PUBLIC SECTOR
AUDIT COMMITTEE FORUM

Audit and Risk Committees in the Public Sector

Role in Oversight of Risk

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1. Introduction

Every entity to which the Public Finance Management Act (PFMA) or the Municipal Management Act (MFMA) or the Financial Management of Parliament and Provincial Legislature Act (FMPPLA) applies must implement and maintain an effective, efficient and transparent system of risk management.

The scope of this document is limited to the Audit Committees role and responsibilities for oversight of risk management in a public institution. It elaborates the succinct elements of the Public Sector Risk Management Framework (Framework), which was developed in response to the requirements of the PFMA and MFMA for institutions to implement and maintain effective, efficient and transparent systems of risk management and control.

It is noted that the underlying intention of the Framework is that Institutions should through the risk management process achieve, among other things, the following outcomes needed to underpin and enhance performance:

- more sustainable and reliable delivery of services;
- informed decisions underpinned by appropriate rigour and analysis;
- innovation;
- reduced waste;
- prevention of fraud and corruption;
- better value for money through more efficient use of resources; and
- better outputs and outcomes through improved project and programme management.

2. Institutional Risk Management Arrangements

There are many role players in the typical risk management process. However, relevant financial management legislation holds the Accounting Officers (in departments) or Accounting Authorities (in public entities) responsible and **accountable for risk management.**[1] Some of the responsibilities attached to this accountability arrangement may be delegated to other officials, for example, senior managers, line managers or technical specialists.

2.1 The role of the Accounting Officer / Accounting Authority

Although this is not the focus of this paper it should be noted that the Accounting Officer/Accounting Authority is responsible for **creating an enabling environment for the management of risks** by setting an appropriate tone by supporting and being seen to be supporting the Institution's aspirations for effective management of risks, and the **setting of institutional objectives so that risk management can take place.**

It should be noted that the Framework gives the Accounting Officer/Accounting Authority the responsibility for delegating responsibilities for risk management to Management and internal formations such as the Risk Management Committee, Fraud Prevention Committee, Finance Committee, Information and Communication Technology Committee. It is therefore clear that the Risk Management Committee is seen as a management committee and not on the same level as the Audit Committee.

The Risk Management Committee **is appointed by the Accounting Officer / Accounting Authority** to assist them to discharge their responsibilities for risk management. The membership of the Risk Management Committee should comprise both management and external members with the necessary blend of skills, competencies and attributes, including the following critical aspects:[2]

- an intimate understanding of the Institution's mandate and operations;
- the ability to act independently and objectively in the interest of the Institution; and
- a thorough knowledge of risk management principles and their application.

1 All references hereinafter to Accounting Officers denotes those pertaining to public departments and references to Accounting Authorities denotes those pertaining to in public entities.

2 National Treasury, Public Sector Risk Management Framework, (2018), available at https://oag.treasury.gov.za/RMF/Pages/s101ExecutiveSummary.aspx

2.2 The role of Internal Audit[3]

Internal Audit must evaluate and contribute to the improvement of risk management, control and governance processes using a systematic and disciplined approach. Internal Audit is responsible for providing assurance to management and the Audit Committee on the adequacy and effectiveness of the risk management process. Risk management is a key responsibility of the Accounting Officer/Accounting Authority and management. Management should ensure that adequate risk management processes are in place and functioning as intended.

Internal Audit must assist management and the Audit Committee by examining, evaluating, reporting and recommending improvements on the adequacy and effectiveness of management's risk processes. Conducting assessments and reporting on the organisation's risk management process should be a high audit priority.

Internal Audit must be satisfied that the organisation's risk management processes address five key objectives to formulate an opinion on the overall adequacy thereof. The five key objectives of risk management are:

- Risks arising from business strategies and activities should be identified and prioritised. These risks should focus on the efficient, economic and effective use of resources, as well as any duplications of functions that might exist;
- Management should propose the level of risk acceptable to the organisation;
- Risk mitigation activities should be designed and implemented to reduce or manage risk to a level acceptable by the organisation;
- Management should receive periodic reports of the results of risk management processes; and
- Ongoing activities should be conducted to periodically reassess risk and the effectiveness of controls to manage risk.

Internal Audit must evaluate risk exposures relating to the organisation's governance, operations, and information systems regarding:

- Reliability and integrity of financial and operational information;
- Effectiveness, efficiency and sustainability of operations;
- Safeguarding of assets and the environment; and
- Compliance with laws, regulations, and contracts.

The Audit Committee should ensure that these issues are incorporated in the Internal Audit work plan.

2.3. The Audit Committee

In terms of the PFMA and MFMA, an Audit Committee is established to serve as an independent governance structure whose function is to provide an oversight role on the systems of internal control, risk management and governance.[4]

The Audit Committee is the only committee recognised in the aforementioned legislation **as being responsible for the oversight of risk management.** In terms of the revised Treasury Internal Audit Framework risk management is an essential part of effective corporate governance and whilst it is a management responsibility, management expects the Audit Committee to oversee and provide advice on the organisation's risk management.

Where there is no separate Risk Management Committee, the risk oversight responsibilities of the Audit Committee should be identical to those ascribed to the Risk Management Committee by the Framework, namely to:

a) review and recommend for the Approval of the Accounting Officer / Accounting Authority, the:
   (i) risk management policy;
   (ii) risk management strategy;
   (iii) risk management implementation plan;
   (iv) Institution's risk appetite, ensuring that limits are:

   - supported by a rigorous analysis and expert judgement;
   - expressed in the same values as the key performance indicators to which they apply;
   - set for all material risks individually, as well as in aggregate for particular categorisations of risk; and
   - consistent with the materiality and significance framework.

3 National Treasury, Internal Audit Framework, (2009), available at http://www.treasury.gov.za/publications/other/Treasury%20Internal%20Audit%20Framework%2 Revised%202009.pdf
4 National Treasury, Internal Audit Framework, (2009), available at http://www.treasury.gov.za/publications/other/Treasury%20Internal%20Audit%20Framework%2 Revised%202009.pdf, page 5

2.3. The Audit Committee (continued)

(v) Institution's risk tolerance, ensuring that limits are supported by a rigorous analysis and expert judgement of:

- the Institution's ability to withstand significant shocks; and
- the Institution's ability to recover financially and operationally from significant shocks.

(vi) Institution's risk identification and assessment methodologies, after satisfying itself of their effectiveness in timeously and accurately identifying and assessing the Institution's risks.

b) evaluate the extent and effectiveness of integration of risk management within the Institution;
c) assess implementation of the risk management policy and strategy (including plan);
d) evaluate the effectiveness of the mitigating strategies implemented to address the material risks of the Institution;
e) review the material findings and recommendations by assurance providers on the system of risk management and monitor the implementation of such recommendations;
f) develop its own key performance indicators for approval by the Accounting Officer / Accounting Authority;
g) interact with the Audit Committee to share information relating to material risks of the Institution; and
h) provide timely and useful reports to the Accounting Officer / Accounting Authority on the state of risk management, together with accompanying recommendations to address any deficiencies identified by the Committee.

Furthermore, the Audit Committee needs to consider:

- Whether management has a comprehensive risk management framework;
- Whether a sound and effective approach has been followed in developing strategic risk management plans;
- The impact of the organisation's risk management framework on the control environment; and
- The organisation's fraud prevention plan to be satisfied that the organisation has appropriate processes and systems in place to capture, monitor and effectively investigate fraudulent activities.[5]

In order to exercise appropriate oversight and to provide meaningful counsel under this critical mandate, the audit committee must have detailed knowledge and understanding of the Institution's:

- mandate, objectives and performance targets;
- significant risk factors and opportunities;
- system of risk management - including the process for identifying, evaluating, prioritizing and managing risks, and monitoring the effects of actions taken to manage risks within predetermined parameters;
- risk governance - including the appropriateness of the risk policy and strategies, institutional (structural) arrangements and capacity to manage risk;
- the current risk profile and actions proposed or being taken to manage risks falling outside predetermined parameters, and to exploit opportunities; and
- emerging risks, the institutions preparedness to cope, and plans to build resilience.

The audit committee needs to develop this knowledge through its own initiatives as well as through engagements with at least the following stakeholders:

- Executive Authority;
- Accounting Officer or Accounting Authority;
- Executive management;
- Senior/Line management (heads of the various business units);
- Risk management committee (and its sub committees if necessary);
- Auditor-General of South Africa or External auditors;
- Internal auditors; and
- Other assurance providers (including regulatory authorities, monitoring and oversight authorities, etc.).

5 National Treasury, Internal Audit Framework, (2009), available at http://www.treasury.gov.za/publications/other/Treasury%20Internal%20Audit%20Framework%20Revised%202009.pdf, page 13-14

To ensure the necessary skills and experience in the Audit Committee it is recommended by Treasury that members should be selected from different areas of expertise to enhance the Audit Committee's overall knowledge of the organisation. The appointed members should collectively possess the following:

- Broad business, corporate governance and/or financial management experience;
- Public sector experience;
- An understanding of the business in which the organisation operates;
- Familiarity with risk management practices;
- An understanding of internal controls;
- An understanding of major accounting practices and public sector reporting formats;
- Familiarity with legislative requirements; and
- Understanding of the roles of internal and external audit.[6]

It should also be noted that Treasury recommends that at induction of new members of the AC specific attention should be placed on education of members in the areas of risk management, corporate governance and financial reporting.[7]

It is the role of the Chief Audit Executive (CAE) to provide advice, counsel, and opinions regarding the organisation's efficiency and effectiveness in risk management, internal control and corporate governance and performance management. The CAE should be appointed at a senior management level. He/she should possess a high level of personal and professional ethics including an understanding of the risk management processes and practices.[8]

In the development of a strategic audit plan the CAE is to ensure the following analysis:

- Assesses the effect of each risk on the objectives;
- Considers the relevant risk management activities applied to the risk;
- Assesses the effectiveness of such activities; and
- Identifies any action needed to improve the risk management activities.

In considering the effectiveness of risk management activities' actual or perceived control, measures are identified, and their effectiveness assessed with regard to the identified risk.[9]

Insofar as it concerns the responsibilities of the Audit Committee for risk management, the Accounting Officer / Accounting Authority should evaluate the performance of the Audit Committee through the following and other relevant indicators:

- the results of the Audit Committee's own 360 degree assessment;
- the Committee's co-ordination of the work of Internal Audit, External Audit and other assurance providers in respect of risk management; and
- the quality and timeliness of the Audit Committee's counsel and recommendations on matters concerning the system of risk management.[10]

6 National Treasury, Internal Audit Framework, (2009), available at http://www.treasury.gov.za/publications/other/Treasury%20Internal%20Audit%20Framework%20Revised%202009.pdf, page 19
7 ibid, page 22
8 ibid, page 26
9 National Treasury, Internal Audit Framework, (2009), available at http://www.treasury.gov.za/publications/other/Treasury%20Internal%20Audit%20Framework%20Revised%202009.pdf, page 34
10 National Treasury, Public Sector Risk Management Framework, (2018), available at https://oag.treasury.gov.za/RMF/Pages/s101ExecutiveSummary.aspx

3. Disclosure and Reporting

The Audit Committee is responsible to review and recommend disclosures on risk matters in the annual financial statements and in the annual report, also to report on financial risks including fraud and IT risks.

The Chief Risk Officer (head of the risk management unit) is responsible for timeous reporting on all risk-related matters to the Audit Committee and Risk Management Committee and the Accounting Officer / Accounting Authority.

4. Conclusion

The Audit Committee plays a distinct and integral role in the risk management process of the institution in that it independently assesses and oversees the entire risk management function, coupled with counsel and guidance to improve the system. The Audit Committee can leverage and delegate certain of its responsibilities to a risk management committee, by exercising appropriate and adequate oversight of the risk committee without compromising its own effectiveness.

The effective function of the role of the audit committee in risk management should enhance the internal controls of the institution not only to assist with sound financial management but also assisting the institution in achieving its public mandate.

5. Bibliography

National Treasury. 2009. Internal Audit Framework. Republic of South Africa (2nd Edition)

National Treasury. 2018. Public Sector Risk Management Framework.
Available at: https://oag.treasury.gov.za/RMF/Pages/s101ExecutiveSummary.aspx.

For further Best Practice on Audit Committees, please refer to the King IV Report on Corporate Governance for South Africa, 2016, as found on the website of the Institute of Directors in Southern Africa **(www.iodsa.co.za)**

Notes

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