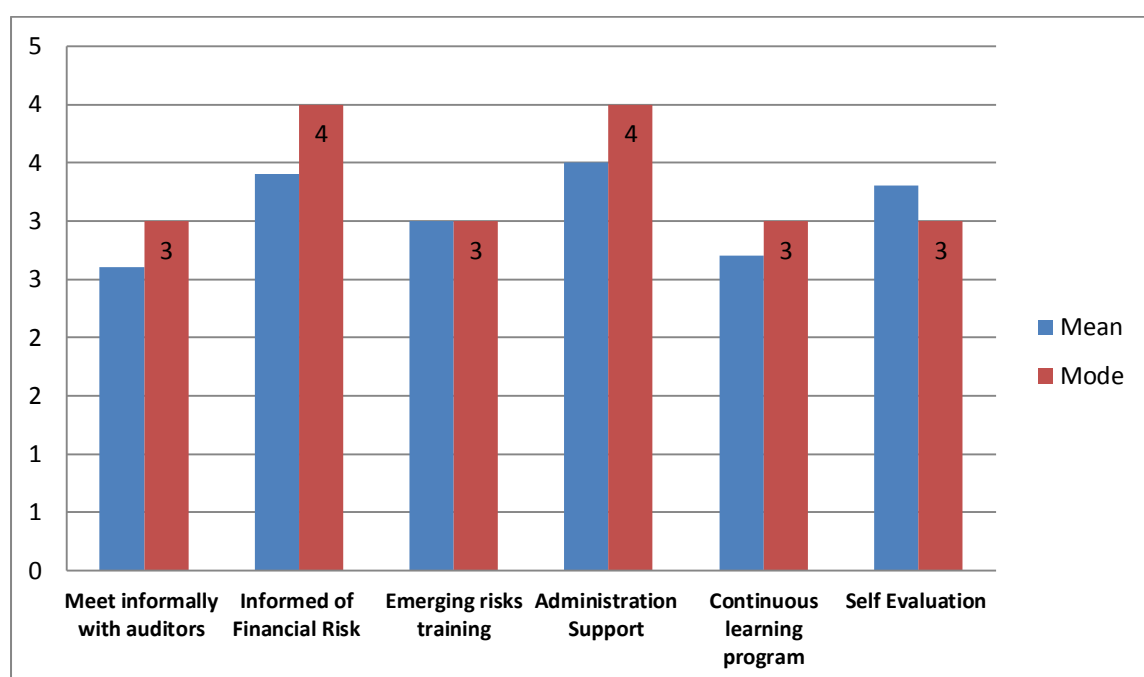
Table 4.22 above indicates that 40% of the respondents agreed with the statement that the audit committee evaluates its own performance to identify areas for improvement, whereas 50% neither agreed nor disagreed with the statement, and the remaining 10% disagreed. From the statistics, it can be deduced that 50% of the

respondents are uncertain as to whether or not the audit committee evaluates itself in order to bring about improvements in its functioning. Self-evaluation is important for any organisational entity, in order to ensure that their activities stay in line with those of the organisation. Without self-evaluation, an entity such as the audit committee may easily find itself being side-lined and becoming irrelevant. This aspect should be addressed by the management team, as well as the audit committee. Recommendations in this regard will be made in chapter five.

4.5.6 Overall analysis of Section C: Standards for the effectiveness of audit committees

The overall analysis for all the statements in Section C is presented in Table 4.23 below, which illustrates the results for this section.

Table 4.23: Overall perspective regarding standards for the effectiveness of audit committees



Source: Drawn from the discussions in Section C

The aim of Section C is to assess the extent to which the audit committee has adopted standards for the effectiveness of audit committees, which are regarded as the leading practice for the enhancement of an audit committee's effectiveness.

Table 4.23 above illustrates a pattern of an average of three out of five for the statements concerning the audit committee's communication with the internal and external auditors, the continuous learning of the audit committee, and training on emerging risks in local government. The statement presented to determine if the audit committee is provided with sufficient support obtained a higher average score of four (4) out of five, as the majority of respondents are in support of this statement. The statements about financial reporting risks associated with areas of judgement by management obtained an average score of three (3) out of five and a mode of four (4). This indicates that there is a higher percentage of respondents who support the statements, whereas the statement about self-evaluation by the audit committee obtained an average of 3, which indicates that a lesser percentage of the respondents agreed with the statement.

4.6 SUMMARY OF THE FINDINGS OF THE TWENTY QUESTIONS

It is necessary to summarise the findings of the empirical study, as this will give an even clearer picture of the results of the questionnaire.

SECTION A OF THE QUESTIONNAIRE: QUESTIONS ON PRINCIPLES ASSOCIATED WITH THE EFFECTIVE FUNCTIONING OF AUDIT COMMITTEES

Question A.1: The audit committee charter provides sufficient authority for the audit committee, which is in line with its assigned audit. 90% of the respondents responded positively to this question, which means that they were satisfied with the performance of the audit committee.

Question A.2: The audit committee comprises members with relevant qualifications. 90 % of the respondents agreed that audit members have the skill composition which makes them eligible to be members of the audit committee.

Question A.3: The audit committee members have sufficient experience in financial reporting to serve on such a committee. The results revealed that 70% of the respondents agreed about the financial expertise and experience of the audit

committee members, with 30 % being undecided as to whether or not audit committee members have the required level of skills and knowledge in financial reporting.

Question A.4: The audit committee holds a sufficient number of meetings. Seventy percent of the respondents appeared to be satisfied with the number of meetings held by the audit committee.

Question A.5: The audit committee receives appropriate agendas, quality reports and documentation on time, in order to review them before meetings. The results revealed that 70% of the respondents were not in support of the statement, with only one-third of the respondents agreeing. This indicates that audit committee members are not provided with the agendas and reports in sufficient time for them to adequately prepare for meetings.

Question A.6: The audit committee discusses the scope of the internal and external audit regularly. The results indicate that 60% of respondents appeared to be aware of the fact that the audit committee discusses the scope of the internal and external audit regularly, while the remaining respondents were uncertain or disagreed.

Question A.7: The audit committee maintains a productive relationship with management. Half of the respondents agreed that the audit committee maintains a productive relationship with management, with the other half being either noncommittal or not in agreement with the statement.

Question A.8: The audit committee has open lines of communication with management. Seventy percent of the respondents supported the statement and were therefore satisfied that the audit committee has an effective line of communication with management.

SECTION B OF THE QUESTIONNAIRE: QUESTIONS ON THE QUALITIES AND CHARACTERISTICS OF EFFECTIVE AUDIT COMMITTEE MEMBERS

Question B.1: The audit committee members act independently, without any undue influence from management in the discharge of their oversight function. 90% of the respondents were satisfied about the independent posture of the audit committee members in the performance of their function.

Question B.2: The audit committee members act impartially. 100% were in agreement with the statement, and were therefore satisfied that the audit committee members acted impartially.

Question B.3: The audit committee members probe for more information from management when provided with inappropriate or unsatisfactory responses. All the respondents (100%) were satisfied with the extent to which the audit committee probes for more information from management.

Question B.4: The audit committee ask questions beyond the financial information and reports provided by management. Seventy percent of the respondents were in agreement with the question and therefore appeared to be satisfied with the extent to which the committee members probed for details when analysing the financial information provided by management.

Question B.5: The audit committee members are well informed of developments in local government. 70% of the respondents were in agreement that the audit committee members were well informed of developments in local government, whereas the remaining 30% were uncertain and disagreed.

Question B.6: The audit committee members consistently attend meetings. The results revealed that all the respondents (100%) were in agreement about the audit committee members' attendance of meetings.

SECTION C OF THE QUESTIONNAIRE: QUESTIONS ON STANDARDS ASSOCIATED WITH THE EFFECTIVENESS OF AUDIT COMMITTEES

Question C.1: The audit committee meets informally with the internal and external auditors throughout the year. The results revealed that 90 % of the respondents did not agree that the audit committee constantly meets with the internal and external auditors throughout the year, with only 10% of the respondents responding positively to the statement.

Question C.2: The audit committee probes for more explanation on financial risks associated with areas of management judgement. Sixty percent of the respondents supported the statement that the audit committee, when presented with financial information which includes areas of judgement by management, evaluates the information and seeks explanation to clarify uncertainties.

Question C.3: The audit committee receives appropriate training on existing and emerging risks in local government. The results revealed that 80% of the respondents had a negative response to this statement, which raises a concern with regard to how the audit committee members update their skills and knowledge base, in order to stay abreast of new developments in local government.

Question C.4: The audit committee is provided with sufficient administrative assistance and support for logistical arrangements for their meetings and reporting. 70% of the respondents were in agreement with the statement, and were therefore satisfied with the support and logistical assistance provided to the audit committee for their meetings.

Question C.5: Management has developed a continuous learning programme for audit committee members. The results revealed that 80% of the respondents were uncertain about the existence of a learning programme for the audit committee, which correlates with the results for C.3, which showed a negative response with regard to training on existing and emerging risks in local government.

Question C.6: The audit committee evaluates its own performance to identify areas for improvement. In this instance, only 40% of the respondents appeared to be aware of the audit committee's assessment of their own performance, whereas the remaining 60% were uncertain and did not agree.

In the final analysis, it has been determined that the overall results were positive (15), confirming the perception regarding the effectiveness of the audit committee, with only a minority (5) having a negative perception. The negative responses are addressed in the next chapter in the form of recommendations for the Westonaria Local Municipality to consider.

4.7 CONCLUSION

In this chapter, the results of the empirical study were discussed. The questionnaire was employed as the tool for data collection, and was divided into three sections, comprising twenty (20) questions in all. The questions were based on the literature review. The first section of the chapter described the protocol for the research and outlined the basis for the selection of the sample population, as well as the instructions on how to complete the questionnaire. The response rate achieved for the questionnaires was 100%.

Section A of the questionnaire aimed to assess the effective functioning of the audit committee as a collective. The criteria for assessment were based on the determinants identified in the audit committee literature, namely composition, authority, resources and the audit committee process. The results from the responses revealed that the audit committee's composition, qualifications and the authority provided by the charter are all in line with the requirements for the effective achievement of its oversight function. The results also indicated that the audit committee hold a sufficient number of meetings and that it has productive engagements during meetings. However, it is disturbing to note from the results that the audit committee is not provided with the agendas and reports in sufficient time to prepare for meetings. Another problem that came to the fore is that there are some difficulties in terms of the relationship between the audit committee and the management of the municipality.

Section B focused on the assessment of the effectiveness of audit committee members, with their independence and diligence as the criteria. The overall results suggest that the audit committee members possess attributes that render them independent and diligent in the discharge of their oversight role.

Section C dealt with the standards for the effective functioning of the audit committee, which are regarded as leading practices. The results revealed that in most of the areas measured in this section, the audit committee is lacking with regard to issues pertaining to leading practices that enhance its effective functioning. The results indicate that the audit committee is not provided with training on emerging risks in local government, and it was also revealed that there is no learning programme on corporate governance issues for the audit committee. The results further suggest that the audit committee has not established procedures on communication with the internal and external auditors, which include informal discussions outside meetings.

Chapter five provides a summary of the main findings, discussions and recommendations of the study. It will explore how the effectiveness of the audit committee of Westonaria Local Municipality can be enhanced. The recommendations will be based on the findings obtained from the analysis of the questionnaire, which means that the recommendations are based on the empirical study presented in this chapter.

CHAPTER 5

DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

The AGSA (2012) report has confirmed that audit committees in local government are confronted with challenges of fulfilling their oversight role and protecting local committees' tax payers' contributions. The acceptance of audit committees worldwide as an oversight structure is to derive value and benefits in the provision of an effective oversight function. It is, however, incumbent upon audit committees to demonstrate the merits for existence of the function as a governance structure by fulfilling their legislative responsibilities as dictated by law. Effectiveness as a concept is associated with quality and success. One of the key requirements for enhancing audit committee effectiveness is communication with the external auditors, as well as how such communication can be enhanced for a better audit outcome (Ernst & Young, 2012b:7). It is inevitable that with the application of a collection of the discussed standards and principles on good governance, as well as all characteristic postures, behaviours and attitudes needed to enhance audit committee members' efficacy, audit committees in local government will be in a position to advance their common goal, which is the provision of effective financial reporting oversight with diligence, independence and integrity (KMPG, 2010:3).

This chapter provides discussions on the outcomes of the study and conclusions drawn from the literature review, as well as the main findings presented in the previous chapter. The chapter also presents a number of recommendations based on the empirical findings, which are aimed at improving the effective functioning of the audit committee of the Westonaria Local Municipality.

The results of the questionnaire reveal that there is overall agreement that the audit committee as an accountability structure is effectively performing its function. The discussion on the results of the empirical study in relation to the status and effective functioning of the audit committee of the Westonaria Local Municipality are discussed in the ensuing section.

5.2 ACHIEVEMENT OF THE OBJECTIVES OF THE STUDY

The value of the study for the researcher, as well as the Westonaria Local Municipality (management and audit committee), can be measured in accordance with whether or not the research question has been answered, whether or not the objectives of the study have been achieved, and whether the hypothesis proved to be true or false.

5.2.1 The research question

The research question which directed the study, as stated in Chapter one, was as follows: ***Are the audit activities of the audit committee of the Westonaria Local Municipality effective from a managerial point of view?***

This research question was taken into cognisance throughout the study, and it enabled the researcher to stay focused on the study.

5.2.2 Research objectives

The objectives of a study are guidelines that the researcher must follow, in line with the research question, in order to present a strong framework that will guide the researcher towards the hypothesis. The objectives of this study were as follows:

- To describe the functional and legislation frameworks applicable to audit committees on local government level. Addressed in Chapter 2.
- To determine what is meant by the phenomenon of effectiveness of audit committees at local government level. Addressed in Chapter 3.
- To determine whether or not the audit committee of the Westonaria Local Municipality is functioning effectively according to management. Addressed in Chapter 4 – the empirical study.
- To make recommendations on the basis of the empirical findings regarding the audit function in Westonaria Local Municipality. Addressed in Chapter 5.

All the stated objectives have therefore been achieved in this study.

5.2.3 Hypothesis

The researcher formulated a hypothesis for this study in Chapter one. She, through the formulation of the hypothesis, proposed an explanation of the phenomenon under analysis, and which aimed to determine whether the hypothesis is true or false.

The following hypothesis was formulated for this study:

It is believed by the management of Westonaria Local Municipality that the audit committee is functioning effectively.

This hypothesis is in line with the title of the study, as well as with the research questions and objectives.

It has been determined that the results of the study were in line with the hypothesis formulated in chapter one. This means that the hypothesis has been proven to be true.

5.2.4 Content of the chapters

Chapter one introduced the topic of the study by providing the background and problem statement. It also outlined the scope and research objectives, as well as providing a description of the research methodology employed in the achievement of the research objectives. The aim of the study was to validate the perceptions by management that the audit committee of the Westonaria Local Municipality is effectively performing its oversight role. The role of audit committees in the local sphere of government has been established to serve as an oversight structure to promote much-needed financial accountability, as well as to independently assess programmes on service delivery.

Chapter two presented a literature review on the formation of audit committees in the local sphere of government. The literature review offered comprehensive information on the role of audit committees in the local sphere of local government, their purpose

and functions, as well as the applicable legislative framework. Audit committees in the local sphere of government were introduced after the promulgation of the Municipal Finance Management Act (MFMA) in 2003, which provided for municipalities to implement appropriate financial management systems and related internal controls. In recent years, there has been a review of regulations governing the affairs of audit committees, together with the leading practices, with a view to enhancing the effective functioning of the audit committee.

Chapter three presented a discussion on the principles and standards for effective auditing, which provided the basis for the investigation of the phenomenon of audit committee effectiveness. The discussion also focused on the measurement of audit committees' effectiveness. The researcher found it relevant to first introduce effectiveness as a concept, by providing its definition and inferences in management and various disciplines, as well as its context within the local governance system. The characteristics associated with leading best practices on audit committees' effectiveness were also discussed in detail and subsequently adopted as measurements for the evaluation of the effective functioning of audit committees in the empirical study. The objective for the establishment of audit committees was to strengthen accountability. However, there is scepticism among some scholars about their role as an effective oversight structure in organisations.

In Chapter four, the researcher presented the research design and methodology adopted in the study, with a discussion on reasons for selecting the research methodology and data collection techniques employed in this study. The chapter also provided a discussion on the selection of the sample population, as well as details regarding the analysis and interpretation of the findings from the empirical study. The study was conducted by means of the development and utilisation of a questionnaire. The data presented by the questionnaire was analysed with a view to drawing conclusions and determining whether the hypothesis is true or false.

Chapter five presented a discussion of the main findings and conclusions drawn from both the literature review and the findings from the empirical study. The findings of the study revealed strong support for the idea that the audit committee is providing

an effective oversight function in order to ensure quality service delivery by the municipality.

From the foregoing exposition, a conclusion can be drawn that the objectives of the study have been achieved. The conclusion drawn from the results of the study, as well as the recommendations on how the audit committee can strengthen accountability in local government, are presented in the following sections.

5.3 RECOMMENDATIONS TO BE ADDRESSED BY THE WESTONARIA LOCAL MUNICIPALITY TO IMPROVE THE EFFECTIVENESS OF THE AUDIT COMMITTEE

This section focuses on the discussion of the findings from the questionnaires, which are based on the theoretical discussion presented in chapters two and three. The empirical research aimed to determine the effectiveness of the audit committee on the basis of effective auditing principles, qualities and characteristics of audit committee members, and the extent to which the audit committee of the Westonaria Local Municipality has adopted best practices in the execution of its oversight role. The following are recommendations to further enhance the effectiveness of the audit committee:

Recommendation one: Addressing the administrative function with regard to the audit committee

The results of the study revealed that the audit committee was not receiving the appropriate agenda and supporting documentation in sufficient time to adequately prepare for meetings. Audit committee meetings constitute a critical element of the committees' performance of their oversight function. The challenge of not receiving the agenda and the appropriate information on time has an impact on the optimisation and effectiveness of meetings. Diligence and exercise of due care by the committee members is measured by the number of meetings held, with cognisance being taken of the quality of such meetings, the deliberations and the relevance of the engagements. This aspect should be addressed by the Westonaria Local Municipality.

Recommendation two: The relationship between the audit committee and the management of the local government

The outcome of the study indicates that there are problems with regard to the relationship of the audit committee with management. The supportive and constructive relationship by management with the audit committee is pivotal for an effective functioning of the audit committee. Lack of such relationship weakens the support of the audit committee by management. It also disallow candid engagements and can compromise honesty in the discussions and responsiveness by management when probed for more information when clarifications on critical governance matters such as financial reporting and audit process are being sought by the audit committee.

Therefore, management must be honest in reporting on financial information to the audit committee and to be responsive and transparent in their engagements with the members especially when requested for sensitive or critical information by the audit committee. In strengthening the relationship, the audit committee should in return be also truthful, must maintain confidentiality and be transparent in their engagements with management. The decisions of the audit committee and recommendations addressed to management must be based on ethical grounds and also befitting with their scope of work to ensure that their work withstand scrutiny.

Recommendation three: The lack of proper informal meetings between external and internal auditors

The majority of the respondents indicated that the audit committee do not hold informal meetings with the internal and external auditors. Audit committees consultation sessions with the internal and external auditors outside formal meetings are very important as they allow a dialogue for in-depth discussions on confidential matters of concerns including those matters where fundamental solutions are solicited. These may include in particular issues of disagreement between management and external auditors as well as risks on financial reporting associated

with areas of management judgements, suspected irregularities or fraud, accounting errors as well as any related confidential matters that the audit committee may not ordinarily be aware to ask in a formal meeting. The audit committee should regard this predicament as serious and should consider this aspect in future planning sessions.

Recommendation four: The absence of continuous learning programmes for the audit committee

One of the most important aspects that an audit committee should focus on is the continuous learning of the audit committee members. Without this the audit committee cannot improve their qualifications, particularly in relation to the changes and developments in the auditing and financial reporting matters. The audit committee must also stay on course with regards to emerging risks associated with new development in local government. Such matters, although they are internal matters need to be communicated to the audit committee in a continuous learning situation. This aspect is, like in any other organisation, one of the cornerstones of effective activities.

With the support of management, the audit committee must develop an on-going integrated learning programme and include the following:

- the areas where gaps have been identified;
- how the training will be provided;
- when the training will be provided; and
- the expected outcomes of the learning programmes.

Recommendation five: The lack of self-evaluation of its audit activities

Another concern identified during the study is the lack of self-evaluation by the audit committee and its members. Self-evaluation of the audit committee serves as mechanisms to take introspect on its own functioning. Sometimes organisations do not undertake self-evaluation actions because they are aware of specific problems and are willing to function with it unattended to or that they are not aware of it. The

audit committee in Westonaria Local Government should attend to its evaluation processes and should pay attention to reviewing their processes and procedures with the focus of reengineering of the audit function and the municipalities operations at large.

The evaluations of the audit committee function must be conducted on an annual basis, which also includes self-evaluation of the performance of the audit committees. The basis for self-evaluation of the audit committee is to assess the extent to which the committee is fulfilling its oversight responsibilities, as provided in the charter, and the leading best practices, as well as to identify any areas for improvement. There are several considerations when deciding on the most appropriate evaluation process of the audit function, as there are several options which are also used for different results. Once the results are known, the audit committee can use them for setting goals and strategies for improvement of the identified gaps in its oversight operations, hence self-evaluation is regarded as a means to improve performance.

5.4 CONCLUSION

The validation of the perception of management with regard to effective functioning of the audit committee in Westonaria Local Municipality was the focus area of the study and the results suggest that the audit committee is generally effective in the discharge of their oversight role. Effectiveness as a concept relates to doing the right things which in essence is in line with the principle of “apply and explain” recommended by King III, wherein if a recommendation is applied differently, an explanation should be provided. Therefore, audit committees in the local sphere of government are supposed to take cognisance of the prevailing facts and circumstances in local government and to determine those processes and procedures which can “work” best for their circumstances and provide an explanation on instances where the principles were applied differently (IoDSA, 2009:6). The spirit of “apply and explain “ is based on the fact that audit committees are expected to make decision in the best interest of local government and in doing so to ensure that the objectives to adhere to good governance principles are still achieved.

The establishment of an audit committee in the local sphere of government is a legislative requirement and therefore audit committees have a legal obligation to effectively carry out their oversight function (MFMA, 2003). In linking good governance and compliance with the law, King III categorised audit committees duties into two, as the duty of care, skill and diligence and the fiduciary duties (IoDSA, 2009:6). However, the Auditor General in his report on Local Government Audit Outcomes for 2011 raised concerns about failures of internal audit and the audit committee functions to meet the minimum legislative requirements which regrettably have contributed to the negative audit outcomes (AGSA, 2012: 86). The report further provided a deduction in terms of the correlation between findings on audit committee, internal audit functions and audit outcomes which depicted the lack of review of adequacy, reliability and accuracy of financial reporting.

This study on the audit function in the Westonaria Local Municipality, although not presented with a clean bill of health, has indicated that the audit committee is effective in the performance of its audit function. If the identified problems are adequately addressed, the audit committee will develop into an even more prosperous entity.

BIBLIOGRAPHY

AARF (Australian Accountancy Research Foundation). 2000. *Best practices guidelines: Local government entities - Audit committee and internal audit*.

http://www.dpcd.vic.gov.au/__data/assets/pdf_file/0006/53079/Best-Practice-Guidelines-Local-Government-Entity-Audit-Commit Date of access: 5 April 2012.

Abbott, J.L., Parker, S., Peters, G.F. & Raghunandan, K. 2003. The Association between audit committee characteristics and audit fees. *Journal of practices and theory*, 22 (2):17-32.

Abbott, J.L., Parker, S. & Peters, G. F. 2004. Audit committee characteristics and restatement. *Journal of practice and theory*, 23(1): 69-87.

AGA (Association of Government Accountants). 2008. *Characteristics of effective audit committee in Federal State and Local Governments*. (Research report series, 17). http://www.agacgm.org/AGA/Documents/Research/CPAG_No17-1-.pdf Date of access: 2 Jun. 2012.

AGSA (Auditor General of South Africa). 2011. *Consolidated general report on the local government audit outcomes for 2009*.10.
www.info.gov.za/view/DownloadFileAction?id=147648 Date of access: 5 April 2012.

AGSA (Auditor General of South Africa). 2012. *Consolidated general report on the local government audit outcomes for 2010*.11.
<http://www.agsa.co.za/Reports%20Documents/MFMA%20Consolidated%20p2.pdf>
Date of access: 10 Sep. 2012.

AICPA (American Institute of Certified Public Accountants). 2009. *Audit Committee brief; Self -evaluation: A primer for audit committee*.
<http://www.aicpa.org/ForThePublic/AuditCommitteeEffectiveness/AuditCommitteeBrief/DownloadableDocuments/Self%20Evaluation.pdf> Date of access: 10 Jul. 2012.

AICPA (American Institute of Certified Public Accountants). 2011a. *Audit committee brief; Benefit of audit committee and audit committee charters for government entities: The business industry and government team.*

http://www.aicpa.org/ForThePublic/AuditCommitteeEffectiveness/AuditCommitteeBrief/DownloadableDocuments/Benefits_of_AC_Government.pdf Date of access: 5 Jul. 2012.

AICPA (American Institute of Certified Public Accountants). 2011b. *Audit Committee Brief: Current Accounting Issues and Risks.*

<http://www.aicpa.org/publications/newsletters/auditcommitteeealert/pages/default.aspx> Date of access: 16 Jun. 2012.

Al-Lehaidan, I. 2006. *Audit committee effectiveness: Australia and Saudi Arabia.* Australia, Melbourne: Victoria University. (Thesis - PhD).

Al Sa'eed, M.A. & Al – Mahamid, S.M. 2011. Features of an effective audit committee, and its role in strengthening the financial reporting: Evidence from Amman Stock Exchange. *Journal of public administration and governance*, 1(1):39-63.

Ananthanarayanan, U. 2011. *Audit committee independence and expertise, institutional ownership and executive compensation as determinants of audit fees in the post- Sox Era.* New Zealand, Albany: Massey University. (Thesis - PhD).

Apollo, M. 2008. *Impact assessment of the local government reforms in Rwanda: The case study of Kigali City.* Port Elizabeth: NMMU. (Thesis - MPA).

Babbie, E. 2010. *The practice of social research.* 12th ed. Belmont, CA: Wadsworth.

Baxter, P. J. 2007. *Audit committee and financial reporting quality.* Queensland: University of Southern Queensland. (Thesis - PhD).

BDO. 2012. *AC'sence: Audit committee self evaluation*. www.bdo.com Date of access: 12 Jan. 2013.

Beasley, M.S., Carcello, J.V., Hermanson, D.R. & Neal, T.L. 2009. The audit committee oversight process. *Contemporary accounting research*, 26(1): 65-122.

Best, G. 1997. *Research in education*. 3rd ed. Engelwood, NJ: Prentice Hall.

Boynton, W.C., Johnson, N. & Kell, W.G. 2001. *Modern auditing*. 7th ed. New York, NY: Wiley.

Braiotta, L. 1994. *The audit directors guide*. Malabar, FL: Robert and Krieger.

Braiotta, L. 2004. *The audit committee handbook*. 4th ed. Hoboken, NJ: Wiley.

Brink, V.Z. & Witt, H. 1982. *Modern internal auditing- appraising operations and controls*. New York, NY: Wiley.

Burger, A. & Silima, T. 2006. Sampling and sampling design. *Journal of public administration*, 41(3.1): 656 – 668.

Cadbury Committee. 1992. *The report of the Committee on the financial aspect of corporate governance*. <http://www.jbs.cam.ac.uk/cadbury/report/> Date of access: 12 Oct. 2012.

CIPFA (Chartered Institute of Public Finance & Accountancy). 2005. *Audit committee: practical guidelines for local authorities*.

<http://www.wyita.gov.uk/NR/rdonlyres/2D87FAA9-DB5A-4BCD-855B-2761AFD299CA/0/AGC28NOVEMBER2006ITEM4APPENDIX.pdf> Date of access: 17 Jun. 2012.

Crosslin & Associates. 2010. *Guide to forming and running an effective audit committee*.

<http://www.crosslinpc.com/pdfs/guideToFormingAuditCommitteesBooklet.pdf> Date of access: 17 May 2012.

Deloitte. 2010. *Public sector – shaping our future*.

<http://www2.accaglobal.com/pdfs/technical/tech-gc-001.pdf> Date of access: 5 April 2012.

Deloitte. 2011. *Audit committee- resource guide*.

<http://www.corpgov.deloitte.com/site/us/audit-committee/audit-committee-resource-guide/?jsessionid=ndyLTN2c9PygQJTFQ5FSXHv22mF1nWcNQ8d2vL1psm5hSq3h93D7!1501908958!NONE> Date of access: 17 Feb. 2013.

Deloitte. 2012a. *Audit committee brief – composition, skills, experience, diversity and leadership*.

http://www.corpgov.deloitte.com/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet/lreEng/Page%20Copy/Home/ACbrief_May2012.pdf Date of access: 9 Jul. 2012.

Deloitte. 2012b. *Audit committee brief: audit committee composition, meetings, practices and education*.

http://www.corpgov.deloitte.com/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet/lreEng/Page%20Copy/Home/ACbrief_May2012.pdf0 Date of access: 6 Jul. 2012.

De Mabior, G. J. 2006. *Take town to the people: The local government framework for Southern Sudan*. <http://www.mlgi.org.za/resources/local-government-database/by-country/sudan/sub-national-policy/LG%20Framework.pdf/download> Date of access: 14 April 2013.

Dictionary online. 2013. *Ask a question*.

<http://answers.ask.com/Reference/Dictionaries/what> Date of access: 8 Oct. 2013.

Dlalisa, W. T. M. 2009. *Strategies for enhancing good governance in South African local government*. Stellenbosch: Stellenbosch University. (Thesis – MPA).

Du Plooy, G.M. 2006. *Communication research techniques, methods and applications*. Lansdowne: Juta.

E-business dictionary. 2012. *E- commerce*.

<http://www.businessdictionary.com/definition/effectiveness.html>

Date of access: 19 Dec. 2012.

Edwards, P., Roberts, I., Clark, M. & DiGusepi, C. 2002. Increasing response rates to postal questionnaires: systematic review. *British medical journal*, 324:1183 - 1185.

Enhanced Disclosure. 2011. *Audit committee reports, global disclosure guidelines*.

<http://en.youscribe.com/catalogue/tous/professional-resources/accounting/audit-committee-duties-and-best-practices-542236> Date of access: 4 Feb. 2012.

Ernst & Young. 2012a. Audit committee leading practices and trends.

<https://www.google.co.za/#q=Ernest+and+Young.+Audit+committee+leading+practices+and+trends%2C+Ernst+and+Young+LLP> Date of access: 3 Dec. 2012.

Ernst & Young. 2012b. *Enhancing transparency of the audit committee, auditor oversight process - point of view*.

[http://www.ey.com/Publication/vwLUAssets/Enhancing_transparency_of_the_audit_committee_auditor_oversight_process_November_2012_Point_of_view/\\$FILE/EY%20Point%20of%20view%20audit%20committees%20November%202012.pdf](http://www.ey.com/Publication/vwLUAssets/Enhancing_transparency_of_the_audit_committee_auditor_oversight_process_November_2012_Point_of_view/$FILE/EY%20Point%20of%20view%20audit%20committees%20November%202012.pdf) Date of access: 3 Dec. 2013.

Explorable. 2013. *Empirical research*. <http://explorable.com/empirical-research>

Date of access: 8 Oct. 2013.

Fenwick & West LLP. 2002. *Audit committee duties and best practices' corporate and securities law*. http://www.fenwick.com/fenwickdocuments/corp_sec_03-21-02.pdf Date of access: 4 May 2012.

Ferreira, I. 2007. *The role of internal audit in the professional development of audit committee members*. Pretoria: University of South Africa. (Dissertation – Mcom)

Fink, A. 2010. *Conducting research literature*. 3rd ed. London: Sage.

Gravetter, F.J. & Forzano, L. B. 2009. *Research methods for the behavioural sciences*. 3rd ed. Belmont: Wadsworth.

Gray, I. & Masion, S. 2000. *The audit process, principles, practices and cases*. 2nd ed. London: Thompson Learning.

Gregory, H.J. & Simms, E.M. 1999. *Corporate governance: What it is and why it matters*. 9th International Anti- corruption Conference, Durban, SA, 10-15 October. http://9iacc.org/papers/day2/ws3/dnld/d2ws3_hjgregorymesimms.pdf Date of access: 17 Jan. 2013.

Harvard Business Review. 2004. *What makes a leader: OnPoint article*. www.hbr.org Date of access: 8 Jan. 2013.

Huyseman, G.K. 1994. *Methodology for social behavioural sciences*. Cape Town: Southern.

IIA (Institute of Internal Auditors). 2001. *Standards for the professional practice of internal auditing standards*. <http://www.theiia.org/guidance/standards-and-guidance/ippf/standards/?search=standards> Date of access: 23 Jan. 2013.

IIA (Institute of internal Auditors). 2006. *Role of auditing in public sector governance*. www.theiia.org/download.cfm?file=3512 Date of access: 8 Jun. 2012.

IIA (Institute of Internal Auditors). 2010. *International standards for the professional practice of internal auditing standards*. <http://www.theiia.org/guidance/standards-and-guidance/ippf/standards/?search=standards> Date of access: 23 Jan. 2013.

INTOSAI (International Organisation of Supreme Audit Institution). 2013. *Fundamental principles of public sector auditing*. <http://www.issai.org/composite-192.htm> Date of access: 18 Feb. 2013.

IRBA (Independent Regulatory Board for Auditors). 2012. *Guidance for auditing in the public sector*.
http://www.irba.co.za/index.php/component/docman/doc_download/1246 Date of access: 17 Dec. 2012.

IoDSA (Institute of Directors of Southern Africa). 2009. *King (King III) code of governance for South Africa*.

IoDSA (Institute of Directors of Southern Africa). 2013. *Public sector audit committee forum: Public sector audit committee role in overseeing internal audit*.

IPA (Institute of Public Administration). 2011. *Audit committee in government departments: a research paper*. <http://www.ipa.ie/pdf/AuditCommitteesReport.pdf>
Date of access: 19 Jun. 2012.

Jonas, M. 2011. *The effectiveness of a performance management system in enhancing service delivery: the case of Maquassi Hills Local Municipality*.
Potchefstroom: NWU. (Dissertation - MPA).

Kim, E.E.K. & Mattila, A. A. 2011. *The impact of language barrier & cultural differences on restaurant experiences: a grounded theory approach*.
http://scholarworks.umass.edu/cgi/viewcontent.cgi?article=1175&context=gradconf_hospitality Date of access: 17 Mar. 2012.

KPMG. 2006. *Five guiding principles for audit committees: Audit committee Institute*. <http://www.kpmg.co.il/acisrael/1.pdf> Date of access: 17 Feb. 2012.

KPMG. 2012. *Five guiding principles for audit committees: Audit committee Institute*.
<http://www.kpmg.com/ca/en/services/audit/auditcommittee/pages/default.aspx> Date of access: 4 Dec.2012.

Lee, S. & Whitford, A. B. 2008. *Government effectiveness in comparative perspective*. Athens: University of Georgia.
http://citation.allacademic.com/meta/p268650_index.html? Date of access: 12 Feb. 2013.

Lipman, F.D. & Lipman, L.K. 2006. *Corporate governance – best practices on strategies for public, private and not for profit organisations*. Hoboken, NJ: Wiley.

Lukashenko, O. 2009. *Towards effective public administration, methodology of functional analysis* - United Nations.
[http://www.undp.org/content/dam/serbia/Publications%20and%20reports/English/UN DP_SRB_Towards_Effective_Public_Administration_-
_Methodology_for_Functional_Analysis.pdf](http://www.undp.org/content/dam/serbia/Publications%20and%20reports/English/UN_DP_SRB_Towards_Effective_Public_Administration_-_Methodology_for_Functional_Analysis.pdf) Date of access: 12 Feb. 2013.

Lutabingwa, J. & Nethonzhe, T. 2006. Ethical issues in social research. *Journal of public administration*. 41 (3.1): 694 – 702.

Mandl, U., Dierx, A. & Ilzkovitz, F. 2008. *European economy- the effectiveness and efficiency of public spending. European Commission Publication, Economic paper 301*.
http://ec.europa.eu/economy_finance/publications/publication11902_en.pdf Date of access: 17 Dec. 2012.

Marx ,B., Schonfeldt, N., Van Der Watt, A. & Potgieter, V. 2006. *Fundamentals of auditing*. 3rd ed. Johannesburg: LexiNexisButterworths.

Marx, B. 2008. *An analysis of the development, status and functioning of audit committee at large listed companies in South Africa*. Johannesburg: UJ. (Thesis – Dcom).

Marx, B. 2009a. *Ethics and governance: evolving responsibilities for audit committee resulting from the credit crunch*. Conference proceedings: 9th Annual BEN - Africa conference, ACCRA, Ghana, 25 August 2009.

Marx, B. 2009b. An analysis of audit committee responsibilities and disclosure practices at large listed companies in South Africa. *Southern African journal of accounting research*, 23(1): 31-44.

Marx, B. 2009c. An analysis of audit committee effectiveness at the largest listed companies in South Africa from the CFO and audit committee perspective. *Acta Commercij*, 9: 13 – 23.

Mouton, J. 2012. *How to succeed in your master's and doctoral studies – a South African guide and resource book*. Pretoria: Van Schaik.

Muhiuddin, Md. & Karbhari, Y. 2010. Audit committee effectiveness: a critical literature review. *AUIB Journal of business of economics*, 9 (10): 97 – 125.

Nhlanhla, N. 2011. *Does the global financial crisis call for more stringent governance requirements?* Address by the Deputy Minister of Finance at the Annual Audit Committee Conference, Sandton, SA, 5 October.

http://www.treasury.gov.za/comm_media/speeches/2011/2011100501.pdf Date of access: 8 Jun. 2012.

NSW Government (New South Wales Government). 2010. *Internal audit guidelines, Premier and Cabinet -Division of Local Government*.

http://www.burwood.nsw.gov.au/verve/_resources/Internal_Audit_Guidelines_-_September_2010.pdf Date of access: 4 Mar. 2012.

Online encyclopedia. 2012. *Encyclopedia*. <http://www.encyclopedia.com/> Date of access: 19 Dec. 2012.

Protiviti. 2009. *Risk and consulting: internal audit, guide to internal audit, frequently asked questions about developing and maintaining an effective audit function*. 2nd ed. www.protiviti.com Date of access: 17 Feb. 2013.

PwC (PricewaterhouseCoopers). 2009. *King's Counsel *King III at a glance - steering point*. <http://www.sustainabilitysa.org/LinkClick.aspx?fileticket=4-oBRs5okYU%3D&tabid=281> Date of access: 25 April 2013.

PwC (PricewaterhouseCoopers). 2010. *Audit committee matters: where to from here?* <http://www.PwC.com.au/assurance/assets/audit-committee/Audit-Committee-Matters-Mar10.pdf> Date of access: 17 April 2012.

PwC & IIA RF. 2011. *Audit effectiveness – what works best*. 4th ed. Altamonte Springs, FL: PWC.
http://www.PwC.com/et_EE/EE/publications/assets/pub/AuditCommBK_0603.pdf
Date of access: 5 Jun. 2012.

PwC. 2012. *Ten (10) minutes on effective audit committees*.
<http://www.pwc.com/us/en/10minutes/assets/pwc-10minutes-effective-audit-committees.pdf> Date of access: Dec. 2012.

QFinance. 2013a. *World class internal audit*. www.qfinance.com Date of access: 13 Mar. 2013.

QFinance. 2013b. *Internal auditing for the public sector*. www.qfinance.com Date of access: 13 Mar. 2013.

Reference for business. 2012. *Encyclopedia of management*.
<http://www.referenceforbusiness.com/> Date of access: Dec. 2012.

Republic of South Africa. 1996. *Constitution of the Republic South Africa, Act No. 108 of 1996*. Pretoria: Government Printers.

Republic of South Africa. 2003. *Local Government Municipal Finance Management Act No.56 of 2003 (MFMA)*. Pretoria: Government Printers.

Republic of South Africa. 2001. *Local government municipal planning and performance management regulations of 2001*. Pretoria: Government Printers.

Republic of South Africa. 2006. *Local government municipal planning and performance management regulations of 2006*. Pretoria: Government Printers.

Republic of South Africa. 2000. *Local Government Municipal Systems Act No. 32 of 2000*. Pretoria: Government Printers.

Republic of South Africa. 1993. *Local Government Transition Act of 1993 (LGTA)*. Pretoria: Government Printers.

Republic of South Africa. 1998. *Local government Municipal Structures Act No. 117 of 1998*. Pretoria: Government Printers.

Republic of South Africa. 2011. *National Treasury - audit committees, PFMA implementation, and compliance with Treasury Regulations: progress made, 2011*. Pretoria: Government Printers.

Republic of South Africa. 2011. *National Treasury - framework guide on departmental financial reporting, 2011*. Pretoria: Government Printers.

Republic of South Africa. 2009. *National Treasury - internal audit framework, 2009*. 2nd ed. Pretoria: Government Printers.

Republic of South Africa. 2003. *National Treasury - normative measures for financial management (Phase I: Perfecting the basics)*. Pretoria: Government Printers.

Republic of South Africa. 2012. *National Treasury - MFMA Circular No 65: Internal audit and audit committee of 2012*. Pretoria: Government Printers.

Republic of South Africa. 2004. *National Treasury - modernising financial governance: implementation of Municipal Finance Management Act. 2003*. Pretoria: Government Printers.

Republic of South Africa. 1999. *Public Finance Management Act No.1 of 1999, as amended (PFMA)*. Pretoria: Government Printers.

Republic of South Africa. 2010. *Umjindi Local Municipality, audit committee report, 2009*. <http://www.umjindi.gov.za/pa/Audit%20Committee%20Charter.pdf> Date of access: 3 Jun. 2012.

Republic of South Africa. 2011. *Westonaria Local Municipality: annual financial statements 2010.11*.

Republic of South Africa. 1998. *White Paper on Local Government of 1998*. Pretoria: Government Printers.

Sage. 2010. *Making sense of the social world – methods of investigations*. <http://www.sagepub.com/chambliss4e> Date of access: 8 Oct 2013.

SAICA (South African Institute of Accountants). 2002. *King II Report on corporate governance: summary of code of practices and conduct*. <https://www.saica.co.za/Technical/LegalandGovernance/King/tabid/2938/language/en-ZA/Default.aspx> Date of access: 19 Oct. 2013.

SALGA (South African Local Government Association). 2012. *SALGA comments on: The State of Local Government Finances and Financial Management Report*. http://www.thepresidency.gov.za/ElectronicReport/downloads/volume_4/business_case_viability/BC1_Research_Material/State_of_municipal_finances_Jan2012.pdf

Date of access: 24 Feb. 2013.

Sampling- UIAH (University of Art and Design in Helsinki). 2012. *Sampling*. <http://www2.uiah.fi/projects/metodi/152.htm> Date of access: Feb. 2012.

Sherer, M & Turley, S. 1997. *Current issues in auditing*. 3rd ed. London: Paul Chapman.

Shields, P. M. 1998. *Pragmatism as a philosophy of science: a tool for public administration*. San Marcos: Texas State University. http://www.polisci.txstate.edu/people/faculty/shields/5335/contentParagraph/06/content_files/file1/shields_pragmatism_philosophy.pdf Date of access: 14 Oct. 2013.

Sirayya, T. 2005. *Strategic role of effective public administration and efficient developmental financial management in building harmonious society through enhanced citizen participation: Cases- India* (within the theme on enlarging citizen participation and increasing local autonomy in achieving societal harmony). Annual Conference Network of Asia - Pacific Schools and Institutions of Public Administration and Governance (NAPSIPAG). Beijing, China, 5 -7 December. <http://www.napsipag.org/pdf/SurayyaTeki.pdf> Date of access: 17 Dec. 2012.

Spencer Picket, K.H. 2005. *The essential handbook of internal auditing*. West Sussex: Wiley.

Spreadsheets.about.com. 2013. Choosing the right graph - excel graphs and their use. <http://spreadsheets.about.com/od/spreadsheetlessons/ss/excel-graph-use-5.htm> Date of access: 8 Oct. 2013.

Summers, D.C.S. 2009. *Quality management- creating and sustaining organisational effectiveness*. 2nd ed. Upper Saddle River, NJ: Pearson /Prentice Hall.

SurveyMonkey. 2013. The Likert scale explained.
<http://www.surveymonkey.com/mp/likert-scale> Date of access: 8 Oct. 2013.

Struwig, F. W. & Stead, G.B. 2001. *Planning, design and reporting research*. Cape Town: Maskew Millar, Longman.

Tampieri, L. 2005. *Performance evaluation indexes in public administration: some issues of their actual usefulness*. Forli, Italy: University of Bologna.
http://www.academia.edu/3423445/_2005_Performance_evaluation_indexes_in_Public_Administrations Date of access: 8 Jun. 2012.

The Combined Code. 2000. *Principles of governance and code of best practices – derived from the Committee on Corporate Governance from the Committee's final report and from the Cadbury and Greenbury reports*.
www.ecgi.org/codes/documents/combined_code.pdf Date of access: 12 Feb. 2012

TheFreeDictionary. 2012. *Thesaurus*. <http://www.thefreedictionary.com/diligence>
Date of access: 19 Dec. 2012.

Thomas, A. R. & Smith, P.J. 2003. *Spotlight on social research*. Boston: Pearson.

uOttawa (University of Ottawa). 2010. *Society, the individual and medicine -validity and reliability of measurements*. <http://www.med.uottawa.ca/sim/data/measurement-validity.htm> Date of access: 9 Oct. 2013.

VAADA Comorbidity. 2009. *Terms of reference: a definition and some example by Ward Gail*. <http://www.comorbidity.org.au/node/498> Date of access: 17 April 2012.

Van der Nest, D.P. 2005. Audit committee in government department: an internal audit perspective. *Southern African journal of accountability and auditing research*, 6: 75 -84.

Van der Nest, D. P. 2006. *Audit committee in the South African public service*. Pretoria: Tshwane University of Technology. (Dissertation – PhD).

Van der Nest, D.P. 2008. The perceived effectiveness of audit committees in South African public service. *Morden accountancy research*, 16(2): 175 -188.

Van der Nest, D. P., Thornhill, C. & De Jager, J. 2008. Audit committees and accountability in the South African public sector. *Journal of public administration*, 43(4): 545 – 558.

Waweru , N., Kamau ,R.G. & Uliana, E. 2008. *Audit committees and corporate governance in a developing country*. Working paper series.

http://www.yorku.ca/laps/people/working_papers/SAS-ACC2008-05-Waweru.pdf
Date of access: 15 Feb. 2013.

Webb, W. & Auriacombe, C.J. 2006. Research design in public administration: critical consideration. *Journal of public administration*, 41(31): 588 – 602.

WiseGeek. 2013. *Clear answers for common questions*. <http://www.wisegeek.com/what-is-the-difference-between-quantitative-and-qualitative-research>
Date of access: 19 Oct. 2013.

APPENDICES

Appendix 7.1

RESEARCH PARTICIPATION CONSENT FORM

TOPIC: AN EVALUATION OF THE EFFECTIVENESS OF THE AUDIT COMMITTEE OF THE WESTONARIA LOCAL MUNICIPALITY

Dear Respondent

My name is Matsiliso Chaka. I am currently studying for a Masters in Public Administration (MPA) degree at North West University (NWU) – Potchefstroom Campus. As part of completing the degree, I am required to conduct a study which involves a survey. You have been selected to participate in the survey. The selection is based on your working relationship and interaction with the Audit Committee of the Westonaria Local Municipality.

The primary objective of the study is to evaluate the effectiveness of the audit committee in Westonaria Local Municipality (WLM). The completion of the attached questionnaire will contribute towards ensuring the validity of the results of the study. The attached questionnaire is divided into four sections, namely section A, B, C and D, with a total of twenty (20) questions. It will take you 15 minutes to complete the questionnaire, and you are required to place an 'x' in the box next to the most appropriate answer.

Once completed, please return the questionnaire to the following email address: matsilisoc@sassa.gov.za. You may contact me on 011 241 8387 during office hours should any additional information be required.

The information obtained from the survey will be kept confidential and used only for the purpose of the study. The results of the study will be used in an aggregate form, and therefore the anonymity of your responses will be maintained.

PARTICIPATION DECLARATION

I _____ hereby voluntarily grant permission for participation in the study. I understand my right to choose whether or not to participate in the study and that the information furnished will be treated as confidential.

Appendix 7.2

QUESTIONNAIRE

Title of research: An evaluation of the effectiveness of the audit committee of the Westonaria Local Municipality

The questionnaire contains 20 statements or questions. The statements or questions should be answered according to a Likert scale measuring 1 to 5 as follows:

- 1 – Strongly disagree
- 2 – Disagree
- 3 – Neither agree nor disagree (Neutral)
- 4 – Agree
- 5 - Strongly agree

State your opinion in the applicable box by marking with an X.

SECTION A EFFECTIVE FUNCTIONING OF AUDIT COMMITTEES

A.1 The audit committee charter provides sufficient authority for the audit committee, which is in line with its assigned audit function.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

A.2 .The audit committee comprises members with relevant qualifications.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

A.3: The audit committee members have sufficient experience in financial reporting to serve on such a committee.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

A.4. The audit committee holds a sufficient number of meetings.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

A.5.The audit committee receives appropriate agendas, quality reports and documentation on time, in order to review them before meetings.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

A.6. The audit committee discusses the scope of the internal and external audit regularly (This include issues of concern raised during the audit engagement, the financial statements and management's letter on completion of the external audit, as well as reviews of management responses to audit findings).

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

A.7.The audit committee maintains a productive relationship with management.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

A.8. The audit committee has open lines of communication with management.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

SECTION B: EFFECTIVENESS OF AUDIT COMMITTEE MEMBERS

B.1.The audit committee members act independently, without any undue influence from management in the discharge of their oversight function.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

B.2.The audit committee members act impartially.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

B.3.The audit committee members probe for more information from management when provided with inappropriate or unsatisfactory responses.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

B.4.The audit committee ask questions beyond financial information and reports provided by management.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

B.5.The audit committee members are well informed of developments in local government.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

B.6.The audit committee members consistently attend meetings.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

SECTION C STANDARDS FOR EFFECTIVENESS OF AUDIT COMMITTEES

C.1. The audit committee meets informally with the internal and external auditors throughout the year.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

C.2.The audit committee probes for more explanation on financial risks associated with areas of management judgement (This includes significant accounting accruals, estimates provisions and policies adopted in reporting and disclosure).

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

C.3.The audit committee receives appropriate training on existing and emerging risks in local government.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

C.4.The audit committee is provided with sufficient administrative assistance and support by internal audit and financial department for logistical arrangements for their meetings and reporting.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

C.5. Management has developed a continuous learning programme for audit committee members.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

C.6.The audit committee evaluates its own performance to identify areas of improvement.

1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐

THANK YOU FOR YOUR PARTICIPATION