Audit Committee Member Competency Framework

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1. Introduction

One of the main factors contributing to an effective audit committee is having the right composition and competencies. It is therefore important that the applicable Accounting Authority, Accounting Officer or Council appoints members with the appropriate balance of formal qualifications, relevant experience and desired personal attributes. The aim is to have an appropriate balance of skills and experience on the audit committee to enable it to effectively and efficiently discharge its duties/functions as set out in the applicable legislation as well as the audit committee charter/terms of reference (referred to hereafter as the “AC Charter”).

The purpose of this guide is to provide a summary of the key competencies recommended for audit committee members.

2. Composition

2.1. Size

In terms of section 94(2) of the Companies Act, section 77 of the Public Finance Management Act (“PFMA”) and section 166 of the Municipal Finance Management Act (“MFMA”), the audit committee should consist of a minimum of three (3) members.

The optimum size of an audit committee will vary depending on the size, nature, complexity and needs of the organisation, the industry or sector in which it operates, and the extent of responsibilities delegated to the audit committee as covered in its AC Charter.

2.2. Composition requirements

Both the PFMA and MFMA require that the majority of members of an audit committee must not be in the employ of the department or public entity or municipality/municipal entity. Treasury Regulation 27.1.4 similarly provides that “the majority of the members of an audit committee may not be employed by the public entity or be members of the controlling body”. In other words, this would be interpreted to mean that the majority of audit committee members must be “non-executive”.

Whereas, the Companies Act (section 94(4)) requires and King IV™ (Practice 56) recommends that all members of the audit committee must be non-executive members.

Non-executive means - an audit committee member must not be:

- a member involved in the day-to-day management of the organisation’s business either presently or during the previous financial year; or
- a prescribed officer or full-time employee of the organisation or another related/inter-related organisation either presently or at any time during the previous three financial years; or
- a material supplier or customer of the organisation (i.e. there must be no conflict of interest that could be perceived by a third party); or
- any individual related to any person who falls within the above categories.

It is recommended that all public organisations and municipalities consider, as an enhancement in terms of best governance practices, having an audit committee consisting only of non-executive members.

In addition, the audit committee should also, as recommended by King IV™ for the governing body, “promote diversity in its membership across a variety of attributes relevant for promoting better decision-making and effective governance, including filed of knowledge, skills and experience as well as age, culture, race and gender”.

Non-executive means - an audit committee member must not be:
2.3. Independence

Principle 8 and recommended practice 56 of King IV™ recommends that “all members of the audit committee should be independent, non-executive members of the governing body”. Similarly, both the Treasury Regulations (No. 3.1.5) and National Treasury’s Internal Audit Framework (No. 2.5.4) recommend that the audit committee should operate independently in order for it to be effective.

King IV™ defines Independence as follows:

“Independence generally means the exercise of objective, unfettered judgement. When used as the measure by which to judge the appearance of independence, or to categorise a non-executive member of the governing body or its committees as independent, it means the absence of an interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making.”

Independent non-executive members should be independent in fact and in the perception of a reasonably informed third party.

The following is recommended in order to enhance the audit committee’s independence:

- The majority of members should be independent of the organisation and should preferably not be in the public service.
- Ensuring the appointment of members who exhibit an independence of mind in their deliberations: The integrity and independence of appointees should be carefully considered and the independence of members should be assessed annually by the audit committee (with a more rigorous independence assessment performed for longer-standing members).
- Members should not serve for more than two consecutive terms and no more than six (6) years.
- Members should declare all private and business interests at every audit committee meeting. Specifically, members should not conduct any business with the department, public entity or municipality/municipal entity. Conflicts of interest should be a standing agenda item to ensure that all potential, actual or perceived conflicts of interest are identified and dealt with accordingly, and a conflict of interest register should be kept to record any such disclosed conflicts. The benefit of keeping a conflict of interest register will ensure transparency and safeguard the integrity of the decisions made by the audit committee by providing evidence of the independence of the audit committee should this ever be questioned.

As such, a Councillor/Council member is not allowed to be a member of the audit committee or attend audit committee meetings. While there is nothing prohibiting the chair of the Accounting Authority being a member of the audit committee, in practice and in line with best governance principles the chair is generally not appointed as a member.

2.4. Selecting members

When selecting new or considering the reappointment of audit committee members, consideration should be given to (among others) the following:

- the need to balance the benefits of having experienced members and bringing in new members for fresh insights and perceptions;
- the organisation’s culture, values, business and industry in which it operates, as well as its size and complexity (i.e. what skills are required to address the key risks of the organisation?);
- the number of other governing bodies / councils and audit committees on which the member sits on;
- the audit committee Chair’s recommendations on the skills, knowledge, experience and personal attributes required within the existing audit committee; and
- evaluations and assessment results, especially when such results highlight the need for additional skills or experience within the audit committee.

The PSACF round table discussions held across the regions have highlighted the challenge of audit committees in the public sector to recruit/access competent potential members. In order to address this need, the PSACF has provided an avenue for audit committees to advertise vacancies on the PSACF member database (which consists of varying levels of members with audit committee experience).
2.5. Rotation

Rotation enhances independence and helps to keep the audit committee effective and fresh with new perspectives on processes. It is recommended that an audit committee member should serve a minimum of three (3) years with the option of re-appointment for another three (3) years, based on his/her performance (i.e. not more than two terms of three years each).

In terms of National Treasury’s Internal Audit Framework section 2.5.6 and MFMA Circular 65, “Members should not be contracted continuously for a period exceeding six years. After serving continuously for six years, a cooling off period of two years should be allowed before appointing the same member to the same audit committee.”

Collectively based on the above, it is recommended that an individual should serve a maximum of four (4) terms in total (i.e. two periods of six (6) years in total) with a cooling off period of two years between terms 2 and 3.

It is recommended that audit committee members be rotated on a staggered basis to ensure that institutional knowledge from experienced members is retained and passed on to new members, and so that new members can receive guidance from experienced members regarding business processes, issues and relationships with key stakeholders. The number of members to be rotated will depend on the total number of members, but it is recommended that at least the majority of members should remain (i.e. one third should rotate).

3. Competencies of an effective Chair

The audit committee should be chaired by an independent “non-executive” member (i.e. an individual not in the employ of the public/municipal entity nor a political office bearer), as recommended in section 166 of the MFMA, section 77 of PFMA, Treasury Regulations 3.1.4 and 27.1.3, and King IV™.

The Chair should be able to lead the audit committee in an effective and ethical manner. The Chair should also consider undergoing development courses to develop his/her skills and effectiveness.1

One of the responsibilities of the Chair is to provide an effective line of communication from the audit committee to the relevant oversight authority. The Chair should thus provide regular feedback to the Accounting Authority/Accounting Officer or other relevant authority charged with oversight of the performance, findings and related issues of the audit committee. The Chair is also best placed to provide input to the relevant authority responsible for the appointment of the members on the competencies/skills required within the audit committee in order for it to effectively perform its functions.

3.1. Core skills

An effective Chair should be a respected and experienced member with the following core skills and/or characteristics:

- good leadership skills/qualities;
- financial literacy skills;
- strategy skills;
- requisite business acumen;
- business, governance and/or finance management experience in the public sector (i.e. public sector experience);
- excellent working knowledge of the audit committee’s function and risk management framework;
- ability to understand and identify major financial reporting issues;
- ability to understand the requirements for determining performance objectives, monitoring achievement and reporting thereon;
- understanding of the requirements for, and monitoring of, compliance with legislation;
- ability to lead constructive open and frank discussion with and/or between audit committee members, management, internal and external auditors, other external assurance providers and the applicable Accounting Authority/Accounting Officer/Council/Executive Authority/Portfolio Committee/MEC or Minister;
- interpersonal skills to build, maintain and promote effective working relationships; and
- ability to set/develop, manage and monitor the audit committee agenda as well as the effectiveness of committee meetings.

1 The Audit Committee Forum Position Paper: Guidelines for the audit committee chairperson contains additional information to assist the chair with preparation for audit committee meetings.
3.2. Other personal attributes and skills

Essential characterises of a strong Chair often also include personal attributes, such as:
- having time and energy for the role (i.e. dedication);
- having strong leadership and facilitation skills;
- being a good listener and communicator;
- having confidence and integrity;
- being firm and prepared to ask tough questions;
- the ability to encourage openness and transparency; and
- courage to raise and deal with tough issues/questions, and encourage and support other members to do the same.

4. Member Competency

The skills and experience required from audit committee members, as previously mentioned, will depend on the nature, size and complexity of the organisation. However, as a minimum the audit committee collectively should consist of members with the following skills, knowledge, experience and attributes/characteristics in order to execute its duties effectively.

4.1. Core skills

Collectively the audit committee should have members with the following core skills, knowledge or experience (depending on the required skill needed for the organisation):
- financial or accounting knowledge/literacy;
- financial, performance and integrated reporting experience and ability to analyse complex financial reports;
- understanding of public sector reporting;
- understanding of service delivery priorities;
- understanding of internal financial controls;
- understanding of the external and internal audit roles and processes (i.e. robust knowledge of the audit function);
- understanding of the role of the Accounting Authority/Accounting Officer/Council and other governance role players;
- risk management experience/knowledge;
- knowledge of or competence in sustainability issues;
- information technology governance experience including cyber security, knowledge of IT systems and emerging technologies;
- governance knowledge and experience;
- strong business acumen;
- management skills (i.e. ability to work constructively and communicate effectively with management);
- understanding of the performance management system;
- understanding of the treatment of allegations and investigations;
- understanding of the relevant legislative requirements relating to the organisation/industry and sector;
- a robust knowledge of the organisation, its operations and its industry to assess financial reports effectively;
- previous experience in the same sector/industry as that of the business (at least majority of the members); and
- other relevant technical or specialist experience pertinent to the issues of the organisation’s business.
4.2. Personal attributes and skills

In addition to the above, audit committee members should possess the following personal attributes:

- general business acumen (i.e. the ability to understand the impact of decisions or actions on the organisation)
- high level of integrity;
- strong ethical standards/values in line with those of the organisation;
- necessary available time and personal commitment to the role (i.e. dedication);
- healthy and professional scepticism;
- inquisitiveness and independent judgement (i.e. ability to think independently, objectivity and have an inquiring mind);
- ability, willingness and courage to ask relevant questions, challenge answers and probe for information until completely satisfied with the answers provided;
- ability to offer new perspectives and constructive suggestions;
- strong interpersonal skills;
- openness and transparency;
- ability to be open to, accept and foster change;
- ability and desire to learn; and
- commitment and adherence to continuous professional development (CPD) requirements in terms of his/her specific profession/designation.

4.3. Additional skills, knowledge and experience

The audit committee and the Accounting Authority/Accounting Officer/Council should identify and agree on other skill sets required for the effectiveness of the audit committee. These additional skills may be in relation to the core business of the organisation, key strategies and/or business plans, or key developments in the industry affecting the business operations.

The required skills set for an audit committee should be reviewed periodically, taking into account the current maturity/stage of the organisation to ensure that as the company matures, the skills and knowledge of the audit committee members also develop to enable the audit committee to focus on key issues facing the organisation.

5. Ongoing Assessment and Evaluation

Evaluations serve as a method to assess the performance of the audit committee and individual members and to identify gaps or weaknesses and what the audit committee/members need (such as further training, skills and knowledge etc.) to improve effectiveness.²

The duties/functions of the audit committee are continuously developing and/or increasing due to changes in the risk landscape, and as such new skills may be needed within the audit committee to address these new duties/functions. Thus the need for regular assessments and updating of the AC Charter becomes more necessary.

It is recommended that the applicable authority within the public sector landscape that is responsible for the appointment of audit committee members ensures (with the assistance of the Chair and/or Company Secretary) that the audit committee undergoes annual evaluation assessments on its collective as well as individual members’ performance and effectiveness. In terms of King IV™ it is recommended that an independent evaluation be performed every two (2) years. An informal internal self-assessment can be performed during the interim periods to determine what progress has been made with action plans created since the previous formal evaluation.

In general, the results of the assessment should be received and considered by the relevant authority when determining the selection criteria for new members or the engagement with external specialists/consultants (as and when needed) to ensure that the audit committee has all the required skills, knowledge and experience to effectively fulfil its duties. With regards to municipalities, MFMA Circular 65 provides specific recommendations around results of assessments.

² The Audit Committee Forum Position Paper: Guidelines for assessing the performance of an audit committee contains additional guidance on this matter as well as basic templates for internal assessments.
Annexure 1 - Public Sector Audit Committee Competency Framework Checklist Guideline

*This checklist has been provided as a high-level guide to enable the audit committee to evaluate its overall competency. This evaluation can be included as part of the annual audit committee assessment (which covers a broader performance spectrum). It is recommended that this checklist be used by the authority responsible for the appointment of the audit committee members either on an annual basis or when appointing/reappointing members.

<table>
<thead>
<tr>
<th>Assessment Area/Question</th>
<th>Yes / No</th>
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<tbody>
<tr>
<td><strong>Composition</strong></td>
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<tr>
<td>Are all the members’ independent non-executive members?</td>
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<td>Is there a minimum of three members?</td>
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<td>Does the audit committee have the appropriate number of members relative to the size, nature and complexity of the organisation to effectively and efficiently carry out its functions?</td>
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<td>Is the independence of members assessed annually?</td>
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<td>Does the audit committee have protocols to deal with actual and perceived conflicts of interest? Are conflicts of interest identified and dealt with appropriately?</td>
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<td>Are conflicts of interest recorded in a conflict of interest register?</td>
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<td>Are there clear criteria as well as a list of requirements regarding the qualifications, attributes and experience needed for recruitment/selection of members?</td>
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<td>Does the Chair of the audit committee provide feedback/input in the selection of new members through his/her recommendations on the additional skills/competencies required within the audit committee?</td>
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<td>Are skills gap analyses undertaken to identify the skills required within the audit committee?</td>
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<td>Are audit committee members rotated on a staggered basis?</td>
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<td>Do audit committee members serve longer than a total of six (6) years on the committee? If so, are such members subjected to rigorous independence assessments to satisfy the committee that they are still independent?</td>
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<td><strong>Chair</strong></td>
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<td>Is the Chair of the audit committee an independent non-executive member?</td>
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<td>Is the Chair an experienced governing body member with relevant financial expertise?</td>
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<tr>
<td>Does the Chair possess the core skills, knowledge and experience required of an effective Chair?</td>
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<tr>
<td>Does the Chair have appropriate leadership and facilitation skills?</td>
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<td>Does the Chair have relevant public sector experience?</td>
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<tr>
<td>Does the Chair demonstrate the personal attributes of an effective Chair?</td>
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<td>Does the Chair understand and regularly assess the needs of the audit committee?</td>
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<td>Does the Chair set and manage the audit committee agenda?</td>
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<td>Does the Chair have effective working relationships with all key stakeholders?</td>
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<td><strong>Audit Committee Members</strong></td>
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<tr>
<td>Does the audit committee have an appropriate mix of core skills, knowledge and experience to address the needs and complexity of the organisation and as identified by the Chair?</td>
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<td>Do all or at least a majority of the audit committee members have financial knowledge?</td>
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<td>Does the audit committee have at least one member who is a financial management expert?</td>
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<tr>
<td>Do the audit committee members possess the necessary personal attributes required for an effective audit committee?</td>
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<tr>
<td>Has the audit committee been subject to an evaluation or analysis to determine whether it requires any specific skills and knowledge to deal with specific company concerns/issues?</td>
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<tr>
<td><strong>Evaluation/Assessment</strong></td>
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<tr>
<td>Is the performance of the audit committee and individual members evaluated/appraised annually?</td>
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<td>Does the audit committee adequately address those areas identified as requiring improvement in such evaluations?</td>
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<tr>
<td>Are identified gaps in skills, knowledge and experience dealt with either through appropriate induction of new members; providing training to existing members, or identifying external specialists/consultants to advise the audit committee on such topics/areas?</td>
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**Results of the Checklist**

This checklist provides a template that can be used to assess the audit committee’s independence, composition and current competency. The results of the assessment can assist the audit committee Chair, nominations committee or the relevant authority responsible for the appointment of audit committee members in that organisation when considering the appointment or reappointment of audit committee members.

Any issues identified or arising from this checklist must be added to the audit committee meeting agenda for discussion.