

**AUDIT COMMITTEE EFFECTIVENESS IN AN EASTERN
CAPE PROVINCIAL DEPARTMENT**

BY

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DECLARATION

I, Isaac Koranteng (Student No. 210227347), hereby declare that the treatise for the degree of Masters in Business Administration to be awarded is my own work and that it has not previously been submitted for assessment or completion of any postgraduate qualification to another University or for another qualification.

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ABSTRACT

The discussion on the extent to which audit committees perform the oversight function of financial governance is important. This is particularly so in the Eastern Cape where the implementation of the Public Finance Management Act (PFMA) of 1999 has not significantly improved financial management.

The deteriorating financial management environment of provincial departments impacts negatively on service delivery and is therefore a matter of great concern to the political administrators at both national and provincial levels.

The objective of this study is to determine how effective audit committees are in Eastern Cape provincial departments and how this translates into good financial governance and, ultimately, improved service delivery.

To achieve this objective, a literature review of the link between audit committee effectiveness, accountability and corporate governance in the public sector was conducted. It was found that audit committees in the public sector have similar responsibilities to that of the private sector and lack of accountability in the public sector impacts negatively on service delivery. A second literature review was conducted to highlight the current state of public financial management in South Africa and how this has had an impact on financial management in Eastern Cape provincial departments.

A qualitative research methodology was applied because the researcher is of the opinion that the research question asked is more interpretive than predictive. An interview survey was conducted in which senior management officials were selected from provincial departments and interviewed using semi-structured questions.

The research study concluded, that provincial departments in the Eastern Cape have all established audit committees in line with the Public Finance

Management Act (PFMA) National Treasury regulations. These committees are however ineffective. Ineffectiveness is as a result of, among other factors, lack of stability in accounting officer and chief financial officer positions. Secondly, senior management have not been made to account for the persistent negative audit outcomes in their departments.

The research recommends that the political leadership of the province should ensure stability in leadership, particularly in the position of accounting officer and the chief financial officer.

AUDIT COMMITTEE EFFECTIVENESS IN AN EASTERN CAPE PROVINCIAL DEPARTMENT

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CHAPTER 1: INTRODUCTION AND SCOPE OF STUDY

1.1 Introduction

This chapter introduces the study by describing the concept of *audit committee effectiveness* and the requirement of the Public Finance Management Act (PFMA) of 1999 for all provincial and national departments to establish audit committees. It provides the motivation for the study, the research objectives, research design and methodology, as well as the definition of key concepts.

1.2 Audit committee effectiveness as a corporate governance and accountability tool

There has been debate as to whether audit committees perform their duties effectively. In the private sector, reference is made to the fact that the audit committee of Enron was unable to identify and prevent the company's accounting irregularities.

In the public sector, the establishment of audit committees is the way by which corporate governance is legislated through the implementation of the Public Finance Management Act of 1999 by National Treasury (2009). Section 38(1) of this Act charges audit committees with the responsibility of assisting management to discharge accountability responsibilities to safeguard assets, operate adequate systems of internal controls, and prepare annual financial statements.

National Treasury's '*Treasury Regulations*' (which is an addendum to the PFMA) clearly outlines the review functions of audit committees. These functions include a review of the effectiveness of internal control systems and internal audit function, risks identified in operations as the basis for internal and external audit, the financial reporting process, and compliance with legal and regulatory provisions. An effective audit committee must be seen to discharge these review functions effectively for effective financial management.

The implementation of the PFMA and the establishment of audit committees in provincial departments have however not prevented fraud, corruption and lack of

accountability. It has also not brought about an improvement in service delivery in Eastern Cape provincial departments.

Ohemeng (2011) examines the implications of using legislation to institutionalize a performance culture in public sector organizations. He concludes that this is necessary because it is the best way to infuse a performance culture in public institutions. The effective implementation of the PFMA will be an example of such a legislative tool.

Effective financial management is necessary to hold government accountable. Financial management is the planning, controlling, implementation and monitoring of fiscal policies and activities. This is what the PFMA was intended to do in the public sector. The problem is that more than ten years after its implementation provincial departments in the Eastern Cape do not seem to have achieved effective financial management practices (Barata & Cain, 2001).

An audit committee performs the oversight function of corporate governance over the financial reporting process, internal control structure and the audit function. This oversight function can be fulfilled effectively if the audit committee is independent, competent, financially literate, adequately resourced and properly compensated (Rezaee, Olibe & Minmier, 2003).

The responsibilities of audit committees in the public sector are similar to those in the private sector, except that in the public sector, unethical behaviour and lack of accountability impacts on taxpayers and citizens instead of on shareholders of a company. It can be further argued that lack of effective financial management in the public sector which subsequently leads to the misuse of financial resources provided through taxation consequently leads to lack of service delivery to citizens (van der Nest, Thornhill & Jager, 2008)

1.3 Thesis statement

Improving public sector financial management and accountability in Eastern Cape provincial departments will require improvement in audit committee effectiveness.

The determinants of audit committee effectiveness are *audit committee composition, audit committee authority, audit committee resources* and *audit committee diligence* (De Zoort, Hermanson & Reed, 2002).

1.4 Problem statement

The implementation of the Public Finance Management Act (PFMA) of 1999 has not significantly improved financial management in Eastern Cape provincial departments. This is evident from the fact that these departments continue to obtain negative audit outcomes. The Auditor General's report (Auditor General 2012) on the 2011-12 financial year, highlights the fact that five of the thirteen provincial departments in the Eastern Cape obtained qualified audit reports including the Department of Education which had a disclaimer.

In March 2011 National Treasury invoked Section 100 (b) of the Constitution of South Africa, placed the Eastern Cape Department of Education under administration and took over the running of the department – a sign of a complete breakdown in financial management and accountability (Eastern Cape Department of Education, 2011).

The deteriorating financial management environment of Eastern Cape provincial departments impacts negatively on service delivery and is therefore a matter of great concern to various stakeholders, including the National Treasury and the Eastern Cape Provincial Planning and Treasury. Section 216 of the Constitution of South Africa, (Department of Justice, 1996) provides for the establishment of the National Treasury as an oversight institution to prescribe measures to ensure transparency and expenditure control in the public sector. This responsibility of National Treasury is discharged through provincial treasuries which must put in place effective financial management and accountability mechanisms.

Improving financial management will require that audit committees discharge their corporate governance responsibilities effectively. The present study explores how audit committee effectiveness impacts on financial management in Eastern Cape provincial departments.

In a similar paper, van der Nest et al. (2008) studied the relations between audit committees and accountability in the public sector but used national departments (instead of provincial departments) as the basis for collecting primary information for the empirical study.

The current study will apply qualitative methods to establish the link between audit committee effectiveness and financial management performance in provincial departments of the Eastern Cape.

1.5 Research objectives

In order to address the research problem mentioned above, the following research objectives will be pursued:

1.5.1 Primary objective and research question

The primary objective of this study is to improve accountability and financial management in Eastern Cape provincial departments by improving audit committee effectiveness (as measured by audit committee composition, authority, resources and diligence).

The primary research question is:

How effective are audit committees in Eastern Cape provincial departments in assisting management to improve public sector financial management?

1.5.2 Secondary objectives

In order to achieve the main objective, the secondary objectives of this study are as follows:

- To undertake a literature review of the link between Audit Committee Effectiveness, corporate governance and how it contributes to improved financial management in both private and public sectors of the economy.
- To undertake a literature review of the history of public sector financial management, the introduction of the PFMA and, the current state of financial management and audit committees in Eastern Cape provincial departments.

- To conduct an empirical study to measure the contribution of audit committees to effective financial management (or lack thereof) in Eastern Cape provincial departments. The objective of this study is to answer the following questions:
 - How effectively does the audit committee perform the function of reviewing the effectiveness of internal control system and the internal audit function to determine whether risks identified are the basis of internal audit plans?
 - To what extent are the audit committee independent, and members competent, financially literate, adequately resourced and compensated to perform their functions effectively?
 - How effective is the planning, monitoring and reporting functions of audit committees in provincial departments?
 - Will improving financial management in a department require improvement in audit committee effectiveness only?
 - To what extent are the negative outcomes of departments a reflection of the ineffectiveness of audit committees?
 - What other factors impact negatively on financial management in the department?

1.6 Research design objectives

The broad research methodology to achieve the primary and secondary objectives of the study, are described in this section.

Literature review

A preliminary literature review was conducted to determine the viability of conducting this study. Subsequently, a full review of relevant publications was undertaken to determine the full scope of the state of audit committee effectiveness and its impact on corporate governance, accountability and financial management in Eastern Cape provincial departments.

Sampling plan and empirical study

Qualitative data was collected by interviewing chief audit executives, chief financial officers, chairpersons of audit committees in Eastern Cape provincial

departments. Departments were selected to represent each of the three clusters of government (the Social Needs Cluster, the Government and Administration cluster, and the Economic Growth Cluster). Policy documents and circulars issued by relevant oversight bodies (such as the national and provincial Treasury) was analysed.

Data analysis

Data collected was coded with the aim of summarizing, categorizing and identifying patterns or themes that exist. Pre-coding questions for statistical analysis is part of a questionnaire design. This makes subsequent data entry easier and less prone to error (Collis & Hussey, 2003).

1.7 Limitation of research

Collis (2009) defines the term 'limitation' in this context as describing a weakness or deficiency in the research.

Due to the limitation of time the sample of officials interviewed were taken from a selected number of departments and not from all fourteen provincial departments of the Eastern Cape.

1.8 Methodology and Research paradigm

Collis and Hussey (2009:11) describe a research paradigm as a framework that suggests how research should be conducted. It is based on philosophies and assumptions which have been made about the world and the nature of knowledge. Koshy (2010:79) on the other hand, refers to two paradigms as 'positivist' and naturalistic (or phenomenological)

In differentiating between the two paradigms, (Collis, 2009) point to the fact that the positivist ontological assumption is that social reality is subjective and external to the researcher. The methodology adopted by positivists is the experimental manipulation using quantitative data collected using large sample sizes and analysed by examining associations between variables.

The Interpretivists (phenomenological) ontological assumption is that social reality is subjective since it is socially constructed. Collis and Hussey (2009:59) state that knowledge emerges from the reality studied using qualitative techniques and by analyzing cases.

Qualitative questions are specific in nature and fall into one of three categories: (a) descriptive, (b) comparative, and (c) relationship. Descriptive questions seek to quantify responses on one or more variables. The qualitative questions asked in this study were mainly descriptive (Onwuegbuzie & Leech, 2006).

Onwuegbuzie and Leech, (2006) refer to (Creswell, 2009) who describes qualitative research questions as 'open-ended, evolving, and non-directional. The intention is to seek, discover, explore a process, or describe experiences. The qualitative questions asked in this study was used when interviewing senior management officials of the selected departments.

1.9 Definition of key concepts

Audit committees

An audit committee is an independent governance structure whose function is to provide an oversight role on the system of internal control, risk management, and governance. In line with Section 77 of the PFMA, an audit committee must consist of at least three persons of whom the majority may not be in the employ of the department or public entity (National Treasury, 2009).

Financial Management

Financial Management is the planning, controlling, implementation and monitoring of fiscal policies and activities. Financial management is necessary in order to hold government accountable (Barata & Cain, 2001).

Whereas in the private sector, *financial management* lays emphasis on the examination and selection of alternative sources of finance and the effective utilisation of such finance in order to add value to shareholder interests, in the public sector the focus of financial management is on the prioritisation and usage

of scarce public funds through effective budgetary control over public money and assets and ensuring that there is 'value-for-money' in utilising public funds. (National Treasury, 2000).

'Value-for-money' refers to the three concepts of *economy*, *efficiency*, and *effectiveness*. *Economy* is the acquisition of financial resources (public funds) at the lowest reasonable cost. *Efficiency* refers to utilising the acquired financial resources to maximise outputs, *Effectiveness* measures the extent to which the output obtained ultimately assists in achieving a government's intended outcome. (Mphehle & Qwabe, 2008)

Risk management

Burnaby & Hass (2009) define *risk* as anything that gets in the way of an organisation trying to achieve its objectives. The management hereof is thus referred to as risk management.

Risk Management is thus 'a systematic process to identify, evaluate and address risks on a continuous basis before they impact negatively on the institution's service delivery capacity (National Treasury, n.d.).

Financial Accountability

van der Nest, et al. (2008) describe *financial accountability* as one of the different forms of accountability which monitors financial record keeping and control over expenditure. The PFMA institutionalizes accountability in national and provincial departments by prescribing in Section 38 that indicates that all constitutional institutions must have an accounting officer, who should also be the head of department of the institution.

The accounting officer is charged with accountability and the responsibilities of ensuring that the institution "maintains a system of financial and risk management and internal control" (National Treasury, 2009).

1.10 Outline of study / Chapters

The treatise will consist of the following chapters:

Chapter 1: Introduction. This chapter will introduce the study by describing the concept of *audit committee effectiveness* and the requirement of the Public Finance Management Act (PFMA) of 1999 for all provincial and national departments to establish audit committees. This chapter provides the motivation for the study, the research objectives, research design and methodology, as well as the definition of key concepts.

Chapter 2: Audit Committee effectiveness, accountability and corporate governance. The chapter is a literature review to provide a theoretical framework of the study. It will establish the link between *audit committee effectiveness, accountability and corporate governance*, and how the three concepts contribute to improved financial management.

Chapter 3: The state of financial management and audit committees in Eastern Cape provincial departments. This second literature review chapter will review the current state of financial management and the establishment of audit committees in Eastern Cape provincial departments.

In *Chapter 4*, the research methodology and design used in the study will be discussed, including the choice of sample size, data collection, analysis and measuring instruments.

Chapter 5 will present empirical results, data analysis, and interpretation and summary of the findings of the empirical study undertaken

Chapter 6 covers conclusions and recommendations on how to enhance audit committee effectiveness.

CHAPTER 2 - AUDIT COMMITTEE EFFECTIVENESS, ACCOUNTABILITY AND CORPORATE GOVERNANCE

2.1 Introduction

The objective of this study is to review the current state of audit committees in Eastern Cape provincial departments and how they can be enhanced to improve public sector financial management. This chapter is a literature review to establish the link between *audit committee effectiveness, accountability, corporate governance*, and how the three concepts contribute to improved financial management.

The chapter also explains the differences and similarities between audit committees in the public and private sectors of the economy.

2.2 Audit committees in general

2.2.1 Audit committee functions and responsibilities

The functions and responsibilities of an audit committee are described in the *audit charter*. The charter outlines the committee's responsibilities, size, composition, authority, meetings, diligence, financial literacy and independence. (Rezaee et al., 2003). These responsibilities and functions can be generally classified into *planning, monitoring (and oversight) and reporting* (van der Nest et al., 2008).

The planning function

An audit committee should have a plan to achieve its oversight and monitoring responsibilities. Such a plan should include:

- a review and appraisal of the overall purpose, objectives and resources available for the entity's audit plan in line with the committee's charter.
- a review of the audit plans of the internal and external audit functions.
- an annual appraisal of the corporate audit plan, and
- an orientation of the committee's plans towards the various segments of the audit cycle (being the initial planning, pre-audit and post audit segments). (van der Nest, et al., 2008)

The ability for an audit committee to put together a plan and successfully implement it impacts on the effectiveness of the committee.

The monitoring and oversight function

According to Briotta (2004) cited by van der Nest, et al. (2008) an audit committee's monitoring functions should include the monitoring of:

- the internal audit function
- the internal control system and related business risks
- financial reporting disclosures
- conflicts of interest, ethics and fraud, and
- information technology systems

The audit committee function is viewed as an oversight function of corporate governance, the financial reporting process, internal control structure and the audit function (Rezaee et al., 2003).

The report of the *Blue Ribbon Committee on improving the effectiveness of Corporate Audit Committees* referred to by Rezaee, et al. (2003) articulates the oversight responsibilities of corporate governance which includes the audit committee. The report makes three conclusions as follows:

1. that quality financial reporting can only be achieved through open and candid communication and close working relationships among the corporation's board of directors, *audit committee*, management, internal auditors and external auditors.
2. that strengthening corporate governance oversight in the financial reporting process of publicly traded companies will reduce instances of financial statement fraud.
3. that integrity, quality, and transparency of financial reports improves investors' confidence in the capital market while incidents of financial statement fraud diminish such confidence.

The oversight function can be fulfilled effectively if the audit committee is independent, competent, financially literate, adequately resourced and properly compensated.

The reporting function

In the private sector an audit committee reports directly to the board of directors and not to the chief executive officer. In a public sector department, the committee reports to the accounting officer. (van der Nest et al. (2008). This arrangement is to ensure that the independence of the function is preserved.

The Blue Ribbon Committee's report on audit committee effectiveness recommended that an audit committee report be included in the proxy statements of registered companies. The report should confirm (among others) if the audit committee has reviewed and discussed the audited financial statements with management. Making it mandatory to disclose these facts encourages a more vigilant audit committee oversight function. It also improves corporate governance and increases public confidence in the financial reporting process of the company (Rezaee, et al., 2003).

2.2.2 Audit committees in the public sector

Audit committees in the public sector have similar responsibilities as audit committees in the private sector, except that in the public sector, unethical behaviour and lack of accountability impacts on taxpayers and citizens instead of the shareholders of a company (van der Nest et al., 2008). It can then be further argued that lack of proper financial management in the public sector which leads to the misuse of financial resources provided through taxation. Subsequently this leads to lack of service delivery to citizens.

Legislation

The monitoring and oversight functions of public sector audit committees in South Africa are legislated. Section 76(4) of the PFMA mandates National Treasury to make regulations concerning audit committees and their functioning. (National Treasury, 2009).

National Treasury describes an audit committee as "an independent governance structure whose function is to provide an oversight role on the system of internal control, risk management, and governance. (Department of National Treasury, 2009)

Public sector audit committee as an independent governance structure

In order to effectively play an 'independent governance' role, Section 77 of the PFMA (National Treasury, 2009) specifies the composition of the membership of audit committees as follows:

“An audit committee must consist of at least three persons of whom one must be from outside the public service. The majority may not be persons in the employ of the department. The chairperson may not be in the employ of the department, and the committee must meet at least twice a year”.

Furthermore, Section 3.1 of the Treasury Regulations (National Treasury, 2009) stipulates that the audit committee must be constituted to assure their independence and that their membership must be disclosed in the annual report of the department.

The review and monitoring function of public sector audit committees

Section 3.1.10 of Treasury Regulations (National Treasury, 2009) specifies that an audit committee should review the following:

- the effectiveness of the internal control systems,
- the effectiveness of the internal audit function
- the risk areas of the institution's operations to be covered in the scope of internal and external audits,
- the adequacy, reliability and accuracy of the financial information provided to management and other users of such information,
- any accounting and auditing concerns identified as a result of internal and external audits, the institution's compliance with legal and regulatory provisions, and
- the activities of the internal audit function.

2.2.3 Audit committee effectiveness

The term *audit committee effectiveness*, has been defined and described in different ways by various commentators. The essence of the discussion is to highlight the fact that an audit committee can be used as an effective corporate governance and accountability tool.

De Zoort, et al.(2002) identifies the determinants of audit committee effectiveness as *audit committee composition, audit committee authority, audit committee resources* and *audit committee diligence*.

National Treasury's *Departmental Financial Reporting Framework Guide* (National Treasury- Republic of South Africa, 2012) describes an *effective audit committee* as a tool that management can use to discharge its accountability responsibilities to safeguard assets, operate adequate systems and controls, and prepare financial statements. According to the *Guide*, this is achieved by improvement in communication, creating confidence between management, external and internal auditors, scrutinizing the performance of both internal and external audit and strengthening the credibility of financial reporting.

To enhance audit committee effectiveness in the public sector National Treasury's *Departmental Financial Reporting Framework Guide* (National Treasury- Republic of South Africa, 2012) outlines various ways in which audit committees add value to the oversight process of their public entities. They include the following:

- *audit committee supporting the audit investigations by 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; calling appropriate division heads to meetings to explain how they are delivering on agreed actions or on risks for which they are responsible.*
- *Audit committees holding separate discussions 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 chairperson) and management in the weeks leading up to the meeting to discuss areas for the agenda and papers that each participant should provide;*

Audit committee effectiveness is also closely related to audit committee performance. Ferreira (2007) cites (Epstein, Jones & Roy (2002) describes audit committee performance as a 'system' with *input, process, and output* factors. Input factors are the committee's *composition* (independence, ethics, knowledge skills and experience, and the personal attributes of individual members).

The '*process*' factors of the system are further described by Epstein et al. (2002) as the audit committee structure (chairperson, non-executive directors, diversity of skills, knowledge, and size), as well as the audit committee systems (including productive meetings, induction and professional development, effective succession planning, open communication, reporting systems and effective performance evaluation systems).

The '*output*' of an audit committee performance system, according to Epstein et al. (2002) is the resultant audit committee's effectiveness in performing the oversight function it is established to do.

2.3 Accountability in the public sector

Individuals in positions of authority in the public sector must be held accountable for their actions. Different political systems create various devices to do so. (van der Nest et al., 2008). According to Barata and Cain (2001), effective financial management in the public sector makes it possible to hold government accountable. Various types of accountability in the public sector are described below:

Public Accountability

Public accountability has been described as the hallmark of modern democratic governance. The word 'public' refers to 'openness'. The 'account-giving' (or accountability) is done in public, or, at least is accessible to citizens (Bovens, 2005)

Ayeni (1998) is quoted by van Heerden and Steyn (2012) defining *public accountability* as being "*about how those who exercise powers in the name of the public fulfil their duties and obligations, and the process by which they are made to answer and account for their actions. It is about the responsibility of officials and agencies, ways to minimize the abuse of power and authority, and strategies*

to ensure that those in authority comply with acceptable standards, and can be sanctioned whenever necessary”

In South Africa, *public accountability* is legislated. The Public Finance Management Act of 1999 which gives effect to Sections 214 to 218 of the *Constitution of the Republic of South Africa*, requires that an *accounting officer* be appointed for every constitutional institution to ensure that it has and maintains effective, efficient and transparent systems of financial risk, risk management and internal control. Such an institution must also have a system of internal audit under the control and direction of an audit committee. (National Treasury, 2009).

Financial Accountability

van der Nest, et al. (2008) describe *financial accountability* as one of the different forms of accountability which monitors financial record keeping and control over expenditure. The PFMA institutionalizes accountability in national and provincial departments by prescribing in Section 38 that all constitutional institutions must have an accounting officer, who should also be the head of department of the institution. The accounting officer is charged with the accountability and responsibilities of ensuring that the institution “maintains a system of financial and risk management and internal control” (National Treasury, 2009).

Financial accountability is achieved through the requirement for the executive to present budgets and prepare financial statements to be audited annually. Failure to attain financial accountability is due, mainly, to the prevalence of weaknesses in public accounting, expenditure control, cash management, auditing and the management of financial records. (Barata & Cain, 2001).

Van Heerden and Steyn (2012) citing Ayeni (1998) define public accountability as being “about how those who exercise powers in the name of the public fulfil their duties and obligations, and the process by which they are made to answer and account for their actions”.

Van Heerden and Steyn (2012) comment that in the absence of accountability, many incidents of corrupt practices abound in the public sector which ultimately results in the production and supply of poor quality goods and services, lack of

efficiencies, excessive costs, and ineffective public programmes. In effect, service delivery is undermined (van der Nest, et al., 2008).

Improving service delivery in the public sector requires improved financial management and accountability. Internal audit and audit committees are some of the accountability instruments applied by public sector managers.

In South Africa the concept of accountability of public officials is entrenched in the provisions of the Public Finance Management Act of 1999 (Act 1 of 1999). Section 38 of this act assigns financial management responsibilities to the accounting officer of a government department. This includes the responsibility to ensure that the department maintains a system of financial management, risk management and internal control monitored by an internal audit function under the control of an audit committee. The requirement to have an audit committee has been legislated through the PFMA as an accountability instrument.

2.4 Corporate governance

2.4.1 Corporate governance in the public sector

The term, *governance* or *corporate governance* when used in relation to public sector finance, must be understood in the right context.

Governance in the public sector context is a process by which state institutions and departmental structures co-ordinate government processes and implement public policies by complying with norms and standards set up by government. The elements of governance are *Strategic Planning and Budgeting, Public Expenditure Management, Fiscal Transfer & Accountability, Risk Management & Internal Controls*. (Siswana, 2007).

Governance in the public sector is as important as in the private sector. Hence public sector audit committees must be given similar responsibilities as their counterparts in the private sector. (van der Nest, 2008).

Public sector organisations are not exempt from corporate governance practices and principles. In the private sector, *governance* is simply referred to as *corporate governance* and gives structure to the distribution of rights and

responsibilities amongst stakeholders like board of directors, and shareholders. It is within this structure that corporate objectives are set and achieved. (Koma, 2009).

In the public sector the corporate governing body comprises of the executive authority (or political office bearers) and the senior management (public servants) of the public sector organisation. (Koma, 2009).

The following *elements of governance* in public sector entities are identified by Barret (2002):

- Management Structure
- Strategic and business planning
- Performance information
- Risk management
- Compliance and controls
- Audit Values and code of ethics.

The principles to which public sector entities must adhere in order to effectively apply elements of corporate governance can be outlined as follows:

Leadership – public sector leadership leading by example will effectively encourage accountability and improve performance.

Commitment – a strong commitment by all participants to implement all elements of corporate governance.

Integrity - that there should be high standards of probity and propriety in the stewardship of public funds in managing a public entity's affairs.

Accountability - there is the need to identify responsibilities and relationships between stakeholders, and those entrusted to manage the resources of a public sector entity.

Transparency – Openness through the communication of complete, accurate and transparent information ensures that public entities are fully accountable. This is central to good governance.

Integration – These elements of corporate governance must be integrated into a coherent corporate approach which is well understood and applied throughout the organisation. (Barret, 2001).

Departmental or organisational objectives can be achieved only through *effective governance* and it is governance which supports transparency and accountability. Certain fundamental governance matters can serve as the cornerstone for an effective and efficient delivery of quality service to the public. Such governance matters include *ethics within the public service, financial management, integrated risk management, public expenditure management, accountability, transparency and accounting systems*. Governance is defined as a process by which state institutions and departmental structures co-ordinate government processes and implement public policies by complying with norms and standards set up by the government (Siswana, 2007).

2.5 Chapter summary and conclusion

This chapter is a literature review of the link between audit committee effectiveness, accountability, corporate governance and how this linkage impacts on improved financial management in the public sector.

The audit committee function may be viewed as an oversight function of corporate governance which can be effectively fulfilled if the audit committee is independent, competent, financially literate, adequately resourced and properly compensated. Reference is made to the *Blue Ribbon Committee report on improving the effectiveness of Corporate Audit Committees* which highlights communication with management, and the strengthening of corporate governance oversight as measures to reduce financial management fraud.

Audit committees in the public sector have similar responsibilities as in the private sector and lack of accountability in the public sector impacts negatively on service delivery.

The main determinants of audit committee effectiveness are identified as audit committee *composition, authority* and *resources*. Public sector management can use audit committee as a tool to discharge its accountability responsibility effectively.

Audit committee effectiveness is also linked to audit committee performance – a system whose output is *effectiveness in performing the oversight function* it is established to perform.

Governance is what is simply referred to as *corporate governance*. It gives structure to the distribution of rights and responsibilities in corporate governing bodies. In the public sector this comprises of the executive authority and senior management of public entities. In effect, governance in the public sector is as importance as in the private sector.

In the next chapter a literature review of the state of financial management and audit committees in the Eastern Cape Provincial departments will be undertake

CHAPTER 3 - THE STATE OF FINANCIAL MANAGEMENT AND AUDIT COMMITTEES IN EASTERN CAPE PROVINCIAL DEPARTMENTS

3.1 Introduction

This chapter is a literature review to highlight the current state of public financial management reforms in South Africa and how this has impacted negatively on financial management in Eastern Cape provincial departments. The chapter also reviews the current state of audit committees, as a governance structure, in Eastern Cape provincial departments.

3.2 Public administration and financial management in South Africa

3.2.1 The relationship between public finance and public administration

There is a relationship between *public administration* and *public finance*. *Public administration* is a 'system of structures and processes' which operate within a society to facilitate the formulation and efficient execution of appropriate governmental policy. Governments formulate policies to achieve the political goals of the state through service delivery to the public. These service delivery goals are achieved by putting in place good governance mechanisms to ensure accountability, transparency, responsibility and the rule of law. In effect, *public finance* must be viewed as one of the tools used in the public administrative domain to achieve governmental goals. Public finance consists of budget approval and effective parliamentary oversight, financing government policies and programmes and managing the process through controls, systems and clear lines of accountability and responsibility (Siswana, 2007).

The South African the Constitution is the supreme law of the country. Section 195 of the constitution requires that resources should be used efficiently, economically and effectively and that public administration must be accountable and transparent. (Department of Justice, 1996)

In the public sector, '*Economy*' refers to the acquisition of financial resources (public funds) at the lowest reasonable cost. *Efficiency* refers to utilising the acquired financial resources to maximise outputs, *Effectiveness* measures the extent to which the output obtained ultimately assists in achieving government's intended outcome. (Mphehle & Qwabe, 2008)

3.2.2 The old public finance management paradigm in South Africa

Before 1994, the legislative instruments which governed financial management in national and provincial governments were the Exchequer Act (Act 66 of 1975) and the respective Provincial Exchequer Acts. The main focus of financial management and accountability was the control of expenditure in order to keep within budgetary levels. (van Wyk, 2003)

The act was prescriptive and inflexible because it was based on rules. It was *input and control oriented* rather than focusing on *results and management*. In such a prescriptive and law-based administrative environment, risk management was not a priority because only a few elements of risk in financial management existed. (Siswana, 2007)

3.2.3 The new public management model

The Public Finance Management Act of 1999 was crafted from what is described as the '*New Public Management (NPM)*' model. According to Huges (2003) cited by Siswana (2007), the NPM model is characterised by the following:

- A strategic approach whereby public entities develop long term plans based on well-defined mission, goals and objectives.
- A professional management approach in which managers are responsible for achieving results instead of focusing purely on managing inputs.
- Improved financial management through the introduction of performance budgeting systems to replace the traditional inefficient line-item budgeting approach.
- Improvement in the relationship between managers and politicians in which managers take responsibility for achieving results.
- Improvement in relationship between managers and the public in which managers are directly accountable to the public.

In line with the characteristics outlined above the PFMA requires departments to draft strategic plans to be approved by parliament before the discussion of the department's budget vote as indicated in Treasury Regulation 5.1 (National Treasury, 2009).

To emphasize the participative approach in the budgeting process, and to ensure transparency and accountability, the *medium term expenditure framework (MTEF)* was introduced in South Africa in 1998. This was the beginning of a new era of public finance management reforms driven by the PFMA. The MTEF introduced stability in the budgetary process and enabled departments to plan with long term strategies in mind. (van Wyk, 2003)

3.2.4 The PFMA and Treasury Regulations provisions for risk management internal control and audit committees.

The shift from a *control base* to a *management base* public administration and financial management brought with it new and additional risks which currently make it essential for public entities (and in particular, provincial departments) to identify and manage their portfolios of risk. Section 38(i) of the PFMA requires that accounting officers must ensure that they maintain effective, efficient and transparent systems of financial and risk management and internal control. Treasury Regulations 3.2.1 also require that an accounting officer ensures that *risk assessment* is conducted regularly to identify emerging risks. A *risk management strategy* that includes a fraud prevention plan to direct internal audit effort should be adopted. (National Treasury, 2009).

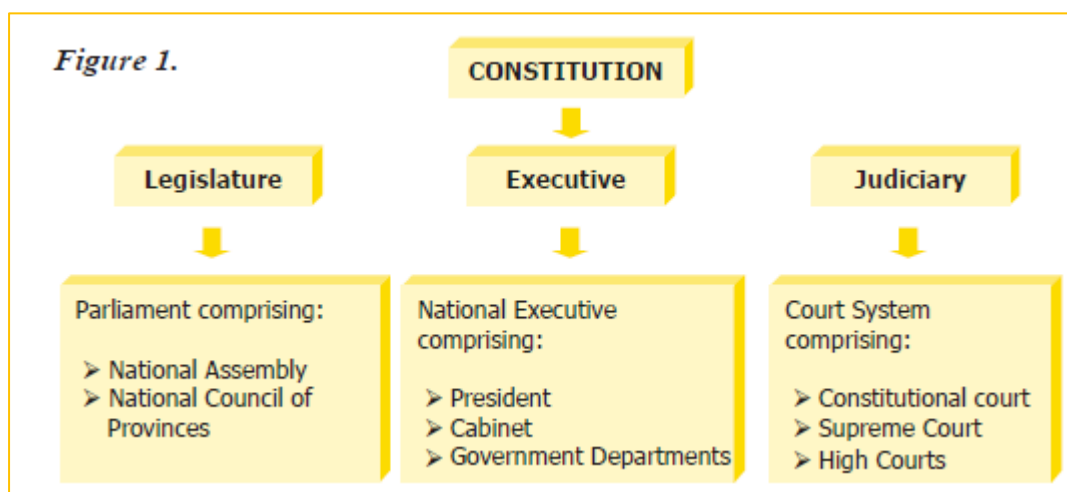
Accounting officers are required to set up *audit committees* which are constituted to ensure their independence and which must report and make recommendations to the accounting officer on various matters including the effectiveness of the internal control system, the internal audit function, and the risk areas of an entity's operations. (National Treasury, 2009)

Without an effective audit committee which ensures that effective internal controls are in place, transparency, accountability and good governance may be undermined.

3.2.5 The oversight role of legislature and the Auditor General's reporting responsibilities

The South African Constitution of 1996 identifies South Africa as one sovereign democratic state with division of power between the *Legislative*, the *Executive* and the *Judicial* authorities as depicted in Figure 3.2.5 below:

Figure 3.1: Division of power between Legislature, Executive & Judiciary



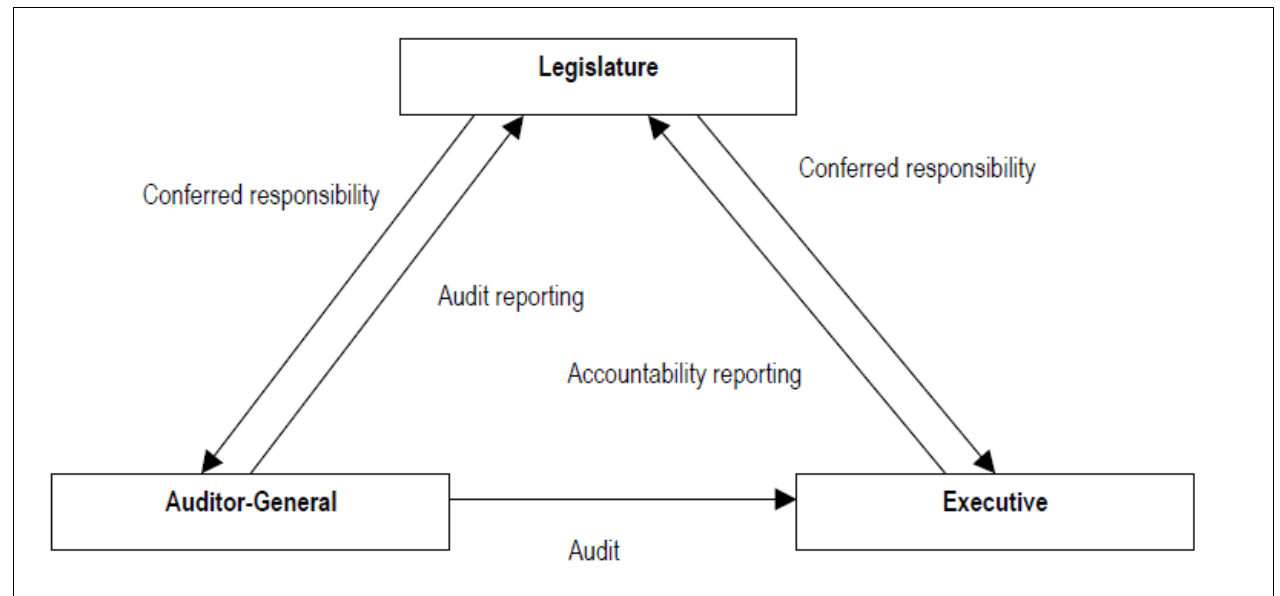
Source: Adapted from (The Department of Public Service & Administration, 2003)

South Africa's *intergovernmental fiscal system* is based on a revenue-sharing model which distributes and transfers revenue to all provincial departments. The formula is based on an agreed formula which takes into consideration the population density, poverty levels, capacity to implement projects, location of area (urban or rural) and capacity to generate own revenue (Government Gazette No. 18512, 1997).

Of the three arms of a democratic state it is the Legislature which plays an oversight role to make the Executive accountable for its financial activities. Public funds are allocated to the executive for service delivery through budget allocations. To perform this oversight role efficiently Legislature relies on the Auditor General of South Africa (AGSA) to utilise internationally recognised audit techniques to examine relevant documents to assess the performance of the auditee provincial departments in line with relevant regulatory provisions. Thus,

there is a relationship between the Executive, Legislature and the AGSA for financial accountability purposes as depicted in Figure 3.2 below:

Figure 3.2: Relationship between Legislature, Executive and the Auditor General (AGSA)



Source: Adopted from (Siswana, 2007)

The Public Audit Act of 2004 (Government Gazette No. 27121, 2004) mandates the AGSA with the responsibility for financial management and control in all spheres of government by auditing expenditure incurred by government entities. The Act requires the AGSA to report to the relevant *public accounts committee* of a provincial legislature and this represents the final link in the chain of accountability in the public service. (Siswana, 2007).

3.3 The Eastern Cape Provincial Government – background and financial management environment.

3.3.1 Background and geographical setting

The Eastern Cape Province was formed in 1994 out of the former South African homelands of Transkei and Ciskei as well as the eastern portion of the former Cape Province. This area was the landing place and home of the 1820 settlers and the home of the Xhosa people. (Wikipedia, 2013)

The Eastern Cape Province is geographically situated in the south-eastern part of South Africa and shares borders in the south with the Indian Ocean, on the west with the Province of Kwazulu Natal and on the east with the Western Cape Province. (Eastern Cape Department of Economic Development & Environmental Affairs, 2010)

After its formation in 1994, the provincial government faced the challenge of creating a single provincial administration by merging six separate administrations, all of which displayed varying levels of administrative and institutional capacity. In terms of surface area the Eastern Cape Province is the second largest of the nine provinces. (Nets-Africa: South African- Tuscan Network, 2009)

3.3.2 Economy

Economically, the province of the Eastern Cape can be described as unevenly developed as indicated by the contrast between the two centres of industrial development in the Buffalo City and Nelson Mandela metropolitan areas and the poverty stricken underdeveloped rural hinterland of the Transkei and Ciskei. A similar contrast can be found between the well-developed commercial farming and socio economic infrastructure in the western parts of the province which are glaringly absent in the east.

The Eastern Cape Province is one of the poorest provinces of which 45.8% (or 1.1 million) of the working age population is unemployed. Two thirds of the population live in underdeveloped rural areas where there is limited access to services, infrastructure and employment opportunities (Eastern Cape Planning Commission, 2014). This bleak picture is in spite of the fact that the Eastern Cape is endowed with the lush and fertile forests of the Wild Coast, the Keiskamma Valley and Langkloof. It is however South Africa's fastest growing province and emerging as a manufacturing hub due to the attraction of investments into modern infrastructure such as exists in Koega and East London IDZ's. (Nets-Africa: South African- Tuscan Network, 2009).

3.3.3 The state of Audit Committees and Financial Management in the Eastern Cape provincial departments

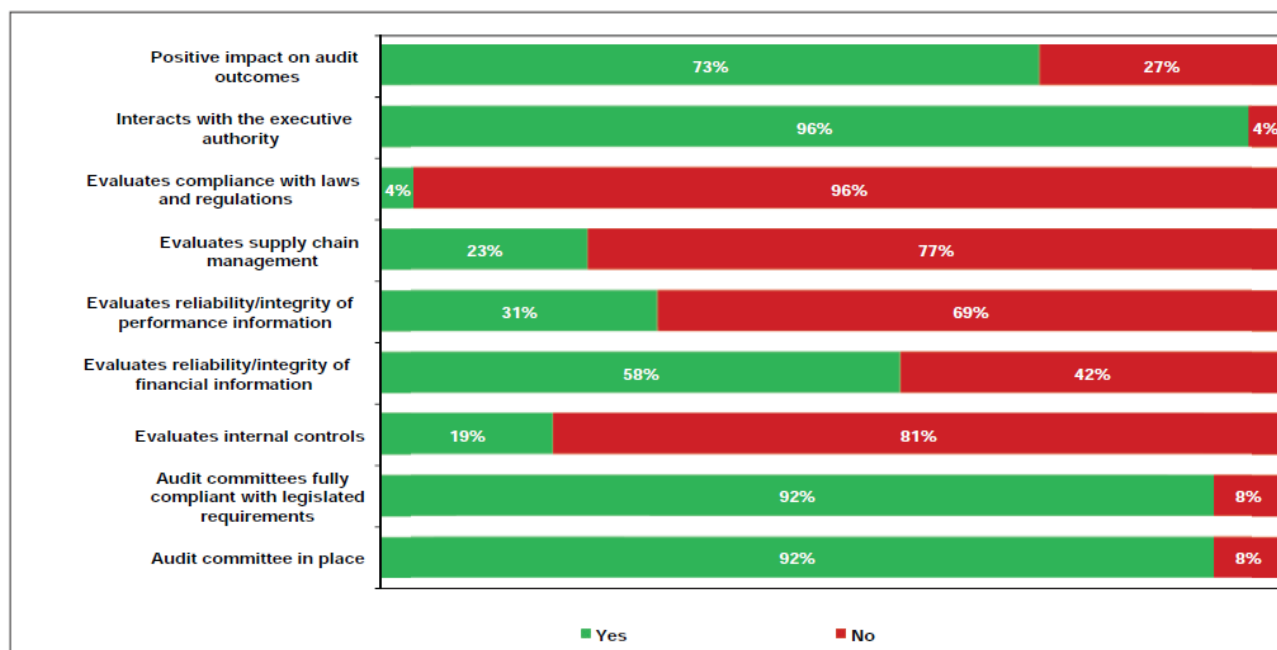
The Eastern Cape Provincial Legislature is one of the nine legislatures in the provincial sphere of government and is subject to the terms and conditions of the Constitution of South Africa which binds all spheres of government to abide by the principles of democracy, transparency and accountability. (The Department of Public Service & Administration, 2003).

The executive authority is vested in the Premier of the Eastern Cape who is assisted by members of an Executive Council (MEC's) to execute duties. MEC's are assigned functions (including that of being the executive heads of provincial departments) and are individually accountable to the provincial legislature as well as to the public for the performance of such functions. (The Department of Public Service & Administration, 2003).

The PFMA requires that every provincial department establishes an audit committee and an internal audit unit. (National Treasury, 2009). Audit committees serve as an independent governance and accountability structure playing an oversight role over systems of internal control, compliance with legislation, risk management and governance.

Fig 3.3 below depicts the effectiveness of audit committees in provincial departments for the 2012 financial year:

Fig 3.3: The state of effectiveness of audit committees – 2012 financial year



Source: Adopted from (Auditor General, 2011.12)

The following observations can be made about the audit committee effectiveness in the year under review:

- Most departments had set up internal audit units with audit committee oversight in compliance with legislative requirements (92%). These committees could however only achieve the following levels of effectiveness:
 - 58% effectiveness in evaluating the reliability and integrity of financial information.
 - 19% effectiveness in evaluating internal controls
 - 23% effectiveness in evaluating compliance to supply chain management prescripts.
 - 4% effectiveness in evaluating compliance with laws and regulations, and
 -
 - 8% effectiveness in making a positive impact on audit outcomes.

In summary it can be concluded that audit committee effectiveness in general was low in government entities in the Eastern Cape Province during the 2011-12 financial year.

3.3.4 Overall audit outcomes for the 2012 financial year

As mentioned earlier in this study the Auditor General of South Africa (AGSA) is mandated by the Public Audit Act of to audit and report to the legislative arm of government on the financial performance of the government in any particular year. (Government Gazette No. 27121, 2004). Thus the main yardstick used in the public sector for measuring financial management performance is the audit opinion report issued by the AGSA.

Fig 3.4 below illustrates the main classification of audit opinions as indicators of financial management performance:

Fig 3.4 : Broad classifications of audit opinion reports

Classification of audit opinions used by the external auditor	
AUDIT OPINION	Explanation
a. Unqualified audit opinion	Good opinion – the financial statements may be regarded as fairly reflecting the financial status of the department or entity.
b. Unqualified audit opinion with emphasis of matter	Least severe opinion – the financial statements may be regarded as fairly representing the financial status of the department or entity, but there are a number of issues that are cause for concern which are raised in the emphasis of matter.
c. Qualified opinion (look for the words “except for”)	Severe opinion – when the auditor concludes that an unqualified opinion cannot be expressed, but that the effect of any disagreement with management, or limitation on the scope of the audit is not so material or fundamental as to require an adverse opinion or a disclaimer of opinion.
d. Adverse opinion (look for the words “do not fairly present”)	Most severe opinion - expressed when the effect of a disagreement is so material and fundamental to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.
e. Disclaimer (look for the words “I do not express an opinion”)	No opinion expressed (also very severe) – when the auditor concludes that the possible effect of a limitation on the scope of the audit is so material and fundamental that the auditor has not been able to obtain sufficient appropriate audit evidence, and accordingly is unable to express an opinion on the financial statements

Source: Adopted from (National Treasury - Republic of South Africa, 2009)

The Eastern Cape provincial government comprises of 27 entities, 15 of which are provincial departments and 12 of which are public entities.

Fig 3.5 below illustrates the overall audit outcomes of the 2012 financial year.

Fig 3.5: Summary of 2011-12 Eastern Cape Government Entities audit outcomes

Audit outcomes	Departments*		Public entities		Total	
	2011-12	2010-11	2011-12	2010-11	2011-12	2010-11
Financially unqualified with no findings (clean audits)	1	2	0	1	1	3
Financially unqualified with findings	8	7	11	9	19	16
Financially unqualified financial statements	60%	60%	92%	91%	74%	73%
Qualified opinion, with findings	5	5	1	1	6	6
Adverse opinion, with findings	0	0	0	0	0	0
Disclaimer of opinion, with findings	1	1	0	0	1	1
Financially qualified financial statements	40%	40%	8%	9%	26%	27%
Total number of audits in the province	15	15	12	11	27	26

**Including legislature and provincial revenue fund*

Source: Adopted from (Auditor General, 2011.12)

The AGSA report included the key outcomes and financial management trends in Eastern Cape provincial departments and their entities. Some of the conclusions made in the report are highlighted below:

- Audit outcomes in the province remain stagnant with only one improvement but three regressions.
- About 70% of the provincial budget is either disclaimed or qualified including allocations to the two big departments of Education and Health.
- Only five of the 27 entities submitted financial statements containing no material misstatements in one or more areas.
- The provincial treasury is currently not effective in complying with its mandate relating to the implementation of the provincial budget and the promotion and enforcement of transparent and effective management in respect of revenue, expenditure, assets and liabilities.
- Five (19%) entities failed to address their 2010-11 qualification findings and remained on a qualified opinion, while one (4%), namely Education, retained its disclaimer of opinion.

- All departments and entities had compliance findings in their audit reports and except for two departments, compliance findings actually increased in number.
- In total, 86% of the departments and 60% of the public entities only achieved 80% or less of their service delivery targets.
- Four hundred and twelve tender awards (2010-11: 698) to the value of R30,8 million (2010-11:R999 million) were made to department officials and/or their close family members. Declarations of interest were not made in any of these cases. This blatant disregard of the SCM legislative framework has an negative impact on all spheres of service delivery in the province.
- In at least 50% of the departments and public entities, expenditure exceeded revenue. In total, 64% of the departments incurred liabilities in excess of the available funds at year-end.
- Most entities have fully established audit committees and internal audit units, in compliance with legislative requirements. Although most governance structures were in place, they had little or no impact on the audit outcomes for the year under review. These structures did not provide adequate assurance for PDO reporting, SCM, compliance with laws and regulations as well as internal controls during the year under review. (Auditor General, 2011.12)

3.3.5 Root causes of negative audit outcomes

According to the AGSA the overall root causes for a lack of change in audit outcomes in the province are as follows:

- *The leadership at the top is does not take full ownership of the key controls.* The auditees in the category of 'financially unqualified with other matters' have become complacent and do not take ownership of the key controls. They are thus not able to create a culture of high performance and accountability.
- *There is no proactive leadership.* Instead, most actions are reactive to crises that arise.
- *A culture of daily accountability is not prevalent.* As a result, daily and monthly financial disciplines are not entrenched within the departments and entities.

Progress towards clean administration has therefore stagnated. Consequently, the auditees just wait for the AGSA to identify and correct errors. To illustrate this, only five (19%) of the auditees submitted financial statements that required no material adjustments, while 12 (44%) could not have obtained unqualified outcomes if material adjustments had not been made to their financial statements during the audit process.

- The lack of accountability is largely due to *a lack of supervision and monitoring* of the daily and monthly tasks. Unfortunately, no punitive action is taken for poor performance and audit outcomes are not sustainable.
- The leadership of the province, including the Executive, does not take enough active enough interest in, or insist on, *credible monthly reporting in all areas*. They also do not adequately use the audit committee and internal audit unit to provide assurance on the credibility thereof.
- *The provincial treasury and the Office of the Premier do not adequately monitor and enforce compliance* and provide financial and other support to departments and entities to ensure that the level of compliance in the province is improved. The action plans drawn up by the auditees are not always relevant in addressing the issues raised by the AGSA. In addition, action plans are drawn up merely as a compliance issue and are not used as a tool for improvement.

The most serious consequence of the root causes outlined above is a lack of processes to verify the credibility of information. Information used for decision-making and oversight may therefore not be necessarily credible. This may impair the effectiveness of oversight and limit progress towards clean administration. (Auditor General, 2011.12).

3.3.4 The success story of the Department of Social Development and Special Programmes

The Auditor General's audit opinion report for the 2011-12 financial year (Auditor General, 2011.12) identifies the Department of Social Development and Special Programmes as the 'success story' of financial management in the Eastern Cape.

The substantial improvement in the audit outcomes of the Department of Social Development and Special Programmes is a special case in point. The AGSA report highlights the following:

“Under a competent and committed head of department, management embraced a leadership tone depicting a willingness to accept accountability for financial management throughout the financial year, creating a control environment that is conducive to accountability and oversight, and decisive action plans with clear time frames to address the root causes of qualifications and the continuous monitoring thereof the three elements under a strong and committed leadership, where the head of department (HoD) facilitated an improved culture of accountability.”

(Auditor General, 2011.12)

Although the department did not move in terms of their audit opinion (unqualified with findings), they made significant strides in reducing noncompliance by almost 70%, and had no material adjustments made to the financial statements and made good progress towards a clean audit.

The success story of the Department of Social Development is directly linked to the state of governance in the department. This study will attempt to verify if such state of good governance in a province generally riddled with lack of accountability has anything to do with the effectiveness of the performance of its audit committee.

3.4 Chapter summary and conclusion

In this chapter, an attempt has been made to highlight the current state of public financial management in South Africa and how this has had an adverse impact on financial management in Eastern Cape provincial departments.

The chapter also reviews the current state of audit committees, as a governance structure, in Eastern Cape provincial departments and their impact on audit outcomes.

The post-1994 South African financial management paradigm based on a secretive budgeting system is currently being replaced by transparent results-based management system in line with the Public Finance Management Act crafted and promulgated in 1999. Risk management and internal control have become features of this new participative approach to financial management.

The state of the economy of the province creates an additional responsibility on the provincial government to deliver services to the poor and vulnerable majority of the population. Financial management is therefore of utmost importance.

The PFMA legislates the establishment of audit committees in all provincial departments as governance instruments. The legislative arm of government exercises an oversight role utilizing audit opinion reports issued by the AGSA as yard stick to pass a judgement on the financial management performance of provincial departments.

The Eastern Cape Provincial Government established in 1994, continues to experience financial management deterioration as evidenced by the 2011-12 AGSA audit opinion reports, in spite of the fact that all provincial departments have established audit committees as prescribed by the PFMA.

In this study an attempt will be made to test the hypothesis that in order to improve public sector financial management and accountability in Eastern Cape provincial departments, an improvement in audit committee effectiveness will be required.

In Chapter 4 the research methodology and design used in the study will be discussed. This will include the choice of sample size, data collection, analysis and measuring instruments.

CHAPTER 4 - RESEARCH METHODOLOGY

4.1 Introduction

The primary aim of this research is to assess how an improvement in audit committee effectiveness ensures effective and improved financial management in Eastern Cape provincial departments.

In Chapters 2 and 3 literature available on the principles of financial governance, accountability and audit committee effectiveness in general, as well as the current state of financial management and the extent to which audit committees have been established and operate in Eastern Cape provincial departments was reviewed. This literature review will serve as the basis for data collection and analysis in this study.

The primary research question is:

How effective are audit committees in Eastern Cape provincial departments in assisting management in improving public sector financial management?

This chapter describes the research methodology and design used to conduct empirical investigation to evaluate audit committee effectiveness in Eastern Cape provincial departments. The procedures used to collect and interpret data collected will be reported. The chapter also focuses on procedures followed to ensure the validity and reliability of the research findings.

In this study, the correlation between the responses from the various interviewees and the findings will confirm reliability. The analyses of the survey will validate the information received from the questionnaires.

4.2 Definition of *business research*

Research is defined as a process of enquiry and investigation which is conducted in a systematic and methodical way that leads to knowledge (Collis, 2009). In research, an attempt is made to answer a question, resolve a problem or understand a phenomenon. This process is sometimes called *research methodology*. *Research* has also been defined as a 'systematic process' during

which data is collected, analysed and interpreted to have a better understanding of a phenomenon (Leedy & Ormrod, 2010).

4.3 Research paradigm

Schwandt (1997:108) argues that the term 'paradigm' plays a significant role. In Thomas Kuhn's monographs a paradigm is defined 'The Structure of Scientific Revolutions' which discusses the rationality of scientific enquiry. Schwandt (1997:108) further argues that the term 'paradigm' offers a convenient conceptual shorthand for pointing to significant differences in methodologies

According to Collis and Hussey (2009:11) a research paradigm is a framework that sets out how research should be conducted. This choice of the correct paradigm to use is dictated by the people's philosophies and assumptions about the world and the principles that drive them. Koshy (2010:79) refers to two paradigms as positivist and naturalistic (phenomenological).

Collis and Hussey (2009:59) and Corbetta (2003:14) argue that positivist ontological assumption has it that social reality is objective and external to the researcher. On the other hand, Epistemological assumption of positivists dictate that valid knowledge is phenomena that is observable and measurable. On methodology, positivists use experimental manipulation and quantitative techniques to analyse variables. Furthermore (Collis and Hussey 2009:59) on quantitative data collection argue that a large sample size must be used and the analysis must look at the association between variables.

The Interpretivists' (phenomenological) ontological assumption is that social reality is subjective because it is socially constructed (Collis and Hussey, 2009:59). Corbetta (2003:14) argued that these constructed realities vary in form and content among individuals, groups, and cultures. According to Corbetta (2003:14) the interpretivists' epistemological assumption is that the researcher and object of study must be seen as interdependent not as separate. (Collis and Hussey, 2009:59) concur with Corbetta confirm that Interpretivists attempt to minimise the gap between the researcher and his or her research. On methodology Corbetta (2003:14) argues that interpretivists emphasise interaction

between scholars and objects studied. Furthermore knowledge emerges from the reality studied using qualitative techniques and analysing cases.

4.4 Research methods : Quantitative & Qualitative methods

Research method is the overall approach taken in the research study. This could be either the Quantitative or Qualitative or Mixed method. Each approach has its own unique purposes, methods of conducting the research enquiry, strategies for collecting and analyzing data and criteria for quality judgment (De vos, 1998)

Leedy and Ormond (2010) state that quantitative research is ideal where the researcher seeks to answer questions about relationships between measured variables. The underlying intention will be to explain, predict and control.

Qualitative research on the other hand, according to Leedy and Ormond (2010), is collecting, analysing and interpreting data by observing what people do or say. It refers to meanings, concepts, definitions and descriptions. This method is used to research and answer questions about the complex nature of a phenomenon, often describing this from the researcher's point of view. It is important to note that the difference between the approaches does not lie in "quality" but rather in procedure. Findings are not arrived at by statistical methods or other procedures of quantification as is the case with quantitative research.

A summary of the main differences between qualitative and quantitative research is given in Figure 4.1 below:

Table 4.1 : Main Differences between qualitative and quantitative research methods (Adapted from Leedy & Ormond (2001)):

Qualitative methods	Quantitative methods
<ul style="list-style-type: none"> • To build theory • To explore and interpret • To describe and explain • Unknown variables • Subjective “insider view” and closeness to data • Holistic perspective • Process oriented • Observations, interviews • Words 	<ul style="list-style-type: none"> • To test theory • To confirm and validate • To predict and explain • Known variables • Objective “outsider view” distant from data • Particularistic or focused and analytical • Result oriented • Standardised instruments • Numbers

4.5 The choice of research type (or research method)

Table 4.2 below was used as a tool to decide on a qualitative research methodology as the most suitable choice for this study:

Table 4.2: Research Type decision table

Use this approach if:	Quantitative	Qualitative	Applicable to quantitative	Applicable to qualitative
1. You believe that:	There is an objective reality that can be measured	There are multiple constructed realities that can be measured	No	Yes
2. Your audience is:	Familiar with/ supportive of quantitative studies	Familiar with/ supportive of qualitative studies	No	Yes
3. Your research question is:	Confirmatory, predictive	Exploratory, interpretive	No	Yes
4. The available literature is:	Relatively large	Limited or missing	Yes	Yes
5. Your research focus	Covers a lot of breath	Involves in-depth study	No	Yes
6. Your time available is:	Relatively long	Relatively short	Yes	No

Use this approach if:	Quantitative	Qualitative	Applicable to quantitative	Applicable to qualitative
7. Your ability/desire to work with people is:	Medium to low	High	No	Yes
8. Your desire for structure is:	High	Low	No	Yes
9. You have skill in the area(s) of:	Statistics and deductive reasoning	Attention to detail and inductive reasoning	No	Yes
10. Your writing skills are strong in the area of:	Technical scientific writing	Literary, narrative writing	No	Yes

Source: Adapted from Leedy (1997)

Concluding from the table above, the researcher is of the opinion that a number of constructive realities can be measured and that the research question asked is more interpretive than predictive. The available literature on the topic (particularly relating to the Eastern Cape environment) is limited and the researcher will apply inductive reasoning and narrative writing techniques to gather information. A qualitative research method was found to be suitable for the purpose of this study. The interpretivists's epistemological assumption was adopted and qualitative techniques were used to collect and analyse data.

4.6 Reliability and validity of measurement

In order to obtain data which is valid and reliable the researcher must ensure that the measurement procedures and instruments have acceptable levels of reliability and validity. *Measurement* consists of establishing rules for assigning numbers to objects so as to represent quantities or attributes numerically. Validity and reliability are the two most important concepts in the context of *measurement*. (De Vos, Strydom, Fouche & Delport, 2011).

4.6.1 Reliability

Reliability is concerned with the consistency of measurement. It is the consistency with which a measuring instrument yields the same result on application when the measuring object or entity has not changed. (Leedy & Ormrod, 2010).

Babbie (2010) also describes reliability as a matter of whether or not a technique applied repeatedly to the same object yields the same results.

4.6.2 Validity

Validity refers to the extent to which an empirical measure adequately reflects the real meaning of the concept under consideration. (Babbie, 2010)

A measurement instrument is valid to the extent that it measures what it is intended to measure. Leedy & Ormrod (2010) judge the efficiency of a measurement instrument using the following two examples: A *yardstick* is certainly a valid means of measuring *length*. On the other hand the extent to which a *standard intelligence test* actually measures a person's intelligence is not so certain.

4.7 Research design: Survey

4.7.1 Interview survey

Survey research has been described as one of the most popular methods in social science research. It involves collecting data by asking people questions. This may take the form of self-administered questionnaires or through face-to-face interviews, or over the phone or by an on-line surveys. (Babbie, 2010)

In an interview, instead of distributing a set of questionnaire and asking respondents to answer them in writing, an interviewer orally asks questions and records the response of the respondent.

Babbie (2010) outlines the following as the advantages of having a questionnaire administered by an interviewer instead of a respondent:

- The response rate is higher in an interview survey than in questionnaire survey.
- The number of 'don't knows' and 'no answers' are reduced considerably because the interviewer is able to probe for answers.
- Respondents can be observed as they answer questions and the body language can indicate whether or not the question is clearly understood and adequately answered in detail.

In this paper, a face-to-face interview method was used.

4.7.2 Data Source

In a scientific research, two main sources of data can be identified. Primary data is collected at source by asking questions or making observations in an uncontrolled environment, or it can be obtained in a controlled environment through experiments. Secondary data on the other hand is already collected and can be obtained from sources such as books, journals and news media articles. (Collis, 2009).

A combination of primary and secondary data was used in this study. Key personnel were selected from provincial departments and interviewed using questions developed and based on the audit committee performance of the PFMA and Treasury Regulations, as well as other theoretical approaches derived from literature review.

4.8 Chapter Summary and conclusion

The chapter has attempted to describe the research methodology and design to conduct an empirical study to evaluate audit committee effectiveness in Eastern Cape provincial departments. The term *business research* is defined and the differences between quantitative and qualitative research methodologies are explained. An attempt is made to justify why the qualitative research methodology was selected as the basis for this study.

The importance of ensuring that the research measurement tool is valid and reliable is explained. The chapter also justified the use *Interview survey* used as the data collection tool.

CHAPTER 5 - ANALYSIS OF EMPIRICAL RESULTS

5.1 Introduction

The purpose of this chapter is to present, and analyse the results of the data collected in the empirical study detailed in Chapter 4 as well as secondary information described in Chapters 2 and 3 of this research. A presentation of the results of the study and relevant references to the literature review will be made and followed by an analysis of the data.

From the data analysis, the researcher will establish whether an effective audit committee is the main contributory factor to good financial management with particular reference to the Eastern Cape provincial department environment.

In a *qualitative study*, qualitative analysis is used to transform data into findings by reducing the volume of raw information and identifying significant patterns. A framework is then constructed for communicating the outcome of the study. (De Vos, et al., 2011)

The key objective of this study as outlined in Chapter 1 is to explore how audit committee effectiveness impacts on accountability and financial management in an Eastern Cape provincial department. As discussed in Paragraph 2.2.3 of this study, audit committee effectiveness is determined and described in different ways by various academic commentators.

For this study the determinants of audit committee effectiveness are **audit committee composition, authority, resources and diligence**, as defined by De Zoort, et al.(2002).

The interpretation of the data collected follows:

5.2 Interview findings and documentary review

In total, eight key senior officials were selected and interviewed using semi-structured questions developed and based on the audit committee performance of the PFMA and Treasury Regulations, as well as other theoretical approaches

derived from the literature review. Each interview lasted between 40 and 50 minutes.

Officials were selected from three departments and interviewed. In the Department of Roads & Public Works the Acting Chief Financial Officer and two members of the audit committee were interviewed. In the Department of Transport the Chief Audit Executive and a member of the audit committee were interviewed. A member of the audit committee, the Director of Accounting Services and the Acting Chief Financial Officer were interviewed in the Department of Social Development and Special Programmes.

In the following paragraphs details of responses given to each interview question will be highlighted and the responses will be supplemented by additional information obtained from literature review findings of the study.

5.2.1 Interview questions and responses

Question 1: (On the *diligence* of audit committee members)

One of the functions of an audit committee is to review the effectiveness of internal control systems and the internal audit function and determine whether risks identified are the basis of internal audit plans. In your view, does your audit committee perform this function effectively?'

Interview responses: reviewing the effectiveness of internal control systems and the internal audit function

Respondents were of the opinion that internal audit units of their departments assist audit committees by ensuring that resources are available for scheduled meetings and that meetings planned for the year take place. This is done under the umbrella of the transversal Internal Audit unit of Provincial Treasury which co-ordinates such meetings.

Audit committees do act and report independently to accounting officers and executive committee members when they find it necessary to escalate issues. The effectiveness of audit committees is however limited to how strong or weak existing internal controls are in the department. Being an advisory committee,

effectiveness depends on what provincial departments decide to do with the advice given to them.

It is the opinion of interviewees that senior managers do not effectively implement audit committee advice and this negatively impacts on the committee's effectiveness.

Question 2: (On the *composition* of audit committees)

Audit committees play an oversight role of corporate governance over the financial reporting process, the internal control structure and the audit function. Do you think that your audit committee is (a) independent, (b) members are competent and financially literate and, (c) members are adequately resourced and properly compensated to perform this function effectively?

Interview responses: Independence, competency and resourcing of audit committee members

Audit committees are reasonably independent and are able to report directly to accounting officers, and if need be, to members of the executive authority. In all departments interviewed, members are externally appointed by the accounting officer to whom they directly report.

Membership should be made up of individuals with diverse qualifications that include a number of chartered accountants. Independence, competency and resourcing by audit committee members should not be factors impacting negatively on the effectiveness of audit committees.

Question 3: (On *Composition, authority, resources and diligence* of audit committees)

Do you agree with the following statement: 'Improving public sector financial management and accountability in Eastern Cape provincial departments will require improvement in audit committee effectiveness.' If so why? If not, why not?

Responses

Respondents only partially agree with this statement. Being an oversight body, an audit committee is only effective to the extent to which its recommendations are implemented. Effectiveness to a large degree depends on having competent and very skilled people as Chief Financial Officer (CFO) and senior management officers who commit themselves fully to their work and who believe in accountability.

Literature review

The review of the Auditor General of South Africa's report for the 2011-12 financial year (Auditor General, 2011.12), indicates that even though 92% of provincial departments had set up internal audit units with audit committee oversight in compliance with legislative requirements, they could only so far as achieve 58% effectiveness of evaluation inter alia reliability and integrity of financial information.

The report also indicated that audit committees could only achieve 19% effectiveness in evaluating internal controls, 23% effectiveness in evaluating compliance to supply chain management prescripts, 4% effectiveness in evaluating compliance with laws and regulations, and 8% effectiveness in making a positive impact on audit outcomes. This is an indication that audit committee effectiveness in general was low in government entities in the Eastern Cape Province during the 2011-12 financial year.

Question 4: (On *Composition, authority, resources and diligence* of audit committees)

Provincial departments in the Eastern Cape continue to obtain negative audit outcomes. To what extent do you think that this is due to the ineffectiveness of audit committees? What do you think is the positive contribution of audit committees to your department's successes in financial management?

Interview responses: Is audit committee ineffectiveness the main cause for negative audit outcomes?

Respondents are of the opinion that audit committee ineffectiveness is not the only cause of negative audit outcomes. They regard an audit committee as more of an oversight body. They are of the opinion however, that in addition to effectiveness, having capable and competent officials in place is necessary – especially in the positions of the Chief Financial Officer (CFO) and programme managers.

Respondents believe that competent and stable leadership supported by a political will, in an effective internal audit and risk management environment are the main determinants of positive audit outcomes, according to respondents.

Other contributing factors include the lack of skilled and competent financial management staff and systems to meet the demand of large departments (such as the Department of Roads & Public Works) the inability to collect, process and store relevant financial management data.

Respondents are further of the view that departments which struggle to achieve positive audit outcomes often lack mechanisms to enforce accountability and stable leadership.

Question 5: (The *authority* of audit committees)

In your opinion what other factors impact negatively on financial management in Eastern Cape provincial departments?

Interview responses: Other factors impacting negatively on financial management

These factors include:

- Lack of competent and skilled financial management personnel for high senior management positions such as Chief Financial Officer (CFO) and programme managers.
- Lack of responsible leadership and mechanisms to enforce accountability.
- Poor understanding (or misinterpretation) of Supply Chain Management prescripts.

- Disruption of government business, especially caused by senior management officials sitting at meetings for long hours to craft plans which are never effectively implemented.

Literature review

Instability in leadership especially at the level of accounting officer and chief financial officer, has been a major contributor to the deterioration in financial management in the province. This fact is emphasized in the Auditor General of South Africa's report (Auditor General, 2011.12) which identifies the following among the root causes of negative audit outcomes:

- That the top leadership does not take ownership of the key controls.
- There is no proactive leadership. Instead, most actions are reactive to crises that arise.
- Lack of accountability is largely due to a lack of supervision and monitoring of the daily and monthly tasks and, as a result, no punitive action is taken for poor performance. Audit outcomes are, as a result not sustainable. (Auditor General, 2011.12)

In March 2011 National Treasury invoked Section 100 (b) of the Constitution of South Africa, placed the Eastern Cape Department of Education under administration and took over the running of the department – a sign of a complete breakdown in financial management and accountability (Eastern Cape Department of Education, 2011).

Question 6: (On the *diligence, resources, authority and composition* of audit committees)

Audit committees perform the functions of planning, monitoring and reporting:

*How effective is the **planning function** in your audit committee – what can be done to improve this function?*

Interview responses: The planning, function of audit committees

The ability of an audit committee to put together a plan and successfully implement it impacts on the effectiveness of the committee.

All respondents agreed that annual planning of audit committee activities takes place using the audit charter as the basis of the plan. Respondents are however of the opinion that planning must be supported by committed senior management with the courage and competence to implement the plans.

Question 7: (On the *diligence, resources and composition* of audit committees)

*How effective is the **monitoring function** of the committee – what can be done to improve this function? Have you ever been summoned or asked to report to the audit committee at any point in time?*

Interview responses: the monitoring function of audit committees:

Respondents to this question are of the opinion that audit committees adequately perform their monitoring function. On a regular basis specific reports e.g. status of audit implementation and financial management reports are asked for by the accounting officer and the executive authority.

Literature review

Section 3.1.10 of Treasury Regulations (National Treasury, 2009) specifies that an audit committee should review the following:

- the effectiveness of the internal control systems,
- the effectiveness of the internal audit function
- the risk areas of the institution's operations to be covered in the scope of internal and external audits,
- the adequacy, reliability and accuracy of the financial information provided to management and other users of such information,
- any accounting and auditing concerns identified as a result of internal and external audits, the institution's compliance with legal and regulatory provisions, and
- the activities of the internal audit function.

Question 8: (The *authority, composition and resources* of audit committees_

*How effective is the **reporting function** of your audit committee – what can be done to improve this function? Have you been affected in any way - positively or negatively - by any action or report issued by the audit committee of your department?*

Interview responses: the reporting function of audit committees

Respondents referred to the fact that they are mandated to report on an annual basis to the accounting officer as well as to legislature on their duties and responsibilities. There have been instances when audit committee chairpersons have been asked to appear before the Portfolio Committee on Finance (PCF) to answer questions on matters of internal controls and financial management.

Literature review

Most entities have fully established audit committees and internal audit units in compliance with legislative requirements. Although most governance structures are in place, they have had little or no impact on the audit outcomes for the year under review. These structures do not provide adequate assurance for financial reporting, SCM, compliance with laws and regulations as well as internal controls during the year under review. (Auditor General, 2011.12)

Question 9: (On the *authority* of audit committees)

PFMA legislates the existence of audit committees in every department:

- *Do you think this is a good idea or not?*
- *Apart from legislation, how can government enhance corporate governance in departments?*

Interview responses

It is imperative that an oversight body like an audit committee be established in all provincial departments in line with the King Code of Governance (King III) of the private sector. However it should not be just a compliance issue. The right professionally competent people should be appointed to the committee.

Literature review

As indicated in the literature review Van der Nest, et al. (2008) argue that audit committees in the public sector have similar responsibilities as audit committees in the private sector in ensuring that individuals in position of authority in the public sector should be held accountable for their actions or lack thereof.

Question 10: *(on the composition and diligence of audit committees)*

In your opinion, to what extent does the audit committee in your department enhance accountability, corporate governance and contribute positively to audit outcomes?

Responses

To a great extent audit committees enhance corporate governance and audit outcomes, but only within the context in which they operate. The major contributor to positive audit outcomes still remains the Chief Financial Officer (CFO) and senior management effort and diligence.

Question 11: *(on the overall effectiveness of audit committees)*

Is there anything that can be done by your department to make your audit committee more effective?

What is it that your department has done differently in order to improve financial management and audit outcomes?

What departments can do to make their audit committees more effective

Respondents were of the view that the time available for audit committee meetings should be increased and the committee should meet at least five times in a year. The executive authority should act quickly and emphatically on recommendations made by the committee on all aspects of their work.

Question 12: *(on the overall effectiveness of audit committees)*

What is it that your department has done differently in order to improve financial management and audit outcomes?

Responses & literature review

This question was specifically posed to respondents from the Department of Social Development and Special Programmes in the context of the improvements in audit outcomes recorded in the 2011-12 financial year.

- The department has had a stable leadership for the past five years, with an accounting officer and chief financial officer in permanent positions during that period. This is in contrast to the other departments where officials were in acting positions in these two very important senior management positions.
- The accounting officer of the department is devoted to ensuring that financial management structures are fully effective. She chairs all executive committee meetings dealing with audit intervention plans and attends all audit committee meetings.
- The department's audit committee is made up of five members made up of a chartered accountant who worked in the Auditor General's office for many years, a competent and devoted chairperson with many years experience in both internal and external audit.

In the year under consideration, the audit committee met five times. The attendance register of these meetings shows that for four out of the five meetings the accounting officer was present. For three of these meetings the member of the executive council (MEC) of the department was present. This is a clear indication of the level of a very high level of commitment.

- The department, on an annual basis, draws up an audit intervention plan which is closely monitored by the audit committee and for which programme managers are directly accountable to report on progress (or a lack thereof) of specified targets to be achieved. A special Audit Intervention Plan committee reports on a quarterly basis to the audit committee and the accounting officer of the department.
- The Department of Social Development and Special Programmes was the only entity identified as the 'success story' of financial management in the Eastern Cape. This is attributed to the existence of a competent and

committed head of department supported by a management team which embraces a leadership tone depicting a willingness to accept accountability for financial management throughout the financial year. This creates a control environment that is conducive to accountability and oversight, and decisive action plans with clear time frames to address the root causes of previous year audit qualifications. As a result, even though the department did not move in terms of their audit opinion (unqualified with findings), significant strides were made in reducing noncompliance by almost 70%, and had no material adjustments made to the financial statements and made good progress towards a clean audit (Auditor General, 2011.12)

5.3 Analysis and summary of findings

The findings in the paragraphs above are the responses to interviews conducted in three provincial departments of the Eastern Cape which are supplemented by relevant literature review information. Twelve questions in total were responded to.

The responses are analysed in the following paragraphs to see how they relate to the research objectives.

5.3.1 Reviewing the effectiveness of internal control systems and internal audit function.

Audit committees in provincial departments in the Eastern Cape have been set up and supported by Provincial Planning and Treasury. They diligently review and make suggestions as to how internal controls should be strengthened. Being an advisory body they have powers only to report and make recommendations to the accounting officer who then has the discretion of implement them or not.

Accounting officers are comfortable with setting up audit committees to comply with the PFMA but not necessarily to use them as a management tool. In departments where audit committee advise is implemented (like in the case of the Department of Social Development) improvement in financial management is evident.

5.3.2 Independence, competency and resourcing of audit committees

Members of audit committees are competent and there is a mixture of various professions which makes them a store of knowledge in various disciplines. Appointments are made by accounting officers. The PFMA categorically prescribes the composition of membership, including who qualifies to be a member, chairperson and even the minimum number of times the committee should meet annually. With all audit committees set up in compliance to this PFMA requirements their independence is theoretically assured.

5.3.3 The extent to which audit committee ineffectiveness contributes to negative audit outcomes

The Auditor General in its 2012 audit report gave only 8% as the overall effectiveness of audit committees in Eastern Cape provincial departments in making a positive impact on audit outcomes. This does not however mean that audit committee ineffectiveness is the only contributing factor to negative audit outcomes.

Competent and diligent senior managers, especially in the position of the Chief Financial Officer will impacts positively on audit outcomes. Secondly a competent and committed leadership supported by political will ensures that an effective internal audit and risk management environment exists in departments This will then subsequently improves financial management and audit outcomes.

Other factors include the poor understanding of supply chain management and PFMA prescripts. What seems to be a major contributor, however is the disruption of government business caused by senior management sitting in meetings for long hours instead of being productive on the field. This is compounded by instability and lack of continuity in leadership, which impacts negatively on accountability.

5.3.4 The planning, monitoring and reporting functions of audit committees

Provincial Treasury, through its transversal Internal Audit unit assists audit committees to craft annual charters and ensures that there is an annual plan

which is based on the audit charter. Planning should however be supported by a committed and competent senior management team in the departments.

5.3.5 The existence of audit committees in departments

There is no doubt that there is the need to have an oversight body like an audit committee in provincial departments in the Eastern Cape. This ensures that government officials in responsible positions are held accountable. However, PFMA's legislative requirement for the existence of audit committees reduces effectiveness when accounting officers set up these committees for compliance purposes only.

5.3.6 The exceptional case of the Department of Social Development

The Department of Social Development and Special Programmes had a special mention by the Auditor General in its 2012 audit report, as one of the few departments with improved financial management and audit outcomes. It can be argued that this achievement was based on both the effectiveness of its audit committee as well as other factors including the following:

- A stable leadership, especially at the level of the accounting officer and the chief financial officer.
- Diligence and commitment of senior management demonstrated by a hands-on approach.
- An audit committee of competent and experienced members coupled whose meetings are regularly attended by programme managers, the accounting officer and the Member of the Executive Council (MEC) in charge of the department.
- Audit intervention plans crafted annually to rectify negative audit findings which is monitored by a special committee reporting to the accounting officer. These plans hold specific individual senior managers accountable for resolving negative audit findings and ensuring that they are not repeated.
- The Department of Social Development and Special Programmes was the only entity identified as the 'success story' of financial management

in the Eastern Cape. This can be attributed to the existence of a competent and committed head of department supported by a management team which embraces a leadership tone depicting a willingness to accept accountability for financial management throughout the financial year. This creates a control environment that is conducive to accountability and oversight, and decisive action plans with clear time frames to address the root causes of previous year audit qualifications. As a result, even though the department did not move in terms of their audit opinion (unqualified with findings), significant strides were made in reducing noncompliance by almost 70%, and had no material adjustments made to the financial statements and made good progress towards a clean audit (Auditor General, 2011.12)

5.4 Chapter summary

In this chapter the researcher presented evidence of the case study. This was presented on a question-by-question basis followed by responses to those questions supplemented by relevant information from the literature review in Chapters 2 and 3 of this study.

The chapter also looked at the analysis and summary of the evidence in line with the primary and secondary objectives of the study detailed in Chapter 1.

In the next chapter, the researcher will draw conclusions from the analysis as it relates to the objectives of the study, make recommendations and propose the need for further research on the subject matter if necessary.

CHAPTER 6: CONCLUSION AND RECOMMENDATIONS

6.1 Introduction

In the previous chapter the researcher gave a detailed account of the results of the research findings. In this chapter a summary of the results conducted on audit committee effectiveness in an Eastern Cape provincial department will be given.

An attempt will be made to explain the extent to which the findings answer the main problem and sub problems of this research.

Finally the limitations and challenges encountered in this research work, as well as suggestions for improvement in audit committee effectiveness will be discussed.

6.2 Summary of research

The current study investigated the role of an effective audit committee in assisting management to improve financial management and audit outcomes in an Eastern Cape provincial department.

To achieve this main objective, the following sub problems were develop which formed the basis of the empirical study conducted:

- How effectively does the audit committee perform the function of reviewing the effectiveness of internal control system and the internal audit function to determine whether risks identified are the basis of internal audit plans?
- To what extent is the audit committee independent and how far are members competent, financially illiterate, adequately resourced and compensated to perform their functions effectively?
- How effective is the planning, monitoring and reporting functions of audit committees in provincial departments?
- Will improving financial management in a department require improvement in audit committee effectiveness only?

- To what extent are the negative outcomes of departments a reflection of ineffectiveness of audit committees?
- What other factors impact negatively on financial management in the department?

In attempting to answer these questions two sets of literature review were made. The first was to establish the link between audit committee effectiveness, corporate governance and how it contributes to improved financial management in both private and public sectors of the economy was undertaken.

The second set of literature review was made to understand the public sector environment of the Eastern Cape by studying the history of public sector financial management, the introduction of the PFMA and the current state of financial management and audit committees in Eastern Cape provincial departments was made.

The researcher then conducted an empirical study to measure the contribution of audit committees to effective financial management (or lack thereof) in Eastern Cape provincial departments.

With reference to the problem statement and the sub questions this research paper makes the following findings:

- *How effectively does the audit committee perform the function of reviewing the effectiveness of internal control system and the internal audit function to determine whether risks identified are the basis of internal audit plans?*

Audit committees in the Eastern Cape provincial departments perform this function effectively where leadership and management creates an enabling environment and acts on the recommendations of audit committees. In such departments audit committee is an effective tool which enhances internal controls and improves financial management.

- *To what extent is the audit committee independent in your departments, and how far are members competent, financially illiterate, adequately resourced and compensated to perform their functions effectively?*

In view of the fact that departments comply with the PFMA's prescription of the composition of membership and meeting requirements, provincial departments (under the scrutiny and guidance of Provincial Treasury) have all set up audit committees with members whose competencies, financial illiteracy and adequate resources to perform are not in doubt. In fact the Auditor General in its comments about the effectiveness of audit committees did not indicate lack of independence, competency and resources of members to perform effectively.

- *To what extent is the negative outcomes of departments a reflection of ineffectiveness of audit committees?*

The study indicates an overall ineffectiveness of audit committees in the Eastern Cape (i.e. only 8% in the 2011-12 financial year). It however identifies contributory factors to this ineffectiveness of audit committees, including lack of competent and committed leadership, lack of understanding of the PFMA and supply chain management prescripts and the fact that government business is disrupted by long hours spent in meetings instead of implementing plans.

- *What other factors impact negatively on financial management provincial departments?*
 - There is lack of stability in accounting officer and chief financial officer positions. This impacts negatively on the ability for accounting officers to strategically plan and execute projects over a reasonably long period of time.
 - Senior management have not been held accountable for persistent negative audit outcomes in departments.

6.3 Conclusions from the research

From the analysis of responses to interview questions and literature review during the research process, the researcher has made the following conclusions:

In Eastern Cape, audit committees have been set up in all provincial departments under the supervision and guidelines issued by Provincial Treasury and in line with Section 77 of the PFMA. This lays down a firm

foundation for audit committees to operate effectively as independent corporate governance tools for good financial management.

These committees are however effective only to the extent to which leadership and management of these departments creates an enabling environment to support and utilize them for such a purpose.

In essence, negative audit outcomes in the province are symptoms of weak financial management in departments where audit committees are not effectively utilized to assist management to institutionalize accountability.

6.4 Recommendations based on the research

To improve audit committee effectiveness in provincial departments, the following suggestions are made:

- Political leadership should ensure that there is stable leadership in departments, especially in the positions of accounting officer and chief financial officer and attract skilled and competent individuals to occupy all senior management positions.
- Accounting officers should demonstrate that they are committed to good financial management through a hands-on leadership style where members of the management team are held accountable for effectively managing their financial resources.
- Audit committees should be composed of competent and experienced members with diverse qualifications. Members of these committees must be to perform their corporate governance responsibilities with the support of top management. They should be judged by their ability to implement the recommendations proposed by the committee.
- A concerted effort should be made to ensure that financial management practitioners are guided by sufficient knowledge and understanding of all

the relevant prescripts that underlie the Public Finance Management Act (PFMA), Treasury Regulations and Supply Chain Management practices.

- Provincial Treasury should work with provincial departments to strengthen internal audit units. All positions in these units must be filled by qualified and competent officials. This will enhance internal controls and enable the Auditor General to then rely on the reports of internal audit to ensure that positive audit outcomes are achieved.

6.5 Challenges and limitations of the study

The objective of the study has been adequately achieved through a case study driven by a qualitative approach. Out of fourteen provincial departments, officials interviewed were selected from only three. Time constraint did not allow for the selection of a larger sample of departments.

It is the opinion of the researcher that even though the departments selected adequately represent the different departmental clusters, value would have been added if officials had had a chance to select from many more departments, and from other levels of government, including public entities and municipalities.

It can be assumed though that the recommendations made in this study are applicable across the board and all levels of government in the province.

6.6 Opportunities for further research

This study has provided a springboard for further research into the use of corporate governance tools, like an audit committee, to strengthen financial management and accountability in the public sector with specific reference to Eastern Cape provincial departments. Any future research work in this area should consider broadening the scope to include:

- the effectiveness of internal audit and internal controls in the provincial departments in the Eastern Cape.
- the impact that political interference in the appointment of senior officials in all spheres of government has on strengthening financial management and accountability in the public sector.

- The effectiveness of using the legislative arm of the state to enforce accountability in the public sector in order to improve financial management in all spheres of government.

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APPENDIXES

Appendix 1 : Letters requesting officials to participate in interviews

Isaac Koranteng
Eastern Cape Provincial Treasury
Bhisho, Eastern Cape

28 August 2013,

The Accounting Officer & Head of Department
Department of Economic Development & Environmental Affairs
Bhisho

Dear Sir/Madam,

PERMISSION TO CONDUCT RESEARCH FOR THE PURPOSE OF ACADEMIC STUDIES

I hereby ask for permission to conduct research interviews in your department.

In fulfilment of the requirements of a master's degree in Business Administration (MBA), I am required to conduct research within my work environment. My research paper is titled, "*Audit Committee effectiveness in the public sector – An Eastern Cape provincial department perspective*". The main objective of the study is to analyse the effectiveness of audit committees in provincial departments and how they can be made more effective to improve financial management in the province.

Officials to be selected and interviewed include:

- The Chief Financial Officer
- The Chief Audit Executive
- A selected number of Audit Committee members, and
- A selected number of programme and sub-programme managers directly involved with financial management and internal audit processes.

I hereby declare that any information collected (through interviews and questionnaires) will be used solely for the purpose of completing this academic research paper and the names of all respondents will not be published and handled with sensitivity and confidentiality.

I hope my request will be gladly accepted.

Kind Regards



Isaac Koranteng (Researcher)

Contacts: Cell- 0795036197: Office- 0406094910: email: ikoranteng@gmail.com

Appendix 2: Cover letter explaining purpose of research work & interviews

28 August 2013

To: All participants/Respondents
Office of the Premier (Eastern Cape)
Bhisho,

Dear Sir/Madam

LETTER TO GUARANTEE CONFIDENTIALITY AND ANONYMITY

This letter serves to guarantee the confidentiality and anonymity of the respondents. As a participant or respondent in this study the information provided will be treated strictly confidential for the purpose of this study only and your identity will also be not be known in your response. To ensure anonymity the names of all respondents will not be recorded or required anywhere in the questionnaire.

Though the research report will in future be published, it would only include tables, graphs, figures, percentages and facts obtained from analysing and interpreting the responses to the completed questionnaires. As a researcher I reassure you that your name will not be identified in the research report.

I therefore urge you assist by fully participating and completing the questionnaire frankly without any reservations. The research report is not conducted for the purpose of any monetary gain and as such participants will not receive any financial benefit but will be contributing to a good course.

Yours sincerely



I. Koranteng (Researcher)

(Contacts: Cell- 0795036197: Office- 0406094910: email: ikoranteng@gmail.com)