

22 March 2005

Mr Matt Brown
Chairman
Public Accounts Committee
New South Wales Parliament
Macquarie Street
Sydney NSW 2000

Email: Vicki.buchbach@parliament.nsw.gov.au

Dear Mr Brown

Review of Audit Committees

CPA Australia welcomes the opportunity to provide input into the Public Accounts Committee's Review of Audit Committees particularly because we understand that this paper was not issued for broad public consultation. Over the last few years there has been significant debate, particularly in the corporate sector, on the ever increasing importance of governance and accountability and, in particular, the need for robust frameworks. The dialogue has been just as prominent in the government sector. Accordingly, we believe that this is a timely issue and a priority for all public sector agencies.

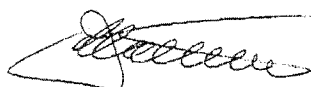
CPA Australia is one of the world's largest accounting bodies, representing 105,000 finance, accounting and business professionals in Australia, Asia and Europe with over 10,500 of these professionals working in the public sector.

In developing the attached submission, we have consulted with areas of expertise within CPA Australia including; the Public Sector Centre of Excellence, the Public Sector Accounting Standards Group and others in the public sector who are prominent in this area.

We would like to publish this submission on our website and in our electronic newsletter for viewing by our public sector membership and therefore request your consideration that the letter be made public.

We trust that our submission will be useful and provide some valuable insight to the Committee's deliberations on this important issue. Should you require any additional information please contact Anna D'Alessandro, Policy Adviser – Public Sector on (03) 9606 9734 or anna.dalessandro@cpaaustralia.com.au.

Yours sincerely



Jim Mitchell FCPA
NSW President

cc: Greg Larsen
Anna D'Alessandro
Ron Switzer

Submission to the New South Wales Public Accounts Committee's

Review of Audit Committees

Introduction

CPA Australia's Public Sector Centre of Excellence (CoE) have provided the comments in this submission. We understand that this inquiry was in the form of a questionnaire for selected agencies and so thank you for the opportunity to comment. We request that you take the following comments by the CoE into consideration as part of your deliberations.

The CoE is responsible for contributing to public sector policy development and thought leadership and is comprised of eight appointed representatives from all tiers of Government (including consultants to Government). The CoE's primary interest is to support the 10,500 public sector membership by providing the necessary mechanisms and frameworks to assist them in their work in government. The CoE meets regularly throughout the year to debate and provide guidance on major public sector policy issues.

Principles for Audit Committees

In response to the governance debate, the CoE has prepared a manual entitled "*Excellence in Governance for Local Government*" which has been issued as an exposure draft for comment across the Australian local government sector. A three month exposure period for this document closed on 25 February 2005. With 40 responses received from a broad cross-section of both Councils, Local Government bodies and Auditors-General, the manual was very well received.

Although the governance principles espoused in this manual have pertained to local government, they can be adapted to any public sector entity within any sphere of government.

Section 9.3 of the manual "Independent Review" identifies the following key principle.

"Local governments should establish internal structures that provide for independent review of processes and decision-making to assist Council to meet its accountability to stakeholders."

We have encouraged, not mandated, the establishment of an internal audit and audit committee function as part of the internal review function. In fact, all the principles identified in the manual are intended to be best practice only and not mandatory in their application. The relevant excerpts have been included in Appendix 1 to this letter.

We believe that an entity should have in place a risk management function and if anything, it is this that should be mandated. The establishment of an audit committee function is a tool by which an entity can manage risk.

CPA Australia supports a principles based approach similar to the ASX Corporate Governance Council. Whilst we acknowledge that the ASX does mandate audit committees, this is not part of their *Principles of Good Corporate Governance and Best Practice Recommendations*, but their listing rules. A listing rule which is subject to a size-based criteria¹.

We believe that the audit committee should have at least one member with suitable qualifications, and these need to be clearly articulated so that the appropriate mix of candidates are chosen to sit on the audit committee. The ASX Principles (Principle 4 is summarised in Appendix 2), can be referred to for further information on this matter.

¹ Top 500 listed entities.

Comments received on Local Government Exposure Draft

CPA Australia's Exposure draft on "Excellence in Governance for Local Government" asks for comments on section 9.3.2 Independent Review (which incorporates the discussion on audit committees and internal audit). It canvasses whether all key issues were identified and appropriately described.

In the main, respondents have been reasonably satisfied with what we are proposing in the manual, this included an Australian State Auditor-General. However, a key issue identified from the responses indicated that the recommendations need to consider the size and resources of a Council as many of the smaller Councils are not resourced to establish the internal audit or audit committee framework that is proposed. This has also been provided as verbal feedback by some Councils.

Appendix 1

“Excellence in Governance for Local Government” – CPA Australia

Audit Committees

Council should establish an audit committee to oversee and advise the Council on matters of accountability and internal control. The capacity to support and service an audit committee is impacted by the size and financial resources of the individual local government.

The overall function of the audit committee is to provide an independent check on key Council activities. This usually includes the integrity of the financial management system and financial management, but should also cover a broader picture of assessing whether stakeholders are receiving value for money for systems, services and projects. Reports from the audit committee support elected members in meeting their accountability for the use of the community's resources to the overall benefit of the community.

The manual also identifies key issues that a Council should consider when establishing an audit committee:

- Audit committee charter. The audit committee should have a clear charter that should set out roles and responsibilities, general scope of activities and structure. This should be approved by the Council and formally reviewed by both the audit committee and the Council periodically.
- Functions of the audit committee
 - Financial performance;
 - The financial reporting process;
 - The scope of work, performance and independence of the internal auditor;
 - Major projects, systems and services
 - The scope of work, performance and independence of the external auditor;
 - The operation and implementation of the risk management framework;
 - Matters of accountability and internal control affecting the operations of the Council;
 - The effectiveness of management information systems and other systems of internal control;
 - The acceptability, disclosure of and correct accounting treatment for significant transactions which are not part of the Council's normal course of business; and
 - The sign-off of accounting policies.

- Composition of the audit committee

- It should include both councillors and independent members. Independent members should not have, or have recently had any employment, contractual or material relationship with the local government;
- The CEO and the CFO should not be members of their own council's audit committee but are to attend relevant aspects of audit committee meetings by standing invitation;
- The chairperson of the audit committee should be one of the independent members;
- The Mayor should not be the chairperson of the audit committee;
- Council should review membership of the audit committee on a periodic basis but at least every three years.

- Relationships

The audit committee should:

- Report its findings to Council on an agreed regular basis;
- Have direct access to the internal, and external auditors without management present;
- Have direct access to the CEO, CFO and Council's management, through the CEO, when required;
- Have the right to seek explanations and additional information; and
- Undertake an annual review of its own performance and report the results to Council.

- Resourcing

The audit committee should have adequate resourcing to enable it to fulfil its functions.

Appendix 2

ASX Corporate Governance Council Principles – March 2003

Audit Committees

Principle 4 of the ASX Corporate Governance Council Principles states that a company should have a structure to independently verify and safeguard the integrity of the company's financial reporting.

This requires the company to put in place a structure of review and authorisation designed to ensure the truthful and factual presentation of the company's financial position. The structure would include, for example:

- Review and consideration of the accounts by the audit committee; and
- A process to ensure the independence and competence of the company's external auditors.

Structure of the audit committee (Recommendation 4.3):

- Only non-executive directors;
- A majority of independent directors;
- An independent chairperson, who is not the chairperson of the board; and
- At least three independent members.

The audit committee should include members who are financially literate (that is, are able to read and understand financial statements); at least one member who has financial expertise (that is, a qualified accountant or other financial professional with experience in accounting matters); and some members who have an understanding of the industry in which the entity operates.