Please note: The Departmental Financial Reporting Framework Guide is being enhanced as part of the cash-to-accrual process. From 2013/14 the Departmental Financial Reporting Framework Guide will be split into two documents namely the Departmental Financial Reporting Framework and the Departmental Financial Reporting Guide. The former document focuses on modified cash principles in a format ordinarily used by other public sector accounting standard setters, whereas the latter will provide detailed guidance on the principles stated in the Departmental Financial Reporting Framework.
Chapter 2 – The Report of the Audit Committee

Contents

1. Introduction ......................................................................................................................................... 3
2. Statutory requirements .......................................................................................................................... 3
3. Process and timelines ............................................................................................................................ 5
4. Evaluation of the financial statements .................................................................................................. 6
   4.1 Review of Audited Annual Financial Statements (AFS) ................................................................. 6
   4.2 Review accounting policies .............................................................................................................. 6
   4.3 Review management report and audit report ................................................................................... 6
5. Enhancing the effectiveness of the audit committee .............................................................................. 7

ANNEXURE A: Example of an audit committee report .......................................................................... 8
ANNEXURE B: Amendments made to chapter ......................................................................................... 10
1. Introduction

The audit committee plays an important role in ensuring that an entity functions according to good governance, accounting and audit standards. It also monitors the adoption of appropriate risk management arrangements.

An effective audit committee can assist management in discharging its accountability responsibilities to safeguard assets, operate adequate systems and controls, and prepare annual financial statements, by:

- improving communication and increasing contact, understanding and confidence between management and internal and external auditors (which may result in a more cost-effective external audit, to benefit both the organisation and the auditors);
- scrutinising the performance of internal and external auditors, thus increasing accountability;
- facilitating the imposition of discipline and control, thus reducing the opportunity for fraud;
- strengthening the objectivity and credibility of financial reporting.

In principle, an audit committee should be advisory and not executive, and will probably only meet quarterly. The committee should not perform any management functions or assume any managerial responsibilities, as this would prejudice objectivity.

This guideline serves as a minimum requirement of issues or topics that must be addressed by the Audit Committee members to discharge their responsibilities in terms of the PFMA and the regulations thereto. The Audit Committee must use their own words in providing relevant information on the topics for the year under review. The Audit Committee may include additional information in the final report as it deems fit.

2. Statutory requirements

<table>
<thead>
<tr>
<th>S38(1)(a) (PFMA)</th>
<th>S38(1)(a)(ii) of the PFMA state the following:</th>
</tr>
</thead>
<tbody>
<tr>
<td>(PFMA)</td>
<td>(1) “The accounting officer for a department,…</td>
</tr>
<tr>
<td></td>
<td>a) Must ensure that that department,….. has and maintains-</td>
</tr>
<tr>
<td></td>
<td>(ii) a system of internal audit under the control and direction of an audit committee complying with</td>
</tr>
<tr>
<td></td>
<td>and operating in accordance with regulations and instructions prescribed in terms of sections 76 and 77”</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TR 3</th>
<th>Requires the following:</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1.1</td>
<td>If considered feasible, the relevant treasury may direct that institutions share audit committees. If such a determination is made, the Auditor-General must be informed within 30 days of the determination.</td>
</tr>
<tr>
<td>3.1.2</td>
<td>In the case of a non-shared audit committee, the accounting officer of an institution must appoint audit committee members in consultation with the relevant executive authority.</td>
</tr>
<tr>
<td>3.1.3</td>
<td>In the case of a shared audit committee, the head of the relevant treasury must appoint audit committee members after consultation with the relevant executive authorities.</td>
</tr>
<tr>
<td>3.1.4</td>
<td>The chairperson of an audit committee must be independent, be knowledgeable of the status of the position, have the requisite business, financial and leadership skills and may not be a political office bearer.</td>
</tr>
<tr>
<td>3.1.5</td>
<td>Audit committees must be constituted so as to ensure their independence and their membership must be disclosed in the annual report of the institution.</td>
</tr>
<tr>
<td>3.1.6</td>
<td>Members of an audit committee who have been appointed from outside the public service pursuant to section 77(a) (i) of the Act must have appropriate experience, be appointed on contract and be remunerated in accordance with paragraph 20.2.2 of these regulations. Should it be deemed necessary, such members may be remunerated taking into account tariffs determined by the South African Institute of Chartered Accountants in consultation with the Auditor-General as provided for in paragraph 20.2.3.</td>
</tr>
<tr>
<td>3.1.7</td>
<td>The relevant executive authority must concur with any premature termination of the services of a person serving on an audit committee.</td>
</tr>
<tr>
<td>3.1.8</td>
<td>An audit committee must operate in terms of a written terms of reference, which must deal adequately with its membership, authority and responsibilities. The terms of reference must be reviewed at least annually to ensure its relevance.</td>
</tr>
<tr>
<td>3.1.9</td>
<td>It must be disclosed in the institution’s annual report whether or not the audit committee has adopted a formal terms of reference and if so, whether the committee satisfied its responsibilities for the year, in compliance with its terms of reference.</td>
</tr>
<tr>
<td>3.1.10</td>
<td>The audit committee must, amongst others review the following:</td>
</tr>
<tr>
<td></td>
<td>(a) the effectiveness of the internal control systems;</td>
</tr>
<tr>
<td></td>
<td>(b) the effectiveness of the internal audit function;</td>
</tr>
<tr>
<td></td>
<td>(c) the risk areas of the institution’s operations to be covered in the scope of internal and external audits;</td>
</tr>
<tr>
<td></td>
<td>(d) the adequacy, reliability and accuracy of financial information provided to management and other users of such information;</td>
</tr>
<tr>
<td></td>
<td>(e) any accounting and auditing concerns identified as a result of internal and external audits;</td>
</tr>
<tr>
<td></td>
<td>(f) the institution’s compliance with legal and regulatory provisions; and</td>
</tr>
<tr>
<td></td>
<td>(g) the activities of the internal audit function, including its annual work programme, coordination with the external auditors, the reports of significant investigations and the responses of management to specific recommendations.</td>
</tr>
<tr>
<td>3.1.11</td>
<td>The audit committee must have explicit authority to investigate matters within its powers, as identified in the written terms of reference. The audit committee must be provided with the resources it needs to investigate such matters and shall have full access to information. The audit committee must safeguard all the information supplied to it within the ambit of the law.</td>
</tr>
<tr>
<td>3.1.12</td>
<td>An audit committee must report and make recommendations to the accounting officer, but the accounting officer retains responsibility for implementing such recommendations.”</td>
</tr>
<tr>
<td>3.1.13</td>
<td>.an audit committee must, in the annual report of the institutions, comment on-</td>
</tr>
<tr>
<td></td>
<td>(a) the effectiveness of internal control</td>
</tr>
<tr>
<td></td>
<td>(b) the quality of in year management and monthly/quarterly reports submitted in terms of the Act and the Division of Revenue Act; and</td>
</tr>
<tr>
<td></td>
<td>(c) its evaluation of the annual financial statements.</td>
</tr>
<tr>
<td>3.1.14</td>
<td>Should a report to an audit committee, whether from the internal audit function or any other source, implicate the accounting officer in fraud, corruption or gross negligence, the chairperson of the audit committee must promptly report this to the relevant executive authority.</td>
</tr>
<tr>
<td>3.1.15</td>
<td>An audit committee may communicate any concerns they deem necessary to the executive authority, the relevant treasury and the Auditor-General.</td>
</tr>
<tr>
<td>3.1.16</td>
<td>The audit committee must meet at least annually with the Auditor-General to ensure that there are no unresolved issues of concern.</td>
</tr>
</tbody>
</table>
The specific responsibilities of the Audit Committee regarding the annual report and financial statements are set out in TR3.1.5, 3.1.9, and 3.1.13 as follows:

✓ membership of the committee must be disclosed in the annual report;

✓ must disclose in the annual report whether or not the committee has adopted a formal terms of reference (as defined in TR3.1.8) and if so, whether the committee satisfied its responsibilities during the reporting period in terms thereof;

✓ comment on the effectiveness of internal control;

✓ comment the quality of in year management and monthly/quarterly reports submitted in terms of the PFMA and the Division of Revenue Act; and

✓ comment on its evaluation of the annual financial statements.

3. Process and timelines

The process and timelines to be complied with are:

✓ the Accounting Officer must complete the Annual Financial Statements (AFS) and submit to the Auditor-General for audit by no later than 31 May together with the Confirmation letter (a copy of this letter is attached at the end of Chapter 1 of this guide). These financial statements should have been reviewed by the Audit Committee¹ and should contain a draft report of the Audit Committee. It is envisaged that this would be a specimen report based on the outcome of the Audit Committee’s activities during the year under review and agreed with the Chairperson of the Audit Committee. The Auditor-General must audit the financial statements within two months of receipt of such statements from the Accounting Officer and submit an audit report on those statements to the Accounting Officer within the required period, but by no later than 31 July.

✓ the Audit Committee should review the audit report of the Auditor-General, the audited financial statements, the management report and management's comments on the audited financial statements. The aforementioned must take place before the Auditor-General’s reporting date. The Auditor and Auditee should plan this process carefully to meet the determined timelines.

Internal audit reports would have been reviewed as and when they were submitted to the Audit Committee during the year.

✓ the Audit Committee must determine its final report to be included in the Annual Report based on the outcome of the above. This report may differ from the specimen report submitted based on the outcome of the evaluation of the annual financial statements by the Audit Committee.

¹ It is not necessary for the external auditors to attend this meeting (i.e. the meeting held prior to submission of the AFS for audit).

Released April 2012 (Updated October 2012)
4. Evaluation of the financial statements

4.1 Review of Audited Annual Financial Statements (AFS)

- inspect and confirm that the AFS have been signed by the Accounting Officer (AO) on or before the date of the audit report;
- enquire from AO if the AFS have been prepared in accordance with the Preparation Guide and Specimen Financial Statements issued by National Treasury and in compliance with all applicable laws and regulations;
- review AFS for abnormal and/or significant transactions of the department and the disclosure thereof in the AFS;
- obtain explanations for all significant variances in the annual financial statements as compared to the appropriated budget and prior year;
- identify areas for the external audit to consider adding to the audit plan;
- review any new or proposed legislation that may have a material impact on policies, the financial statements and disclosure thereof and departmental compliance therewith;
- enquire from management if there are any matters of significant judgement in the financial statements;
- enquire from management, the Auditor-General and Internal Audit about any outstanding litigation, contingencies and claims, and how these matters are reflected in the department’s financial statements.

4.2 Review accounting policies

- ensure that the Accounting Policies are as per the policies disclosed in the specimen financial statements issued by National Treasury. Where there are deviations, ensure that there is evidence of satisfactory consultation with the Office of the Accountant-General regarding the changes;
- consider the reasons for the changes in policies, if any. Assess whether changes have been correctly dealt with and disclosed in the AFS;
- enquire whether these changes are consistent with the required accounting framework and if not, whether National Treasury (OAG) approval has been obtained.

4.3 Review management report and audit report

- determine how significant financial reporting issues for the reporting period were resolved between management and the internal and external auditors;
- review significant adjustments arising from the external audit (“overs and unders schedule”) and their impact on the AFS, the transactions agreed with management and processed, and those not adjusted for;
- enquire from Internal Audit if there is any significant non-compliance with legal requirements and the impact thereof on the AFS;
determine the extent to which the work of Internal Audit contributed towards the total external audit coverage (internal and external audit coverage co-ordination and the reliance of external audit on the work if internal audit);

understand the reasons for the audit qualification and/or emphasis of matter (if any) and the impact thereof on the AFS and the department’s operations and assess the adequacy of the action taken/proposed by management to rectify the qualifications, and/or emphasis of matter;

ensure that the items that gave rise to audit qualification or emphasis of matter in the prior year(s) have been satisfactorily resolved and if not, assess the adequacy of proposed action plans, their timelines and the reporting thereof by Internal Audit Unit to the Audit Committee;

determine the independence, objectivity and competence of internal and external audit.

5. Enhancing the effectiveness of the audit committee

As mentioned above, improving communication between audit committee, management and the internal and external auditors is essential to adding value oversight process of an entity. This can be achieved by:

- audit committee supporting the audit investigations in the following manner:
  - questioning the queries raised with senior management to ensure that they know the cause and impact of the findings on the entity;
  - keeping a log of all audit recommendations (from internal and external audits) and using this to hold the entity to account as to whether they have been implemented;
  - call appropriate division heads to meetings to explain how they are delivering on agreed actions or on risks for which they are responsible.
- a separate discussion being held prior to the audit committee meeting between the committee members and the auditors to discuss the progress made from the last meeting and to inform/influence the agenda;
- interactions between the audit committee (usually the Chair) and management in the weeks leading up to the meeting to discuss areas for the agenda and papers that each participant should provide;
- increasing meeting efficiency in the following manner:
  - optimizing meeting times by having executive summaries for each agenda item outlining the key points and decisions the audit committee is required to make;
  - organize meeting schedules so that all necessary issues and key events are addressed through the year at the right time (e.g. creating a standing agenda for the pre and post PFMA cycle);
  - manage attendance at meetings by limiting the numbers attending for the whole meeting or inviting people solely for the relevant agenda item.
ANNEXURE A:

(NAME OF PROVINCIAL OR NATIONAL DEPARTMENT)

Report of the Audit Committee

The Audit Committee must provide commentary about submitting the report. For example:

We are pleased to present our report for the financial year ended 31 March 2013.

Audit Committee Members and Attendance:

The Audit Committee must state the number of times the Audit Committee should meet and the number of meeting actually held during the year under review. The Audit Committee should further state:

The name of each Audit Committee member stating any members that were appointed or resigned,

The number of meetings attended by each member

Audit Committee Responsibility

The Audit Committee should, at least, address the following with additional commentary:

- Its compliance/non-compliance with section 38(1)(a) of the PFMA and Treasury Regulation 3.1
- Adoption/non-adoption of the audit committee charter,
- Its compliance/non-compliance with the audit committee charter

The effectiveness of internal control The Audit Committee should, at least, address the following with additional commentary:

- Efficiency and effectiveness of the system of internal control applied by the department,
- risk management is effectiveness, efficiency and transparency, King III Report on Corporate Governance requirements,
- the Annual Financial Statements
- the management report of the Auditor-General,
- the quality of in year management and monthly/quarterly reports submitted in terms of the PFMA and the Division of Revenue Act.

Released April 2012 (Updated October 2012)
Evaluation of Financial Statements

The Audit Committee should, at least, address the following with additional commentary:

- review and discussion of the audited / unaudited annual financial statements to be included in the annual report, with the Auditor-General and the Accounting Officer,
- review of the Auditor-General’s management report and management’s response thereto,
- review of any changes in accounting policies and practices,
- review of the departments compliance with legal and regulatory provisions;
- review of the information on predetermined objectives to be included in the annual report; and
- review of any significant adjustments resulting from the audit,
- the quality and timeliness of the financial information availed to the audit committee for oversight purposes during the year such as interim financial statements.

Concurrence and non-concurrence of the Audit Committee with the Auditor-General’s conclusions on the annual financial statements,

Internal audit

The Audit Committee to conclude on the effectiveness of the internal audit function and whether or not the internal audit function has addressed the risks pertinent to the department in its audit.

Auditor-General South Africa

Commentary on whether or not the Audit Committee has met with the Auditor-General South Africa to ensure that there are no unresolved issues.

Chairperson of the Audit Committee

Date: .....................

| Light Bulb | Items reported in the Annual Financial Statements should not be repeated here but reference made to the relevant section in the Annual Report. An item should only be specifically mentioned in this report if it is significant and material. |

Released April 2012 (Updated October 2012)
### ANNEXURE B: Amendments made to chapter

<table>
<thead>
<tr>
<th>Version</th>
<th>Nature of amendment</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 2012</td>
<td>Dates updated</td>
<td>Various</td>
</tr>
<tr>
<td>April 2012</td>
<td>Inserted an information block about changes of the format of this framework/guide</td>
<td>1</td>
</tr>
<tr>
<td>April 2012</td>
<td>Audit committee commentary on financial reporting information during the year.</td>
<td>9</td>
</tr>
</tbody>
</table>