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consulting

24 March 2014

Dr Andrew Southcott MP
Chair
Joint Standing Committee of Public Accounts and Audit
PARLIAMENT HOUSE ACT 2600

Dear Dr Southcott MP

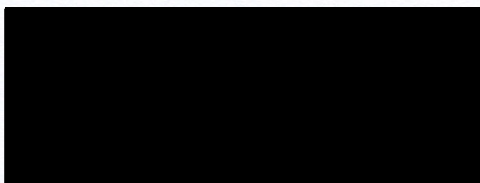
Re: Inquiry into PGPA 2013 Rules Development

Please find attached my submission addressing Part 2-3 Rule 17 on Audit Committee for Commonwealth entities.

Could you please note that I am required to be in Perth, Western Australia on 7 April 2014 for activities associated with the Senate Election on 5 April 2014 and would not be available to attend the Inquiry in person.



Jenny Morison
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**JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT
INQUIRY INTO THE PUBLIC GOVERNANCE, PERFORMANCE AND
ACCOUNTABILITY ACT 2013 RULES DEVELOPMENT**

SUBMISSION

BY

JENNY MORISON FCA

MARCH 2014

Introduction

This submission to the Joint Standing Committee of Public Accounts and Audit's (JCPAA) Inquiry into the *Public Governance, Performance and Accountability Act 2013 (PGPA) Rules Development* focuses on **Part 2-3 Rule 17 Audit Committee for Commonwealth Entities (Audit Committee Rule)**.

I am an experienced independent Chair and Member of Commonwealth audit committees. For over a decade, I have been involved in both *Financial Management Act (FMA)* and *Commonwealth Authorities and Companies Act 1997 (CAC)* entities both large and small. Some of my current FMA appointments include the Department of Human Services, Department of Agriculture, Department of Industry, and Department of Social Services. I hold CAC appointments such as the National Film and Sound Archive, Australian Institute of Teaching and School Leadership, and Australian Institute of Aboriginal and Torres Strait Islander Studies.

This submission provides my views on the Inquiry's Terms of Reference as they relate to the Audit Committee Rule.

1. Purpose of the Rule in the context of the broader Public Management Reform Agenda

I do not believe that Commonwealth audit committees require a specific PGPA Rule. A rule will only minimise flexibility which is not consistent with the broader Public Management Reform Agenda. The requirement to have an audit committee within the PGPA is sufficient.

In my opinion, Commonwealth audit committees are generally well run and adopt charters covering risk management, internal control, financial statements, legislative and policy compliance, internal and external audit, governance, parliamentary reports and performance reporting frameworks. This is supported by a very good ANAO Better Practice Guide on Public Sector Audit Committees.

The entity's accountable authority should be able to structure the audit committee with a charter and membership to meet the specific needs of the entity. Too much specificity in a rule reduces this flexibility and does not take account of the different size, complexity or maturity of organisations.

If we must have a rule, I support **the Functions** of an audit committee as described in the Audit Committee Rule which are brief. I do caution audit committees on the approach adopted by an entity to the *Audit Committee Rule 17- Part 2 (b)* on performance reporting. It is very important that management and boards have clear accountability for achievement of performance and this should not be transferred to audit committees.

2. The development of the Audit Committee Rule and the consultation process

There has been extensive consultation on the development of the Audit Committee Rule by the Department of Finance. I understand that most of the responses to the consultation have revolved around membership of the audit committee. This in my view is a strong reflection of the desire by accountable authorities to have the capacity to construct audit committees with the membership which best suit their requirements. There appears to have been a focus on the use of audit committee members who are 'independent' of management. Whilst current CEOs and Boards recognise the need for independent members on committees (indicated already by the use of such members on most committees) it should be up to the accountable authority to decide if they need

an independent chair and how many independent members are necessary. The rule should not be prescriptive.

I am unsure however, whether the comments made to the Department of Finance during the consultation process have actually been reflected in the proposed Audit Committee Rule. At a meeting of the Commonwealth Chairs of Audit Committees, co-chaired by the ANAO and the Department of Finance on 18 February 2014, the meeting heard that, based on a significant number of comments made during consultation, it was unlikely that the Audit Committee Rule would require a majority of 'independent' members. Yet the proposed Audit Committee Rule now requires a majority of persons who are not officials of the entity (non-corporate entities) or employees (corporate entities).

3. The impact of the Rule

If we must have an Audit Committee Rule, I wish to focus my comments on the Membership of the audit committee at *Sections 17 (3) and (4)*.

Section 17 (3): I agree with this section in regard to a minimum membership of three members. The focus on qualifications, skills, knowledge or experience is important but members must also have the right aptitude and an enquiring mind.

Section 17 (4): A majority of the committee members must be persons who are not officials of the entity - a non-corporate entity.

From my experience this is too prescriptive and not in the spirit of the PGPA. I am not sure what problem we are trying to resolve with this approach, except to cause more expense to government agencies. Comment has been made that the extra members could be sourced from other government agencies on a 'free basis'. I do not believe that open and frank discussion may necessarily take place at an audit committee under such a scenario. There is also a cost at the whole of government level in the use of these resources.

The FMA audit committees of which I am a member, have varying numbers and use independents as members or chairs. Most have at least two independent members. All these audit committees are effective in providing assurance to the Secretary/CEO and suit the circumstances of the entity at a point in time. For example, some committees at the moment are larger than normal to accommodate recent Machinery of Government changes - internal membership will reduce over time.

There is an incorrect assumption that by having a majority of members as independent, the audit committee will necessarily provide independent assurance. This view has some shortcomings including:

- . not all independent members are experienced, forceful and engaged;
- . even a majority of independent members can be ineffective if they are not given the opportunity to brief the entity's accountable authority;
- . to be effective, independent members need to be aware of activity within the agency. For large public sector entities with complex operations and programs it is very difficult to for independent

members to be across the breadth of activities, issues and risks. Senior internal employee members provide a vital link in this regard and are also strong advocates within the agencies for audit committee activity.

Section 17 (4) majority of the members of the audit committee for a corporate Commonwealth entity - be persons who are not employees of the entity.

This part of the Audit Committee rule is not well constructed. *Section 17 (4)* allows in effect, for the audit committee of corporate Commonwealth entities to be comprised entirely of board members. This ignores the inherent conflict that boards are the ultimate decision makers and have overall responsibility for performance of the organisation. To address this conflict audit committees of corporate Commonwealth entities should also have a member/(s) who are truly separate from the board and management.

In my experience there is a lower level of understanding of how Commonwealth CAC audit committees operate than corresponding FMA audit committees. This is in part because board members on the audit committee who are often from industry or corporate environments, do not often understand the government reporting or policy requirements e.g. Commonwealth Procurement Rules. I believe that independent members with a well developed understanding of Commonwealth financial frameworks and policies can bridge the gap and must be a part of corporate Commonwealth audit committees.

In my view, section 17 (4) (b) should read:

The majority of the members of the audit committee must for a corporate Commonwealth entity be persons who are not employees of the entity and include at least one member who is external of the corporate accountable authority.

Whether this is as an independent chair of the audit committee or not should be up to the board. I have undertaken an independent chair role on many occasions and this has been effective in effecting change on these audit committees. However, the decision to appoint an independent chair should be a decision of the board and should not be prescribed in a Rule.

Jenny Morison FCA, FAIM

24 March 2014