The Relationship between Audit Committee and Council (Local Government)

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Introduction

The purpose of this paper is to highlight the importance of an effective relationship between a Municipal Council and its Audit Committee, and to provide some practice guidelines on improving this relationship.

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

Effective working relationships that value all contributions will foster a team approach, ensure effective fulfilment of responsibilities and boost morale.

The legislative and executive authority of a municipality is seated in the Municipal Council, of which the members are elected representatives of political parties. Effectively, the Council is the governing body of a municipality.

The role to be played by the Audit Committee has been legislated in the MFMA and is critical to provide a mechanism for the rendering of impartial advice and recommendations to the municipal manager and Council on financial and non-financial matters, to improve accountability and governance over the activities of municipalities and municipal entities. In addition, many audit findings can be prevented or mitigated through oversight by the Audit Committee.

It is therefore critical that the Municipal Council effectively and regularly engages with the Audit Committee, in order to derive the most benefit for Council and the municipality which it oversees. It is also important that greater emphasis be placed by Council on the work of the Audit Committee.

The role of Council

Councillors have an important oversight and policy setting role, and a wide range of responsibilities that include community leadership, representing citizens, and making decisions about the provision of services for the betterment of communities. Collectively, councillors are responsible for decisions that affect the lives and livelihoods of individuals, organisations and businesses.

In terms of the Local Government Municipal Structures Act:

“19 (1) A municipal council must strive within its capacity to achieve the objectives set out in section 152 of the Constitution.

(2) A municipal council must annually review—
(a) the needs of the community;
(b) its priorities to meet those needs;
(c) its processes for involving the community;
(d) its organisational and delivery mechanisms for meeting the needs of the community; and
(e) its overall performance in achieving the objectives referred to in subsection (1).

(3) A municipal council must develop mechanisms to consult the community and community organisations in performing its functions and exercising its powers.”

In executing its functions and fulfilling its obligations, Council is assisted by various functions within the governance structure of the municipality. One such function is the Audit Committee.

Municipal Council oversight structures will derive immediate benefits through a closer and more effective interaction between Council and the Audit committee.

<table>
<thead>
<tr>
<th>MUNICIPAL COUNCIL</th>
<th>Accountability</th>
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<tr>
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<tr>
<td>MUNICIPAL AUDIT COMMITTEE</td>
<td>Report</td>
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</tbody>
</table>

Does Council recognise the audit committee as a committee of Council?

Does Council delegate to the Audit Committee responsibly without abdicating its own responsibility?
The role of the Audit Committee

The Audit Committee is a committee of the Council and performs the statutory responsibilities assigned to it by the MFMA (sections 165 and 166), and other relevant responsibilities delegated to it under its charter by the Council.

Section 166 of the MFMA requires that each municipality and municipal entity must have an Audit Committee. The Audit Committee is an independent advisory body that must

a) advise the municipal council, the political office-bearers, the accounting officer and the management of the municipality or municipal entity on matters relating to:
   • internal financial control and internal audits;
   • risk management;
   • accounting policies;
   • the adequacy, reliability and accuracy of financial reporting and information;
   • performance management;
   • effective governance;
   • compliance with the Act, the annual Division of Revenue Act and any other applicable legislation;
   • performance evaluation; and
   • any other issues referred to it by the municipality or municipal entity

b) review the annual financial statements to provide the Council of the municipality or, in the case of a municipal entity, the council of the parent municipality and the board of directors of the entity, with an authoritative and credible view of the financial position of the municipality or municipal entity, its efficiency and effectiveness and its overall level of compliance with this Act, the annual Division of Revenue Act and any other applicable legislation;

c) respond to the council on any issues raised by the Auditor-General in the audit report;

d) carry out such investigations into the financial affairs of the municipality or municipal entity as the Council of the municipality, or in the case of a municipal entity, the Council of the parent municipality or the board of directors of the entity, may request and

e) perform such other functions as may be prescribed.

In addition to these legislated duties, as required by King III, the audit committee should:

- oversee annual/integrated reporting;
- ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities;
- satisfy itself of the expertise, resources and experience of the company’s finance function;
- be responsible for overseeing of internal audit;
- be an integral component of the risk management process;
- oversee the external audit process;
- report to council and stakeholders on how it has discharged its duties.

Has Council approved the Audit Committee charter?

Does Council fully understand and appreciate the role of the Audit Committee?

Has a thorough induction of all Audit Committee members taken place, to enable new members to assume their responsibilities effectively?

Has Council assessed whether the Audit Committee has effectively fulfilled its responsibilities?
Appointment

Section 166(5) of the MFMA requires that the members of an Audit Committee must be appointed by the Council of the municipality or, in the case of a municipal entity, by the Council of the parent municipality. One of the members, who is not in the employ of the municipality or municipal entity, must be appointed as the chairperson of the committee.

Councillors are not allowed to be members of an Audit Committee.

When selecting members of Audit Committees, Council should take into account personal qualities, skills and experience as well as independence – all of which are critical. See Appendix A for further guidance on this.

Dismissal

Committee members can be dismissed by the Municipal Council under certain circumstances. The accounting officer or Municipal Council should consult the charter when dismissing members of the Audit Committee. Reasons for dismissal amongst other would normally be detailed in the letter of appointment and contract agreement, such as:

- where an on-going conflict of interest exists;
- where a member has not performed to expectations.

The official dismissal processes as they relate to the municipality or municipal entity should be adhered to by the Accounting officer and Municipal Council when an Audit Committee member is being dismissed.

Where appropriate, the dismissal process should be linked to the charter and member’s performance assessment process. The dismissal of a member should be performed by the Municipal Council and the outcome of the dismissal process should be in writing. The date of dismissal should be minuted by the secretariat of the Audit Committee.

Authority

In terms of the MFMA section 166(3)(a) - In performing its functions, the Audit Committee has access to the financial records and other relevant information of the municipality or municipal entity.

The Audit Committee should have the authority to obtain any information, advice and appropriate resources from within or outside the municipality or entity, in order to perform its functions as legislated.

The Audit Committee may:

- communicate with the Council, municipal manager or the internal and external auditors of the municipality or municipal entity;
- have access to municipal records containing information that is needed to perform it duties or exercise its powers;
- request any relevant person to attend any of its meetings, and, if necessary, to provide information requested by the committee; and
- conduct investigations into the financial affairs of the municipality or municipal entity, as may be requested by the Council of the municipality or in the case of a municipal entity, the Council of the parent municipality or the board of directors of the entity.

Has Council taken a hands-on role in appointing the Audit Committee members?

Are the right people sitting on the Audit Committee?

Is the mix of skills appropriate?

Is the Audit Committee charter clear on expectations and dismissal procedures?

Is an annual independent evaluation performed on the Audit Committee and its members?

Has the Audit Committee had unrestricted access to the documents/information that it needs in order to make informed decisions?

Have appropriate resources been made available to the Audit Committee to enable it to effectively perform its functions?
Interaction between Municipal Council and Audit Committee

The Audit Committee, being a committee of Council, should through its chairperson report to the Municipal Council after each Audit Committee meeting.

Upon receipt of this report, Council should interrogate the information and ask relevant questions to the Audit Committee in order to assess whether they can rely on the information being presented to them.

Whilst the Audit Committee may provide certain summarised information to the Municipal Council, in some instances it may be necessary for Council to read the full report to obtain the necessary assurance.

The table below serves merely as a guideline and should not be taken as an exhaustive checklist.

<table>
<thead>
<tr>
<th>Area</th>
<th>Audit committee should report to Council</th>
<th>Council should ask Audit Committee</th>
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<tbody>
<tr>
<td>Risk and control</td>
<td>Summary of the key risks facing the municipality and how these are being addressed</td>
<td>Is the Audit Committee satisfied that these key risks have been adequately addressed?</td>
</tr>
<tr>
<td></td>
<td>Effectiveness of internal controls and any additional measures that should be implemented to address identified risks</td>
<td>What key control breakdowns have taken place?</td>
</tr>
<tr>
<td>Assurance</td>
<td>Significant external audit findings, recommendations and updated status thereof</td>
<td>Is the Audit Committee satisfied that these have been adequately dealt with and will they be prevented in future?</td>
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<tr>
<td></td>
<td>Significant internal audit findings, recommendations and updated status thereof</td>
<td>Has the Audit Committee reviewed internal audit reports and ensured that recommendations were actioned?</td>
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<tr>
<td></td>
<td>The Audit Committee’s view on the financial position of the municipality.</td>
<td>Is the Audit Committee satisfied with the role, performance and independence of internal audit?</td>
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<tr>
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<td>Has internal audit achieved its objectives?</td>
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<tr>
<td>Finance</td>
<td>Recommendation of draft financial statements to the Council for approval.</td>
<td>Is the Audit Committee satisfied with financial governance including the skills and competence of the finance function and the processes around the reporting?</td>
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<td>Is the Audit Committee satisfied with the appropriateness of the accounting policies used in the preparation of those financial statements?</td>
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<tr>
<td></td>
<td>The Audit Committee’s view on the financial position of the municipality.</td>
<td>Is the Audit Committee satisfied with the financial position of the municipality?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>If not, what could be done to improve the financial position of the municipality?</td>
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<tr>
<td>Compliance</td>
<td>Any areas of non-compliance with the MFMA, DORA and any other applicable legislation.</td>
<td>How did the areas of non-compliance arise and what is going to be done to prevent them from happening in future?</td>
</tr>
<tr>
<td>Performance management</td>
<td>Audit committee’s findings and recommendations in line with integrated development plans and service delivery and budget implementation plan.</td>
<td>What are the main areas within performance management that the Audit Committee is concerned about and how can these be addressed?</td>
</tr>
<tr>
<td>General</td>
<td>Results of any Audit Committee evaluations that have been conducted.</td>
<td>Is the Audit Committee satisfied with its performance?</td>
</tr>
<tr>
<td></td>
<td>Details of meetings and the number of meetings attended by each member of the Audit Committee.</td>
<td>Is the Audit Committee satisfied with its own independence?</td>
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<td></td>
<td>Progress with any specific investigations delegated to the Audit Committee and their outcomes.</td>
<td>Have sufficient number of Audit Committee meetings been held to be able to fulfil its responsibilities?</td>
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<td>Is each member of the Audit Committee adequately attending and participating in meetings?</td>
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<td></td>
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<td>What external advice did the Audit Committee take in coming to its conclusions?</td>
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</tbody>
</table>

Does every Municipal Council meeting have a standing agenda item for report back from the Audit Committee?
Some practical challenges and recommendations

In practice, there are numerous challenges that impact on the relationship between the Audit Committee and Council. There are inherent challenges in the environment and structure of local government that affects the relationship, including political appointments and a myriad of legislation.

One such challenge is in the appointment of the Audit Committee members, which is the legislated duty of Council. In some instances, this duty is performed by others, including the municipal manager, the executive mayor or the MMC for finance.

This leads to confusion over accountability and role clarity, with members of the Audit Committee feeling more accountable to the individual who appointed them than to Council. This severely undermines the governance structure of a municipality and the role that the Audit Committee is meant to play therein.

Council should take full responsibility for the appointment of members to the Audit Committee and ensure that the Audit Committee is treated as a committee of Council and is hence accountable to Council.

Another challenge faced by Council is the inability to attract members with the right knowledge and skills due to lack of resources in the market. This is especially relevant to small and medium size municipalities. Candidates could be sourced from less traditional pools, and Council should encourage ongoing training and development of Audit Committee members.

One of the inherent challenges within the governance structure of a municipality is the lack of role clarity between various committees within the structure, including the Audit Committee, the finance committee, the municipal public accounts committee, and other council portfolio committees. Care needs to be taken to understand the roles that the various committees play in order to obtain synergies and minimise duplication. Each committee charter should be clear on the role and responsibilities of that committee and how it interacts with the other committees.

Finally, one of the most pervasive challenges is the lack of implementation of findings/recommendations raised by the Audit Committee. Where the Audit Committee feels that its recommendations have not been considered / implemented, it has the right to inform the Municipal Public Accounts Committee, the relevant MEC or even the Provincial Premier.

This paper is intended to be an introductory high level guide to the relationship between the Municipal Council and Audit Committee, and will be followed with future papers addressing various other aspects/topics relevant to municipal Audit Committees.

Appendix A

Excerpt from National Treasury Circular 65 MFMA – Internal Audit and Audit Committee

Qualities of members

One of the audit committee members should be appointed as the chairperson, after the following factors have been considered:

- Has good standing and ability to lead discussions;
- Creates vision and provides direction at meetings;
- Builds municipal capabilities by guiding management based on expert knowledge and skills;
- Promotes and achieve quality outcomes at meetings;
- Has the ability to speedily and effectively advise council or the board of directors of any impending non-compliance with the legislative framework;
- Has the ability to encourage other members to participate in audit committee meetings; and
- Conducts meetings in a manner that demonstrates a desire to establish effective communication with all stakeholders.

In determining suitable candidates for an audit committee and maintaining a balanced composition, the accounting officer should seek to appoint candidates that have ability to:

- Perform the role as advisor to management;
- Communicate effectively with management;
- Carefully review information received and obtain clarification from management as and when appropriate;
- Raise relevant questions, evaluate responses and follow up on any matter that is unclear;
- Conduct responsibilities in the context of the municipality’s strategic objectives and overall corporate governance of the council;
- Act independently and be proactive in advising the accounting officer regarding issues that require further management attention;
- Encourage openness and transparency;
- Build relations with management;
- Have a professional approach to performing duties, including commitment of time and effort, and;
- Each committee member must be independent and appropriately skilled.

Skills and experience

Members should be selected from different areas of expertise to enhance the audit committee’s overall knowledge of the municipality or entity and the ability to discharge its obligations and provide appropriate recommendations to the council.

The roles and responsibilities of an audit committee can be used as a baseline to obtain relevant skills that members must possess. This will ensure that appointed members are competent to carry out their responsibilities as set out in the audit committee’s charter.
The appointed members should collectively possess the following skills and experience:

- Private and public sector experience;
- An understanding of service delivery priorities;
- Good governance and/or financial management experience;
- An understanding of the role of council and councillors;
- An understanding of the operations of the organization;
- Familiarity with risk management practices;
- An understanding of internal controls;
- An understanding of major accounting practices and public sector reporting requirements;
- An understanding of public sector reforms;
- Familiarity with legislation applicable to municipalities;
- An understanding of the roles and responsibilities of internal and external auditors;
- An understanding of the treatment of allegations and investigations; and
- An understanding of the performance management system.

Independence

The audit committee should be independent and safeguarded from undue influence in exercising its responsibilities in an objective manner.

To enhance the audit committee functioning, the following is required:

- The audit committee chairperson and members should be independent of the municipality or municipal entity;
- The audit committee chairperson and members should not be biased but exhibit an independence of mental attitude during deliberations;
- All audit committee members should declare private and business interest in every meeting; and

All members should not carry out any business with the municipality or municipal entity (our insertion - other than the purchase of services in the ordinary course of being a resident of the particular municipality).

Notes: