



**VICTORIA
UNIVERSITY**

**A NEW
SCHOOL OF
THOUGHT**

**AN ANALYSIS OF THE ROLE AND PERFORMANCE
OF AUDIT COMMITTEES IN THE VICTORIAN
GOVERNMENT PUBLIC SECTOR IN PROVIDING
ASSURANCE AND GOVERNANCE**

**This thesis is presented for the fulfilment of the requirement
of the degree of Doctor of Business Administration**

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ABSTRACT

The purpose of this thesis has been to identify and analyse: the role of audit committees, the attributes of audit committee members, and the functions and activities that they perform in government-funded public sector organisations, focusing on Victorian government organisations. This research determined how audit committees interact with their major stakeholder partners, namely management, internal audit and external audit. The research also identified the characteristics of audit committees that contribute to their successful performance and their sustainability within a governance and assurance framework.

The methodology employed was a survey of major Victorian government departments, local government, a small sample of public agencies, and a federal government department. Respondents were asked to (a) identify indicators of successful audit committees and (b) to identify the status of their audit committees. Information gathered also included a comparative literature review of audit committees and relevant financial management from Australia, United States and United Kingdom.

The research found that in the Victorian government funded public sector organisations sampled an audit committee's role, the attributes of members, and the functions performed in these Victorian government public sector organisations comply with the *Financial Management Act 1994*, *Audit Act 1994* and the comprehensive set of procedures promulgated by the financial management policy-making body of the Victorian government. The analysis of the survey confirmed that in order for a Board and management to achieve good governance an audit committee's role is to confirm internal audit's assurance that internal control systems exist; and financial reports are properly prepared in accordance with accounting principles and standards; and independently audited by professional external auditors.

The functional model that evolved from this research provides a structured approach for achieving assurance that audit committees can meet their oversight function. The data collection instruments that were developed can be applied to benchmark other state governments, local municipal governments, federal government, and public agencies in Australia and overseas.

The practical and significant value of this research is that the research method, statistical analysis and findings provide an original contribution to the use and practices of audit committees in public sector government organisations. It also provides an approach for governments to meet the challenges they face, operating in a complex and changing political and economic environment to mitigate corruption in order to achieve their goals of governance, accountability, and performance.

DOCTOR OF BUSINESS ADMINISTRATION DECLARATION

I, Geoffrey Wong declare that the DBA thesis entitled “*An analysis of the role and performance of audit committees in the Victorian government public sector in providing assurance and governance*” is no more than 65,000 words in length including quotes and exclusive of tables, figures, appendices, bibliography, references and footnotes. This thesis contains no material that has been submitted previously, in whole or in part, for the award of any other academic degree or diploma. Except where otherwise indicated, this thesis is my own work.

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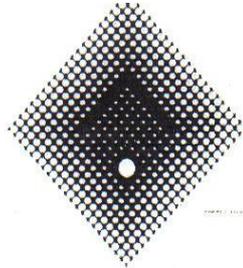
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I am deeply appreciative of all those who have assisted me in accomplishing this journey, particularly to Professor Anona Armstrong and Dr. Peter Demediuk who as my supervisors helped me complete this thesis. For reviewing and advice on the statistical analysis of data collected, I am indebted to Dr. Katrina Simpson. For the idea for this thesis and a review of auditing issues, I wish to thank Dr. David Gowland. To Professor Colin Clark, Professor Geoffrey George, and Professor Naz Islam thanks for the advice and assistance in addressing relevant issues along this journey during the early stages of this thesis. Thanks also to all the course champions that were part of the course content of this professional doctorate and to Dr. Nick Billington for accepting my application.

The journey achieved as a part-time student in preparing this thesis was challenging. There was a need to juggle time - a need to devote the appropriate time to the project. There was also a need to focus and stay within the boundaries of the subject matter researched. For the advice I received to embark on this project and for ideas of solving problems, I wish to thank Professor Colin Clark and Marcia O'Neill. The journey for this thesis involved a quest for knowledge and the need to "play within the rules". There has never been any question about my hunger for knowledge. The major challenge I faced was finding the time as a part-time student to focus on-the-job.

This is my contribution to academic and business literature of a topic in the taxpayer funded public sector - a sector in "business" that is at times given as "a second billing" because most prefer to research organisations that are investor funded. This thesis is my contribution to knowledge of the role, governance, assurance, and performance of audit committees in the public (Government) sector as distinct from the private (Corporations) sector.

VICTORIA UNIVERSITY AWARD FOR THE COURSEWORK COMPONENT OF
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Best Performance - Doctor of
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1. INTRODUCTION

1.1 BACKGROUND

This thesis presents the results of a study that examined audit committees in the taxpayer-funded public sector government public sector. The public sector in the context of this thesis was principally the Victorian State government departments, local government municipalities and public sector agencies (e.g. Water Boards and Universities). A response from a Federal government financial policy making department was obtained to determine a comparative view of the commonly recognised three levels of government in Australia. A survey questionnaire was used to gather data from the sample organisations.

At State government level, Victorian government departments provide a wide range of services to taxpayers funded from Federal government allocations and from State generated revenue including taxes, user pay schemes and fines. The distribution of all these funds must be audited. To gain an appreciation of the materiality transacted in the Victorian government public sector, The Victorian Auditor General's Office (VAGO 2008) reported that including local government the following are aggregate figures for the organisations it audits: Assets \$185 billion, Liabilities \$58 billion, Revenue \$51 billion, and Expenses \$45 billion. At Local government level, funding for basic infrastructure and service needs are provided by the State Government and also from Local Government Councils funds generated income from rates, fines and taxes. Sourced from the Victorian Auditor General (VAGO 2008), local government controls \$47 billion of Assets and annual revenue of \$6.7billion.

Auditing is one of the major governance and assurance mechanisms intended to ensure accountability for the management of these resources. At the most senior levels of the public sector, audit committees are appointed to monitor and facilitate the audit function.

1.2 AIMS

The purpose of this thesis is to find out more about the operation of audit committees in the public sector. The specific aims of this thesis are to:

1. In relation to the audit committee:
 - determine the roles and responsibilities of audit committees in government public sector organisations;
 - determine the attributes of members of audit committees;
 - determine the functions and activities that audit committees perform;
 - determine the relationships between roles, attributes and functions and successful audit committee performance.
2. In relation to critical stakeholder partners, determine the contribution to auditing of management, internal auditors and external auditors.
3. In relation to performance, determine the characteristics of successfully performing audit committees.
4. In relation to the audit committee and critical stakeholder partners develop a model of audit committees together with important stakeholder partners (management, internal audit and external audit) that can guide the future operation of audit committees and also provide a framework for benchmarking audit committee performance across the public sector in Australia and beyond. The Victorian State Services Website (2009) defined a governance framework as the structure upon which to build and develop the strategies that a public entity needs to reach planned objectives and to monitor performance (organisational programs, outputs, outcomes and public value).

5. Audit committee operations have changed over time. Sabia and Goodfellow (2005) identified characteristics peculiar to audit committees distinguishing the old form of audit committee from the new form. Using characteristics Sabia and Goodfellow identified, the present study determines how their audit committees operate at the time of the survey.

This research acknowledges that from the literature, it is generally recognised that an audit committee is responsible for oversight over compliance for governance, assurance and auditing. This research believes that the contribution of stakeholder partners (management, internal auditors and external auditors) give organisations a coordinated approach to enable a successful oversight outcome.

This research was conducted by an empirical survey of Victorian State government departments, Victorian Local government municipalities, from a sample of associated Victorian public agencies and a Federal government department. The criteria for assessment of the audit committees were drawn from the USA (Sarbanes-Oxley Act 2002) and UK (Scottish Government 2008) and best practices by professional bodies (International Federation of Accountants, Institute of Internal Auditors) and the requirements of the Financial Management legislation and its regulatory requirements (Financial Management Act 1994, Audit Act 1994).

1.3 RESEARCH QUESTIONS

Following on from the preceding description of the context of the study, the research questions that are addressed are as follows:

1. What is the actual role of audit committees; the attributes of their members; and the functions (collectively representing activities, procedures, and process) when they operate in government public sector organisations?
2. What relationship and contribution do management (ethical practices, risk management, accountability, records and reports); internal auditors (internal control, risk assessment, evaluating assurance); and external auditors (verifying financial reports, providing assurance to other stakeholders), to assist audit committees to oversee governance (enterprise, corporate and business performance)?
 - 3a. What is success for an audit committee?
 - 3b. What are the characteristics of an audit committee that contribute to its successful performance?
4. What is an appropriate governance framework that enables audit committees to be successful?
5. What is the perceived role of audit committees as perceived by audit committee members?

1.4 CONTRIBUTION TO KNOWLEDGE - Governance, Assurance, Audit and Performance.

This thesis analyses an organisational unit, the audit committee. Created at the highest level of the organisation, it is a sub-committee of the Board or in a government environment, a committee created by legislative or regulatory decree for government departments and agencies accountable to government ministers and the Parliament. According to the authorities and literature the audit committee's major role is the oversight of the governance, and assurance; the soundness of foundations of the financial systems; enabling the integrity of periodic financial results from those systems; and the results of operations and the delivery of goods and services to the stakeholders. These stakeholders are the investors in the private sector and the taxpaying community for the public sector.

The literature suggests the key role of an audit committee is entrusted to perform is its “oversight” function and this involves an oversight of management and administration of the organisation. Audit committees rely on others to provide the financial reports, systems, internal control assurance and independent audit opinion. Auditors are required to perform independent audits and that implies that they need to control financial resources, charged or budgeted in order to engage researchers or consultants; they have to rely on a number of organisational units to support them. The key that an audit committee uses to perform its entrusted role is the information from key stakeholder partners – management, internal audit and external audit.

Scanning the literature on audit committees, the key words that the researcher noted as prominent and identified by authors writing about the role, attribute of members and functions and activities of audit committees were governance and auditing are stakeholders, agency theory, and stewardship:

- Stakeholders in the context of this thesis recognise those who is involved and affected. The word ‘stakeholder’ is used to mean a person or organization that has a legitimate interest in a project or entity. Accordingly it is only when major stakeholders play their part that it can be assured that the oversight function of the audit committee is effectively achieved. In this case, the participants involved in governance and assurance are the audit committee, managers, external and internal audit. It suggests that the relationships between the various stakeholders are a key component in assuring other stakeholders of the possibility of successful performance of an entity.
- The Fraser Institute (2011) defines Agency Theory as a theory of corporate behaviour in which it is recognized that the manager, as agent, may have differing motives from the owner, as principal. Agency theory suggests that there is a problem arising from a conflict of interests between the principals of an organisation (government or the public in this case) and managers that entities such as audit committees are required to ensure the accountability of the managers.

- Stewardship in the context of this thesis maintains that stakeholder interests are maximised by shared values and objectives of both managers and owners (citizens/taxpayers). The stewardship issue questions the Agency Theory noting that the major stakeholders that an audit committee has to interact with are external independent (external auditor), internal (management) and 'deemed' professionally independent but within the employ of the organisation (internal auditors).

The scope of this thesis does not venture into detail examination of the above theories. They point the researcher into asking the questions:

- Who is involved?
- How are loyalties and intent recognised?
- In whose interest do they represent?
- If there are number of "players" involved can their actions be explained?

This thesis contributes to the pioneering empirical research into the accountability and governance of public sector government organisations. It also addresses the environment that ethical governance and performance results are achievable with sanctioned authority (legal), with competent staff performing professional administrative, accounting and auditing procedures, and audit committees in conjunction with major partnership stakeholders of management, internal audit and external audit.

The conceptual framework developed in this thesis provides a model for others to use to identify and benchmark the critical elements of an audit committee (role, members, functions); the major partners and stakeholders that are critical to the fulfilling its oversight duties (management, internal audit, external audit); and the goals of being assured that governance (oversight of legislative compliance, financial reports, public value) is observed.

1.5 OUTLINE OF THE THESIS

This thesis records the activities undertaken in this research:

Chapter 1 - The *Introduction* states the aim, justification and research questions.

Chapter 2 - The *Literature Review* describes literature and previous research relevant to the subject matter being researched. The material is reviewed for relevance, applicability, and a general conceptual framework generated.

Chapter 3 - The *Context* firstly documents incidents that have recognised the consequences of ineffective governance and performance; secondly it examines the changing management philosophy that is evolving; and thirdly it introduces the setting for empirical discovery and analysis for this thesis, the Victorian Government public sector environment. It describes the context of the thesis i.e. the background to the governance policies and practices in the Victorian government. A customised framework of the Victorian Public sector environment has been created. It compares Victoria's financial and audit requirements with those of the Federal government and other Australian States and Territories.

Chapter 4 – The *Conceptual Framework* describes the framework that guided the empirical research conducted in the study.

Chapter 5 presents the *Research Design* adopted to conduct research into the Victorian government public sector. Data were gathered using a structured questionnaire facilitated electronically with the use of a commercial survey package called Survey Monkey. The study also examined the financial management and audit requirements of the Australian Federal government and those of other Australian States and Territories. Audit Committee requirements from the United States of America and the United Kingdom were also investigated.

Chapter 6 - The *Descriptive Analyses of Survey Results* provides a summary of findings from responses received.

Chapter 7 - The *Psychometrics – Reliability & Exploratory Factor Analysis* evaluates the reliability of the data collected for the analysis of the model.

Chapter 8 - The statistical analysis of the conceptual model evaluates the relationships between the key factors that constitute the critical elements of an

audit committee – role, attributes of members and functions and activities undertaken. It also looks at critical relationships essential for audit committees to achieve successful performance.

Chapter 9 - The *Discussion* - This chapter identifies and discusses the research findings and their implications and also assesses the issues associated with using audit committees in a government public sector.

Chapter 10 - The *Conclusion and Recommendations* offers a comprehensive and practically sound conceptual model that attempts to identify all factors that affect the performance of audit committees to provide assurance that governance is observed in government funded organisations that make up the public sector. The chapter recognises the limitations of the research and directions for further study.

1.6 SUMMARY - INTRODUCTION

This chapter provides a background into audit committees, their legislative power, their composition and their functions. It is also recognised that audit committees require the assistance of others in order to operate efficiently and effectively. Being a sub-committee of the Board, its main partners include management, internal audit and external audit. This chapter also documents the aims, research questions, the contribution of this thesis to knowledge, and a brief outline of the context of this thesis.



2. LITERATURE REVIEW

2.1 INTRODUCTION

This chapter is the result of a literature scan for material that addressed audit committees and key words that is associated with audit committees. This chapter identifies and reviews the literature on the role, members and functions of audit committees. This chapter also explores the relationship with the board, management, internal audit and external audit. This chapter recognises that most of the literature relates to audit committees in the private sector environment. The results of material selected is perceived as pertinent to the position of audit committees in the governance structures of the public sector, and research into their role, attributes of members and functions (which in this research refers to the audit committee's activities, procedures, and processes). It also looks at the assessment of the effectiveness of the performance of audit committees, and the relationships of audit committees with those upon whom they rely for information, - the board, managers, internal audit and external audit.

2.2 DEFINITION OF AUDIT COMMITTEES

There are a number of definitions (refer to Table 2.1) for audit committees, each tailored to the environment and structure in which they operate. Table 2.1 displays five definitions of audit committees: the first was developed by the Australian commercial and professional groups; the second defined by a United States professional accounting body; and the next three apply to the Australian government public sector. Definitions of audit committees sourced from

professional bodies, the private sector and the public sector (federal, state and local government) indicate that audit committees are recognised organisational units in both the public and private sectors.

Using a synthesis of definitions from the literature, in this study an audit committee is defined as a subcommittee of the board of directors or its equivalent structure. The defined role is in assisting top management to discharge their responsibilities, assessing risk, achieving governance, obtaining independent assurance and overseeing the financial reporting process. These definitions also highlight the importance of the composition of members (directors, managers and auditors) as well as matters that audit committees address (financial governance, accountability, risks, internal controls, external audit liaison, ethical practices, oversight duties).

Table 2.1 Definitions of an audit committee

- AARF, IIA-Australia, and AICD - Joint Publication *Audit Committees 2002: Best Practice Guide (second edition)* defined “An audit committee is a subcommittee of the Board of an organisation. It provides a forum where directors, managers and auditors together can deal with issues relating to the management of risk and with other governance obligations” (AARF, IIA-Australia, AICD, AARF Joint Publication 2002 :10).
- “An audit committee is a committee of the board of directors responsible for oversight of the financial reporting process, selection of the independent auditor, and receipt of audit results” (AICPA, USA: 2009).
- The Victorian Department of Health website (2010) states “The role of the Audit Committee is to provide independent assurance and assistance to the Secretary on the Department’s risk management and control and compliance frameworks and its external accountability responsibilities”
- The Victorian Mornington Peninsular Municipal Council’s website (2010) states “The purpose of the Audit Committee is to assist Council in the discharge of its responsibilities for financial reporting, maintaining a reliable system of internal controls and fostering the organisation’s ethical development. This Committee consists of two Councillors and three independent community members and does not have delegated authority. Reports are later considered at the next appropriate Council Meeting for a formal decision”
- “The Victorian Government’s Directions of the Minister for Finance places sole discretion to formally delegate financial governance to appointed audit committee for each of the organisations that they fund.” (Victorian Standing Directions for the Minister for Finance 2008: 2.2(c)) “Each Public Sector Agency must, unless an exemption has been obtained, appoint an Audit Committee to oversee and advise the Public Sector Agency on matters of accountability and internal control affecting the operations of the Public Sector Agency. Government Departments are not eligible for an exemption” (Victorian Standing Directions of the Minister for Finance 2008 2.2 (e)).

2.3 THE ROLE OF AN AUDIT COMMITTEE

Research Question1: What is the actual role of audit committees; the attributes of their members; and the functions (collectively representing activities, procedures, and process) when they operate in government public sector organisations?

An audit committee assists the board or a departmental head in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control over financial reporting, the audit process, and the organization's process for monitoring compliance with laws and regulations. To perform its role an audit committee must be established and be empowered with the authority to perform its duties (Standing Directions Minister for Finance (Victoria) 2008).

In the State of Victoria in Australia, government departments and agencies are required to establish audit committees. In Victoria this is addressed by legislation and regulation, specifically in the Standing Directions of the Minister for Finance (Standing Directions Minister for finance (Victoria) 2008) under the Financial Management Act 1994 (Financial Management Act Victoria 1994). The role of the audit committee is documented in a written, authorized and customized charter. Audit committee charters are approved by the board or, in the case of the Victorian Government, compliance with its Standing Directions of the Minister for Finance.

Based on issues raised in this paragraph, the literature suggests the role of an audit committee is to ensure that reliable information about the processes and outcomes of management control and operations and their accountability are conveyed to the board. Therefore, a major issue for audit committees to address is their oversight role. This research seeks to validate this prescription in the perceptions of the role of the audit committee from the perspective of those empowered audit committee members.

2.4 ATTRIBUTES OF AUDIT COMMITTEE MEMBERS

The Canadian Institute of Chartered Accountants (CICA) in a research study of audit committees in Canada recommended the improvement of the quality of committee members. "Committees are only as good as the people on them" (CICA 1981:83). This research also recommended that 'auditors' (all audit committee members regardless of whether or not they are professionally qualified or accredited auditors) should be competent, questioning in a perceptive and effective manner. They must have the time, knowledge, judgement and desire to serve on audit committees (CICA 1981:84).

Krishnan & Lee (2009) examined the determinants of firms' choice of the "audit committee financial experts" for a sample of Fortune 1000 firms. They tested the relationship between the demand for accounting financial experts (AFEs), potential litigation risk, and corporate governance. They found that the firms they researched do not always appoint accounting financial experts (i.e. persons with specialized accounting/ auditing experience) to their audit committees. They found that firms with higher litigation risk are more likely to have accounting financial experts (AFEs) on their audit committee. The association between litigation risk and the likelihood of appointing accounting financial experts occurs for firms with relatively strong governance but not for those with weak governance. Thus, their findings indicated that (1) companies with demand for accounting financial experts, measured by potential litigation risk, seem to be able to secure accounting financial experts, but (2) such benefits only accrue in the presence of otherwise strong corporate governance (Krishnan & Lee 2009:214).

Based on issues raised in this paragraph, the literature recognises that members of audit committees need to possess certain professional and personal attributes and qualities in order to perform their role through functional activities, processes, procedures. This research seeks to determine if such attributes and qualities of audit committees are recognised in the public sector.

2.5 THE FUNCTIONS AND ACTIVITIES OF AN AUDIT COMMITTEE

In the context of this research the role of an audit committee is narrowed to recognise the legal and legislated authority entrusted upon audit committees by way of legislation or the Board's terms of reference. The functions that an audit committee performs include the processes, procedures and activities that audit committees undertake to perform their role. Adams, Grose and Donald (2004) listed a number of these functions which they propose as generic functions that audit committee perform:

- Approving the selection of the external auditor.
- Reviewing the arrangements and scope of audit including reviewing the emphasis of work so that areas considered in need of attention receive it.
- Considering reports from the internal auditor and reviewing management action on them.
- Providing a forum for the board, management, or the auditor to raise matters of concern. Receiving the necessary information from the auditor as required under the International Accounting Standards.
- Reviewing the annual financial statements prior to their approval by the board.
- Coordinating the work of internal audit and external audit.
- Assessing the effectiveness of management information systems.
- Reviewing significant transactions of an extraordinary or abnormal nature.
- Assessing current and potential risks.

A survey by Rezaee, Oibe, and Minmier (2003:530-7) of audit committee disclosures by *Fortune 100* companies discovered that listed companies in USA complied with self-regulatory requirements issued by stock exchanges.

However, despite the fact that the process of fulfilling their oversight function was the major issue in audit committee reports, their survey found that the main focus in an audit committee's reports were a statement of its role, rather than

the process of fulfilling their oversight functions (Rezaee, Oibe and Minmier 2003:535).

Based on issues raised in this paragraph, the activities, processes and procedures are critically important to ensure that audit committees effectively exercise their oversight function.

The factors that appear critical to enable audit committee performance include:

- having clear authority and definition of its role, legal authority, charter, terms of reference and organizational status;
- having audit committee members with the right attributes qualifications and experience ; and
- having the audit committee perform the required oversight functions, processes, activities, procedures and compliance with professional standards.

A key focus in this thesis is to explore the contribution these three factors have on the ability of audit committees to provide effective assurance and so contribute to the effective governance of an organization.

2.6 THE SIGNIFICANCE OF AUDIT COMMITTEE RELATIONSHIPS

Research Question 2: What relationship and contribution do management (ethical practices, risk management, accountability, records and reports); internal auditors (internal control, risk assessment, evaluating assurance); and external auditors (verifying financial reports, providing assurance to other stakeholders), to assist audit committees to oversee governance (enterprise, corporate and business performance)?

Beasley, Carcello, Hermanson, Neal (2009) in their article titled “The Audit Committee Oversight Process”, quoted the NYSE audit committee chair.

“No one really understands how limited an audit committee is in its work. In big companies it is virtually impossible to know what is going on without relying on management, the internal auditor and the external auditor.” (2009:65).

They suggest that it is often challenging to provide effective oversight (Beasley et. al. 2009: 65). Audit committees are a subcommittee of a board of directors. Audit committees are responsible for financial and risk management oversight and are one of several internal governance mechanisms whose function is to assist a board of directors to monitor management performance (ASX 2007).

Best practice governance (OECD 2004) requires Boards to establish boards and audit committees that are independent from management. Independence however is related to composition of the committee. In practice, an audit committee’s network of relationships with organisational units is critical to its successful operation. The OECD definition of governance implies that governance addresses these issues arising from the relationships between those engaged in the entity’s affairs. An audit committee operates within a network of relationships. They are reliant on management, internal audit and external audit to provide the information required to meet their functions of assessment and exercise of control on behalf of their boards

The next sections describe the relationships between audit committees and the governing body; management; internal audit; and external audit.

2.7 AUDIT COMMITTEE’S RELATIONSHIP WITH THE GOVERNING BODY (BOARD OR GOVERNMENT DELEGATE - DEPARTMENTAL HEAD)

This section reviews the relationship of an audit committee with the governing body. In the public sector, there are a number of different structures.

Departments specialising in specific portfolios (Treasury, Environment, Education, Health, etc.) are defined by the Public Administration Act. In public sector departments the Departmental Secretary (Head) is top management, usually supported by an executive group of senior managers. Departmental Secretaries are responsible to financially account to Parliament through their

Minister - an accountability path via Cabinet, to Parliament and the public. In some public agencies created by legislation the Chief Executive Officer is the 'governing body' reportable to a portfolio departmental head or directly to a portfolio Minister.

Some public agencies established by specific legislation under the State Owned Enterprises Act (e.g. Victorian Urban Development Authority, Port of Melbourne Corporation) and others responsible for service deliveries have boards. The responsibilities of the Board include setting and reviewing strategic direction, monitoring organisational performance, appointment of Chief Executive Officers and deciding on key policy positions to take on behalf of directors.

The roles and duties of departments and public sector agencies are specified in their legislation. Financially, they have to prepare financial reports under the Financial Management legislation. The audit committee is accountable for reviewing management's work through the complex collaborative relationship between the board and management.

Typically an audit committee in the private sector is a committee of the board of directors. Directors in the private sector are either executive or non-executive independent members. Audit committee members in private sector organisations are usually independent directors. The audit committee in the public sector, where the governing body do not have a board audit committee, have members appointed and selected by the organisation to provide advice to Departmental Secretaries or boards of directors. For public sector local government municipalities and agencies where councils and boards exist, audit committees report to the Mayor or Chair of those Councils and Boards.

2.8 RELATIONSHIP BETWEEN AUDIT COMMITTEE (PRINCIPAL) AND MANAGEMENT (AGENT)

This section reviews the literature on the relationship of an audit committee with management. Management plays an important role controlling the running of

the business. Management is expected to achieve this through professional and ethical practices and the employment of competent employees or contractors. Audit committees rely on management to supply them with reports and information of how the business is operating.

Management comprises contracted and salaried employees entrusted to run the organization. Management has considerable power in steering an organization towards the goals it plans or is hoping to achieve. Management ensures that business activities are performed and controlled. Management plans and initiates activities and administratively capture the transactions that are periodically summarized into reports to inform interested stakeholders including the board or government who represent either shareholders or the public citizens. Management has considerable power in shaping disclosure in financial reports.

Boards are supposed to operate independent of management. However, because of the power of management, independent directors are appointed to make managers accountable. As well as that, conflict of interest may arise when members have undue personal or vested influence over business contracts. For example, it has been noted that managers who have been recruited from professional firms that are supposed to provide independent audits may find it difficult to objectively provide an opinion on solutions provided by the consulting wing of the same organization. In the case of Enron, an organization which failed, it has been questioned that false accounting and conflict of interests existed when independent directors appointed were former auditors or management consultants (Swartz 2003:4).

Audit Committees are supposed to reflect and take an independent and objective approach. As issues such as conflict of interest, greed, falsifying accounts, and fraud are slowly being identified, corrective action is put in place to address the weakness in the ability to manipulate accounts identified in these private sector incidents. Thus the impression is created that an audit committees is a 'Band-Aid' measure responding to those issues. Accountability and transparency is important, in the public sector where a Code of Conduct

should be promoted to all staff. In the public sector the Chief Executive Officers/Departmental Secretaries and Chief Financial Officers are not allowed to be members of their Audit Committee (Directions 2.2 2008). Departmental Secretaries, Chief Executive Officers (CEO) and Chief Financial Officers (CFO) have considerable influence over what is presented to the audit committee because they can decide what is reported. Audit committees want much from CFOs. Characteristics topping the list include integrity, honesty, knowledge of the business and industry and guts. Most of all, they want the CFO to communicate - the good news, bad news or in between (Heffes 2010).

2.9 RELATIONSHIP BETWEEN AUDIT COMMITTEE AND INTERNAL AUDIT

2.9.1 The nature of internal audit

This section reviews the literature on the relationship of an audit committee with internal audit.

Audit committees are expected to meet a minimum of twice each financial year. In order to function as an audit committee they would require reliable analysis of the internal control systems in place. Reports from internal auditors can provide audit committees with assurance that internal control practices are being evaluated to ensure that they exist and are tested. These assignments are usually conducted on a risk basis by internal auditors, as follows:

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes." (International Professional Practices Framework (IPPF) 2009).

Internal auditors provide professional help for an organisation to accomplish its objectives by bringing a systematic, disciplined (professionally independent) approach to evaluate and improve the effectiveness of risk management,

control, and governance process (IIA Professional Practices Framework, Definition of Internal Auditing, cited by Standards Australia HB158-2006:9).

The Institute of Internal Auditors Standards are categorised into performance and attribute standards. These standards are requirements that internal auditors must abide by when performing a broad range of internal audit activities, and for evaluating if internal audit performance is of a professional standard to provide objective assurance of assignments conducted

An organisation's performance goals can be documented as key performance indicators, profits, outputs and outcomes. Internal auditors address the systems and operations elements of performance, namely efficiency, economy and effectiveness. Efficiency is the way the activity is being performed, economy involves assessment of the use of resources to achieve value for money, and effectiveness is assessing whether goals, objectives, outputs and outcomes are achieved. However, internal auditors seldom challenge management policy decisions, unless they are incorrect or unethical, because the role of internal audit is to assist management achieve performance goals.

2.9.2 Audit Committee relationship with Internal Audit

Governance implies oversight, not management. The Internal Audit (IA) function provides the board and management with a level of independent overview of how the organization and management is being run. For example internal audit information provides governance thus ensuring stakeholder confidence that information system's risk is managed pragmatically, appropriately, and in a cost-effective manner (IIA 2005:1). The Institute of Internal Auditors (IIA) advises its members that in the interest of clear segregation of duties, governance should be clearly understood by the audit committee. Audit committees that seek to interfere with management prerogatives are courting two hazards. Firstly, they are taking on more than they can handle and secondly they are relieving management from responsibilities. Audit committees try to find an appropriate balance between overseeing and advising management, while avoiding micromanaging, whilst monitoring compliance with laws and

regulations and codes of conduct, and overseeing risk management (Bromilow & Berlin 2005:ix).

The Institute of Internal Auditors (IIA 2010) has long been a proponent of the value of audit committees and has published a position statement on audit committee titled *Internal Auditing and the Audit Committee: Working Together toward Common Goals*. The IIA after examining the professional literature of the AICPA, interviewing audit directors, studying SEC legal activities, and examining related projects by public accountants, concluded that audit committees play a critical role in detecting and reporting fraud, and recommended that public-held companies establish and maintain audit committees comprising outside directors with financial and/or business background (IIA 2010). The importance of the role played by the audit committee is a central focus of the IIA Standards for the Professional Practice of Internal Auditing (SPPIA), Statements of Internal Auditing Standards (SIAS) and the Professional Standards Bulletins (PSB) (IIA Professional Practice Framework 2010).

In 1985, the IIA issued the Position Statement on Audit Committees and recommended that every publicly listed company (private sector) has an audit committee organized as a standing committee of the board of directors. Stock Exchanges like the Australian Securities Exchange Listing Rules (ASX Listing Rule 4.10.2) made it a requirement for their listed companies to have audit committees. The Institute of Internal Auditors also encouraged the establishment of audit committees in other organizations, including not-for-profit and government bodies (Vanasco 1994:1).

Internal auditors provide audit committees with valuable information from their performance of internal audit assignments. Their scope of activities includes financial, operations and information technology. Their audits are enhanced by applying computer aided techniques. This allows them to perform continuous audit. With the use of these techniques they have been able to provide management with more intelligent monitoring processes, improving supervision of processes and transactions reporting by exception any unusual transactions

and highlighting them for further investigation. Internal auditors compliment the work of the external auditors. Relationships between internal audit and audit committees exist in order to foster competence, corporate culture and positive thinking. Internal auditors also seek to influence the role of the audit committee and ensure maximum effect in respect of good corporate management and control (Cooper 1993). Internal auditors assist in independently testing internal control systems and thus provide the audit committee with assurance that internal control systems exist and if complied efficiently would help audit committees achieve their oversight duties.

The next section expands on the notion of internal audit providing assurance to audit committees. Professionally, internal auditors provide the organisation with independent assessments and assurances services. Assurance is *“A process that provides confidence that planned objectives will be achieved within an acceptable degree of residual risk”* (Standards Australia HB 158 2006:6).

Assurance involves the professional independent service of testing, evaluating and providing a positive or negative opinion on the performance of systems, assets, reports and reported results in organisations.

Power (1997:20) discusses systems based audits and the problem of defining the scope of the internal control system relevant to financial audit. A system addresses the whole set of activities of converting inputs through to outputs. Auditors normally segregate the activities into financial and performance activities. External auditors focus mainly on verifying results and balances reported in financial reports. This is what they term as conducting an ‘attest audit’. Hay (Hay 1993) noted that official definitions of internal control have varied over time. Internal control applies to important checkpoints for both financial and performance activities. Thus the scope and boundaries to consider if systems based audit is performed can be narrowed to purely financial activities or can include operational performance activities of the system.

It is noted that much of the published material on audit committees, especially those from accounting firms, is the provision of practical as opposed to theoretical arguments (SOX 2002, Victorian Standing Directions of the Minister

for Finance 2008, Australian Accounting Research Foundation et.al. 2001, PWC (2003), Deloitte & Touche 2003, Auditor General Alberta 2003, and AICPA 2005).

Audit committees provide an oversight to the auditing and assurance function. Auditing and assurance assignments are a series of procedures, methods and techniques. This is an observation on audit procedures. There is theoretical basis for auditing and assurance, although some argued that auditing is completely practical (Mautz & Sharaf 1977:1). Mautz and Sharaf argue that generally there is an applied discipline, and meeting the market test was a significant requirement. Theorists, generally academics argued differently. Theorists base their arguments on carefully constructed rationales and reasoned to conclusions that are sometimes substantially different from activities and responsibilities on the part of practicing accountants and auditors. However when applied in practice, these arguments (e.g. principles verses rules based legislation) influence practice.

Auditors in the performance of their professional duties identify a number of basic assumptions (assertions) and a body of integrated ideas, the understanding of which will be of direct assistance in the development and practice of the art of auditing. At the present time auditing and assurance assignments are plagued by a number of problems involving a number of issues. For example, are the customary rituals of audit committee meetings sufficient to justify proper oversight of audit and assurance activities in an organization? Another example of auditing issues is: what testing is sufficient to justify an opinion. This involves issues regarding sampling, statistical testing, probabilities versus judgement of an experienced practitioner, laws of inference and probability theory and audit independence.

The next section expands on the notion of external audit providing audit services (financial reports attest audits, performance and assurance assignments) to audit committees.

2.10 RELATIONSHIP BETWEEN AUDIT COMMITTEE AND EXTERNAL AUDIT

Audit committees gain valuable information from audit engagements to attest to financial reports of an organisation. For public sector government organisations, legislation gives the Auditor-Generals the right to conduct performance audits on issues of public interest.

2.10.1 The nature of external auditing

External audit is defined as:

“The examination by an independent third party of the financial statements of an organisation, resulting in the publication of an independent opinion whether or not, in all material respects, the financial report is presented fairly in accordance with Accounting Standards and, when appropriate, relevant statutory and other requirements” (AARF 2002 AUS 702 also cited by Standards Australia HB 158-2006:8).

Attest and performance audit assignments performed by professionally qualified personnel, conducted under professional and legislative authority, objectively, and with the independence to report objectively without the fear of conflict, provide all stakeholders related to an organisation with the reassurance that organisations are operating as they should. Audits should be performed by competent internal as well as external auditors. Certified Internal auditors are professionally supported by the International Institute of Internal Auditors (2010) and external auditors with professional bodies, in the case of Australia, the Institute of Chartered Accountants (CA), CPA Australia and the Institute of Public Accountants (IPA). The focus of the different perspectives of the internal and external audit complements rather than duplicate the audit and assurance process.

Under s.8 of the Audit Act (Victoria) 1994, the Victorian Auditor-General is responsible, on behalf of Parliament, for the external audit of the financial operations and resource management of the Victorian public sector.

Accordingly, the primary role of the Auditor-General is to provide information/audit assurance to the Parliament – independently of public sector agencies and the government.

The role of external auditors is to conduct independent financial audits of financial reports of a client organisation. Being independent means being a legal entity separate from the client organisation. It also means not being involved in paid consultancy engagements regarding the client's operations. External auditors audit private as well public sector organisations, be they companies, government, individual, organisation with a legal identity. External auditors provide auditing as well as assurance services. The difference between assurance assignments and external audit assignments is that external audits are highly structured and highly regulated and assurance assignments are negotiated to the level of conformance that is required. Members who conduct financial audits are required to be professionally qualified, professionally accredited, and experienced to conduct the audits. The functions, activities, and processes adopted by external auditors are either generally accepted standards or standards approved under statute.

2.10.2 Audit Committee relationship with External Audit

Audit committees must be confident that financial reports are presented as a true and fair report of the results over a period and the asset and liability balances are reported correctly and accurately. Audit committees are best suited to liaise with the external auditors to ensure that professional service is delivered.

External auditors professionally testing and verifying the results in accordance with the auditing standards provide an independent opinion on the financial reports. Audit committees (private or public sector) liaise with their external auditors. Private sector audit committees may be involved in the selection and engagement, including audit fee negotiations) as well as liaising with the external auditors. This activity is not applicable for public sector audit committees because the Government Auditor General is appointed auditor by legislation.

From the definition documented in the Glossary of this thesis, audit is “an independent, professional service that provides high level assurance through the application of procedures for the expression of opinion on management’s representation of their financial reports” (Australian Accounting Standards). Procedures are aimed at proving through the expression of an opinion on the assertions including presentation and disclosure of financial reports; completeness of the financial reports; correct valuation of assets, liabilities, revenue, expenditure and equity; right and obligations; and existence of transactions, assets and liabilities. Auditing is a critical component of modernist conceptions of accountability since it legislates the information on which formal, financial accountability rests (Power 1997).

External auditors conduct financial report audits in order to express an opinion on their truth and fairness. In order to do this, they assess the reliability of information systems (financial and operational) by conducting attestation of results and balances reported in the financial reports. They conduct regulatory audits which are compliance and governance audits. They have legislative power to perform performance audits. Performance audits are conducted on topical issues that affect public sector accountability.

2.11 THE PERFORMANCE OF AUDIT COMMITTEES

Research Question 3a: What is success for an audit committee?

Research Question 3b: What are the characteristics of an audit committee that contribute to its successful performance?

Spira (2002) interviewed audit committee chairs, finance directors and auditors in the United Kingdom between 1994 -1996. Spira proposes that audit committees were ceremonial by nature, providing comfort regarding financial reporting. Spira (2002) uses Actor Network Theory (ANT) to illustrate the role and activities of the audit committee. Spira explains that Actor Network Theory is a theory which sees the world as a series of networks and this theory emphasizes the role of the performers, the actors, who sustain these networks

(Spira 2002:56). An audit committee is only a part of many wider networks. Many professional bodies doubt whether audit committees can really ensure the integrity of a firm's financial statements because, as outsiders, audit committee members do not know enough to dig deeply beneath the numbers. Spira argues that such criticism overlooks the ceremonial function that audit committees play. The audit committee is an arena where members can form and strengthen shifting and fragmented networks with each other and with the external auditors. Within these networks, both consensus and independence are demonstrated, generating comfort, which legitimises the company and maintains its access to external sources of capital. The context of Spira's work is Britain's private sector environment and is a response to the Cadbury Committee's recommendations. Spira recognises that the audit committee is a key part of the corporate governance structure within an organisation. This thesis will not pursue this line of thought as it is outside the scope of the thesis.

An audit committee acts on behalf of the board to assess information provided by management and both internal and external auditors. An internal audit is appointed to undertake independent assurance assignments on risks and evaluate the internal control features of business systems, which include financial systems (IIA Australia 2003:12, Standing Directions of the Minister for Finance (Victoria) 2008). For Australian corporations and government public sector organisations, external auditors are required by legislation to audit and provide an independent opinion on the truth and fairness of financial reports that management has prepared (Corporations Act 2001:s307, Audit Act 1994 (Victoria):s8, Audit Act 1997 (Federal):s11-13).

There may be other sources of information like "whistle blowers" or the Press that could provide information on unusual organisational activities but these sources are outside the scope of this research.

The Blue Ribbon Committee (BRC 1999) regulating US corporate environment suggested that three important issues should be addressed in order to successfully improve the performance of a Corporate Audit Committee: (i) effectiveness, (ii) accountability, (iii) independence.

(i) In terms of the issue of effectiveness, DeZoort & Salterio (2001) found that, in the case of auditor-management disputes, the independent members of an audit committee and the level of members' auditing knowledge were positively associated with support for the auditor, thus assuring that financial disclosure would be in compliance with standards. Effectiveness is also associated with the appointment of audit committee members who are financially literate. Regarding financial expertise, Davidson, Xie & Xu (2004) found that auditing and audit firm experience is more important than corporate financial management and financial statement experience because auditors are required to verify what management has prepared. Verifying and evaluating presented financial reports against accounting standards by applying procedures specified in auditing standards provides that additional assurance.

(ii) On the issue of accountability, the Blue Ribbon Committee (BRC) refers to the relationship between the audit committee, the external auditors, internal auditors and management. Accountability for the audit committee, the external auditor, the internal auditor, and management means performing the role that each is empowered to contribute, working through people with the right skills, qualifications, who proficiently apply their professional activities, procedures as per professional standards required within the environment (human, mechanical or electronic) that business is conducted. An audit committee's oversight role involves its review and reporting on management's production of financial reports and its consideration of the opinion of the external auditor. The audit committee should ensure that management provides the proper quality of information supplied and compliance with accounting principles captured and summarised through reliable systems which have been assessed in accordance with an internal audit review program.

(iii) With regard to the issue of independence, independent members in the audit committee, having an independent external auditor, and having a professionally recognised internal audit function that can conduct internal audit evaluation of operating systems enables a functional environment to be created.

Abbott, Park and Parker (2000:58-65) found that firms, in which independent directors in audit committees that meet at least twice per year, were less likely to be associated with both fraudulent and misleading reporting. A study by Krishnan (2005:649-76) suggests that an independent audit committee decreases the incidence of internal control problems.

The Blue Ribbon Committee's (BRC 1999:37-44) guiding principles on effectiveness relate to the issue of independence, diligence and knowledge of audit committee members. Diligence is defined as the willingness of committee members to work as a team in the context of a "three legged-stool" relationship between board of directors (including the audit committee), financial management (including the internal auditors) and the external auditors. Akin to the best practice suggested by the Blue Ribbon Committee, DeZoort et.al. (2002) proposed four determinants of audit committee effectiveness namely authority, composition, resources and diligence. The issues addressed by DeZoort in relation to composition and diligence relates well with the Blue Ribbon Committee's recommendations that an audit committee should be independent, financially literate, have integrity and have objectivity. On the issue of resources required to perform a successful audit committee, DeZoort et.al. (2002) commented on the importance of the size of the audit committee. They considered that an audit committee of between three and six members is considered suitable.

An effectively performing audit committee has the authority, competent audit committee members and resources, required to protect stakeholder interests by ensuring reliable financial reporting, internal controls, and risk management through its diligent oversight efforts (DeZoort et.al. 2002:41). There are increased concerns about corporate governance and the quality of financial reporting. Analysing and summarising reviews conducted of audit committees DeZoort et.al. (2002:41) categorised four factors that contribute to effective audit committee performance. Audit Committee effectiveness considered under their four dimensions include:

- Authority – responsibilities, influence;
- Resources – adequate number of members, access to stakeholders;
- Composition – expertise, independence, integrity, objectivity;
- Diligence – incentive, motivation, perseverance (DeZoort et.al 2002:42).

Agrawal and Knober (1996) examined a range of governance variables within a simultaneous regression framework and found that the proportion of the number of outside directors on company boards is the only governance mechanism which consistently affects corporate value, suggesting the value and contribution of independent members of a board (ultimately independent audit committee members). Fama and Jensen (1983) argued that effective corporate boards must be composed largely of outside independent directors holding managerial positions in other companies. They argued that effective boards have to separate the problems of decision management and controlling the making of decisions. They further stated that the Chief Executive Officer (CEO) if allowed to dominate the board, thus overcoming separation of these functions and the oversight freedom of the audit committee would have a negative effect, and shareholders would suffer as a result. Outside directors, they contend, are more able to separate these functions and exercise decision controls, since reputational concerns, and perhaps any equity stakes, provide them with sufficient incentive to do so.

In a thesis on the determinants of audit committee effective performance, Wayne (2003) developed a four sector framework that documented an understanding of audit committee effectiveness. Given that a major role of the audit committee is to ensure the integrity of financial reporting, the four sectors they suggested that identify Committee's level of effectiveness are:

1. Paralyzed - where an audit committee cannot be effective.
2. Institutionalised - where an audit committee must be able to trust and confer legitimacy symbolically.
3. Agency – where an audit committee must have and use technical resources to substantively ensure that trust exists.

4. Professional – where an audit committee must be able to trust, have and use technical resources to perform substantive oversight (e.g. verified assurance).

Wayne noted the role of the audit committee was to ensure integrity of financial reporting and for each of the four types of audit committees.

The range of indicators (Wayne 2003:83) for identifying audit committee effectiveness included:

1. Paralyse Audit Committee: Symbolic in nature; cannot trust managers, thus must be proven; cannot trust internal and external auditors, thus must be proven; Management is opportunistic; Symbolic oversight is not sufficient; Substantive tasks are performed by others; the audit committee has no technical resources; symbolic oversight, but evidence is needed, none is available; presumed lack of integrity of financial reporting.
2. Institutional Audit Committee: Symbolic in nature; Implicit trust in managers; Implicit trust in internal and external auditors; Management is not optimistic; Symbolic oversight is sufficient; Substantive tasks are performed by others; The audit committee has no technical skills; Symbolic oversight, evidence is not needed; Presumed integrity of financial reporting.
3. Agency Audit Committee: Technical in nature; Cannot implicitly trust managers thus must have evidence; Cannot implicitly trust internal and external auditors thus must have evidence; Management is opportunistic; Substantive oversight is not sufficient; Substantive tasks are performed by the audit committee; Audit committee must have technical resources; Substantive gathering of evidence; Presumed lack of integrity of financial reporting.
4. Professional Audit Committee: Technical in nature; Implicit trust in management; Implicit trust in external and internal auditors; Management is not opportunistic; Substantive oversight of all professionals is the duty

of the audit committee; Substantive tasks are performed by the audit committee; Audit committee must have technical resources; Substantive oversight used to discharge professional duty of audit committee; Presumed integrity of financial reporting.

Wayne focused heavily on the audit committee with less emphasis on the contribution of others like the Board, Chief Executive Officer, Chief Finance Officer, internal audit and external audit to achieve its oversight responsibility. Focusing solely on the audit committee, Wayne's model highlights the different levels of contribution of these stakeholder partners.

Turley and Zaman (2004, 2007) addressed the informal processes of group dynamics and on power relationships among governance participants. Turley and Zaman's research involved investigating by way of a case study the charter, structure, members and processes of audit committee operating as an organisational unit. They found that power relationships of audit committee members (e.g. arguing different accounting treatment of transactions on issues of disclosure) and the informal voluntary networks between audit committee members, set the attitude towards governance (e.g. agency theory, differences between principal and agent; plus differences in goals between management and external auditors). They also noted that informal structures and processes have a significant effect on audit committee effectiveness.

2.12 THE AUDIT COMMITTEE AND GOVERNANCE

Research Question 4: What is an appropriate governance framework that enables audit committees to be successful?

Agency theory suggests that an agency problem occurs because of the separation of the ownership (the principals) and control (represented by management) (Clarke 2004). In these circumstances the interests of shareholders (represented by the board) may conflict with those of management. Governance principles and guidelines recommend audit committees as one means of addressing this problem and assuring the

accountability of management to the shareholders on safeguarding the integrity in financial reports (ASX 2007:25).

Viewed from an Agency theory perspective, the audit committee is another governance mechanism that can be used to align the interests of managers and shareholders (Armstrong, Jia, & Totikidis, 2005). In the United States of America the Sarbanes-Oxley Act 2002 specified that the listed companies under their jurisdiction must have an audit committee comprising a majority of independent (non-executive) directors. Similarly in Australia, ASIC's Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure Act 2004 CLERP 9) changes to the Corporations Act 2001 and the Australian Securities Exchange Corporate Governance Council ASX, (2003), have specified that the top listed companies under their jurisdiction have an audit committee comprising a majority of independent (non-executive) directors. Their main purpose is to enable transparency and accountability in the reporting of company information and to assure shareholders of its reliability as a 'true and fair' view of a company's financial performance.

The Victorian government legislated and provided instructions (Financial Management Act 1994 & Standing Directions of the Minister for Finance) that must be followed to enable transparency and accountability of budgeted government funding and the annual reporting requirements to assure Parliament and ultimately its citizens and taxpayers of its reliability. Its financial performance is 'presented fairly' in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the financial reporting requirements of the Financial Management Act 1994.

The Organisation for Economic Co-operation and Development (OECD 2004) documented a set of standards of governance for developed countries that promote transparency and efficient markets, consistent rule of law, and clearly articulate the division of responsibilities on supervisory, regulatory and enforcement authorities. The OECD defines corporate governance as:

... The system by which entities are directed and controlled. Corporate governance addresses the issues arising from the interrelationships between boards of directors, such as interaction with senior management, and relationships with the owners and others interested in the affairs of the entity, including regulators, auditors, creditors, debt financiers and analysts (OECD 2004:17).

In the United Kingdom, the Independent Commission on Good Governance in Public Service (2004) - an organisation established by the Office for Public Management (OPM) and the Chartered Institute of Public Finance and Accountancy (CIPFA) in partnership with the Joseph Rowntree Foundation - has developed a common code and set of principles for good governance. Its publication *The Good Governance Standard for Public Services* provides six good governance principles (The Independent Commission for Good Governance 2004) which summarise their lessons on governance as follows:

1. Governance focuses on the organisation's purpose and on outcomes for citizens and service users. This means being clear about the organisation's purpose and its intended outcomes; making sure that users receive high quality service; and assuring that taxpayers receive value for money.
2. Governance means performing effectively in clearly defined functions and roles. This means being clear about the functions of the governing body, its management responsibilities; and its relationship with the public.
3. Governance is promoting values for the whole organisation and demonstrating the values of good governance through behaviour. This means putting organisational values into practice and exercising behaviour in ways that uphold and exemplify effective governance.
4. Governance is taking informed transparent decisions and managing risks. This means being rigorous and transparent about how decisions are taken, through the use of good quality information, advice and support and making sure that an effective risk management system is in operation.

5. Governance is developing the capacity and capability of the governing body to be effective. This means appointing skilled, knowledgeable and experienced people who sees a need to perform well; developing and evaluating performance of the individual and team; and striking a balance in the membership of the governing body, between continuity and renewal.
6. Governance is engaging stakeholders and making accountability real. This means understanding formal and informal accountability relationships; taking an active and planned approach to dialogue with the public and with staff; and effectively engaging institutional stakeholders (The Independent Commission for Good Governance 2004).

The Institute of Internal Auditors Professional Guidance (IIA 2009) (Figure 2.1) suggests that responsibility for corporate governance is spread among several organizational entities. The cornerstones of effective governance are relationships between the board of directors (the audit committee being a sub-committee of the board or in the case of government departments and agencies the entity to which the committee is responsible is the Departmental Secretary or Chief Executive Officer), executive management, the internal auditors, and the external auditors. The Institute of Internal Auditors illustrates this by suggesting the use of a model (Figure 2.1) to achieve effective governance by identifying the Board, external audit, internal audit and management as critical partners (Figure 2.1).



Figure 2.1 Effective Governance Model (IIA) (Sourced; (<http://www.iaa.org.au/>) accessed 13SEP10).

The Information Systems Audit and Control Association (ISACA 2011) defines enterprise governance as *“the set of responsibilities and practices exercised by the board and executive management with the goal of providing strategic direction, ensuring that objectives are achieved, ascertaining that risks are managed appropriately and verifying that the organisations are used responsibly.”* (ISACA 2011:35).

The International Federation of Accountants (IFAC 2003) proposed a comprehensive definition for governance, calling it enterprise governance. Enterprise governance covers both the corporate governance (legal compliance) and the business management governance (performance) aspects of organisations. It takes into consideration compliance of legal and ethical issues; it also covers strategic and tactical aspects of business performance and sustainability. The emerging term, “enterprise governance” applies itself not only to the private shareholder sector, but also the public taxpayer funded government sector. The emerging term is applicable also to strategic alliances, joint ventures, and generally any organisation. Enterprise governance expands the definition of stakeholders beyond shareholders to cover employees, and society. The International Federation of Accountants recognises that

governance of the whole organisation can be better referred to as enterprise governance. Enterprise governance is defined as the organisation's entire accountability framework

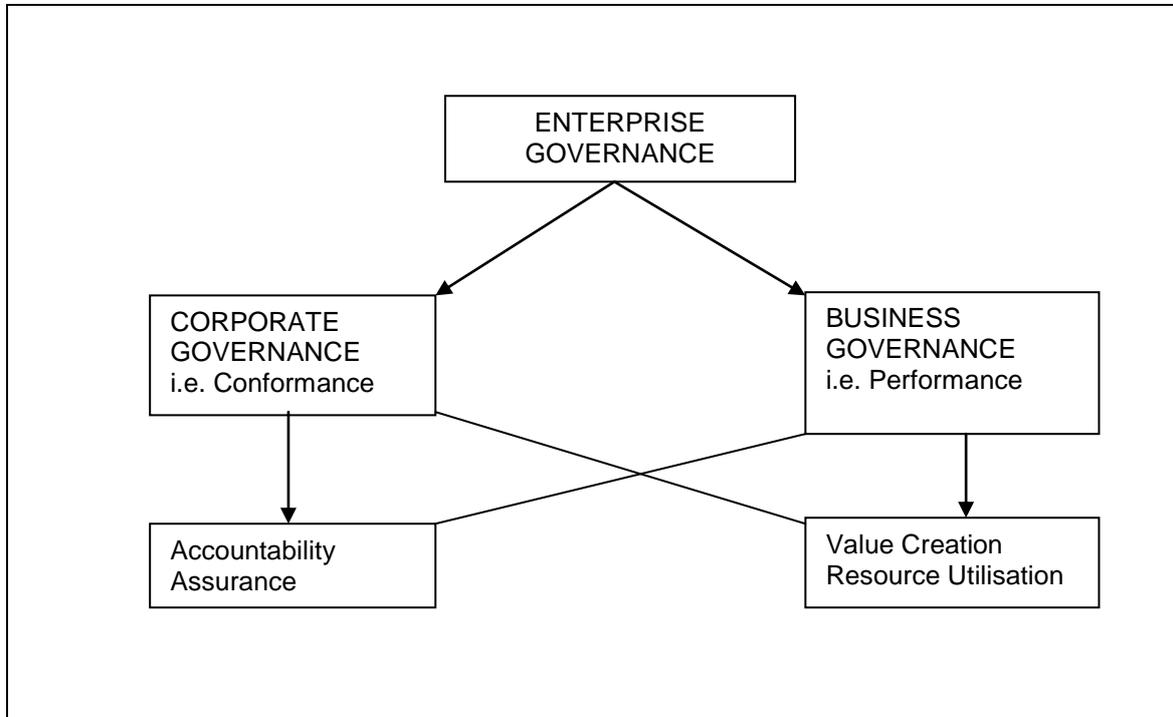


Figure 2.2 The Enterprise Governance Framework (Sourced: The Enterprise Governance Framework (IFAC 2004:10)

In summarising issues of governance on audit committees, the literature recognises that audit committees interact with other organisational bodies internally as well as externally. Organisations operating under business conditions must comply with laws and adopt ethical practices when making decisions. Operating any business also requires taking calculated risk. For organisations, compliance and governance cannot be solely entrusted to management. The audit committee's oversight role has to be assisted by auditors to provide reasonable assurance that compliance and ethical practices have been adhered to. That involves relying on other organisational units referred in this thesis as stakeholder partners.

In Australia, both Federal and State governments and their Auditors-General have promoted models of governance (such as Federal ANAO, Victoria and

Queensland). Similar models are available for most developed countries (such as Scotland and AICPA). Most reliant professional associations also have governance models for their members. The examples from the International Federation of Accountants and the Internal Auditors Profession provide a good linkage between outcomes and process.

2.13 PERSPECTIVES ON GOVERNANCE IN AUSTRALIA

2.13.1 Governance - Federal Government of Australia

The Federal Government of Australia (2003) commissioned a study into governance expectations for its statutory agencies. It defines corporate governance as encompassing the arrangements by which the power of those in control of the strategy and direction of an entity is both delegated and limited to enhance prospects for the entity's long-term success, taking into account risk and the environment in which it is operating. *“Governance is about ensuring the success of an activity. It encompasses the arrangements by which owners, or their representatives, delegate and limit power to enhance the entity's prospects for long-term success”* (Federal Government of Australia 2003:22). This definition was employed for the review of the corporate governance of Federal government statutory authorities and office holders, to identify reforms that might assist in improving the performance of these bodies, without compromising their statutory duties – but it was noted that there is no universally accepted definition of corporate governance, or agreement on the structures and practices that are required to achieve good governance.

2.13.2 Governance - Australian National Audit Office (ANAO)

The Australian National Audit Office (2003) defines corporate governance as “the process by which organisations are directed, controlled and held to account” (ANAO 2003), and argues that it encompasses authority,

accountability, stewardship, leadership, direction and control exercised in the organisation.

Public sector governance covers:

“...the set of responsibilities and practices, policies and procedures, exercised by an agency’s executive, to provide strategic direction, ensure objectives are achieved, manage risks and use resources responsibly and with accountability” (ANAO 2010).

Public sector management requires leadership in ensuring that sound governance practices are instilled throughout the organization and the wider responsibility of all public servants to apply governance practices and procedures in their day-to-day work. According to the ANAO’s *Better Practice Guide on Public Sector Governance* (2003):

“Good governance is about both:

- *Performance —how an agency uses governance arrangements to contribute to its overall performance and the delivery of goods, services or programs, and*
- *Conformance —how an agency uses governance arrangements to ensure it meets the requirements of the law, regulations, published standards and community expectations of probity, accountability and openness. “*

This means that, on a daily basis, governance is typically about the ways in which public servants take decisions and implement policies. Published in the ANAO’s *Better Practice Guide on Public Sector Governance* (2003:7-8):

“The governance framework is based on principles of public sector governance including:

- *accountability—being answerable for decisions and having meaningful mechanisms in place to ensure the agency adheres to all applicable standards*

- *transparency/openness—having clear roles and responsibilities and clear procedures for making decisions and exercising power*
- *integrity—acting impartially, ethically and in the interests of the agency, and not misusing information acquired through a position of trust*
- *stewardship—using every opportunity to enhance the value of the public assets and institutions that have been entrusted to care*
- *efficiency—ensuring the best use of resources to further the aims of the organization, with a commitment to evidence-based strategies for improvement*
- *Leadership —achieving an agency-wide commitment to good governance through leadership from the top.” (ANAO 2003:7-8)”*

2.13.3 Governance in the Victorian Public Sector

Governance principles for the Victorian Public sector are promulgated by the State Services Authority. The exercise of external auditing is conducted by the Auditor General of Victoria. The former Auditor General of Victoria, Wayne Cameron (2003) recognises the value that audit committees contribute to governance, accountability and stewardship. The Victorian Auditor-General’s Office used a conceptual framework (Fig 2.3) to identify the elements that would deliver good governance - performance, accountability, structure, and strategy. The Victorian Auditor General’s (VAGO) Governance Framework identifies four silos, namely performance, compliance, structure, and strategy. Performance means the ability to get the information required on a timely basis. Compliance means the ability to monitor and identify situations when non compliances occur. Structure means having an explicit role definition of key participants in the governance process that includes the control, reporting and accountability arrangements established to facilitate communication, action and monitoring. Strategy means having goals and objectives that are supported by plans covering finance (budget), assets, and technology and personnel requirements. Government require strategy, policies and other directions to be clearly specified, communicated and understood.

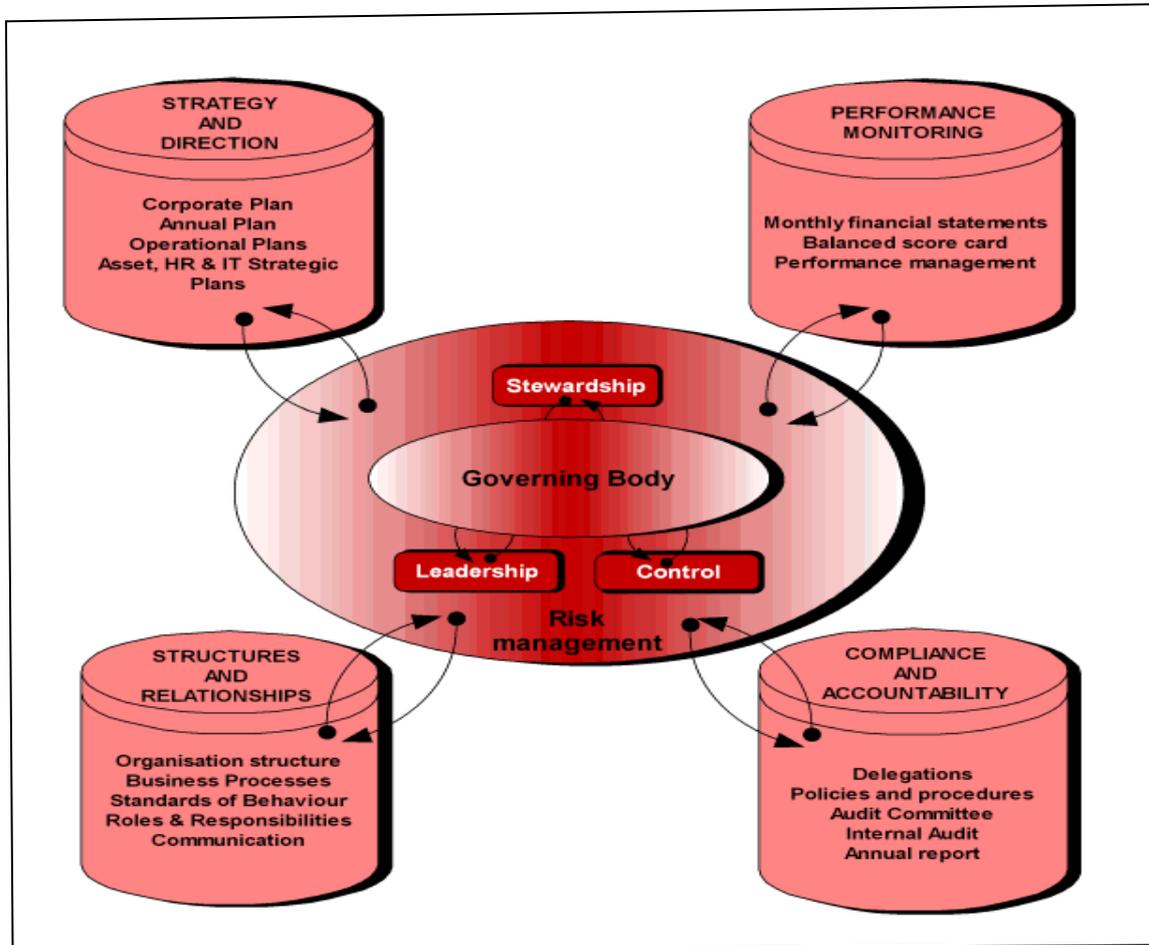


Figure 2.3 Victoria Auditor-General's Office (VAGO) Governance Framework

Source: VAGO

Spira (2002) and Turley and Zaman (2004, 2007) calls for additional qualitative research on the audit committee process to increase understanding of the linkages between audit committee inputs and outputs, particularly those related to financial reporting and internal control. Enterprise risk management is highlighted in Blaskovich J and Taylor EZ (2011)'s article titled *By the Numbers: Individual Bias and Enterprise risk management*. They found that groups with accounting or financial backgrounds placed greater emphasis on financial risks compared with cross-functional groups, focusing on accounting and financial issues and reporting of business financial results and situation. Audit committee members with accounting and financial audit contribute value to the audit

committee process. Anderson RJ and Frigo M (2012) in their article ERM – What should Directors ask about risk management, draws attention to enterprise risk oversight and management’s assistance in helping the board add strategic value on process and reporting. The challenge facing boards is how they can effectively oversee the organisation’s enterprise-wide risk management in a way that balances managing risks while adding value to the organisation. Barua A and Yan YC (2011) in their article titled Appointment of New Executives and subsequent SOX 404 opinion noted that the Chief Financial Officer and the Chief Executive Officer of a company play a crucial role in financial reporting process. They found that newly appointed executives were more critical and report adverse SOX 404 reports that address internal control issues. Roy M. (2011) in his article Board information: meeting the evolving needs of corporate directors found that corporate boards do not receive adequate information to help them fulfil their current and emerging roles.

2.14 PERCEIVED ROLE OF AUDIT COMMITTEES

Research Question 5: What is the perceived role of audit committees as perceived by audit committee members?

Sabia and Goodfellow (2005) noted that there have been changes in the way audit committees operate over a period of two decades and have indicated that expectations have changed. From a scenario of audit committees being inserted between management and the board where the auditors appeared to be little more than an extension of management (Sabia and Goodfellow 2005:7), auditors have more recently been made to be more accountable, and have much stronger and more dynamic working relationships with the audit committee. In emphasising this dichotomy, Sabia and Goodfellow classified audit committees as either old audit committees or new audit committees with characteristics as listed in Table 2.2.

Table 2.2 Old & New Characteristics of Audit Committees

OLD AUDIT COMMITTEES	NEW AUDIT COMMITTEES
<ol style="list-style-type: none"> 1. Underutilised 2. Not empowered 3. Dominated by management 4. Reactive 5. Focused on compliance with minimum legal requirements 6. Uncertain as to role beyond minimum legal requirements 7. Little attention paid to relationships 8. Dealt with the external auditor principally through management 9. Minimum involvement in the selection of members and chairman 10. Undemanding 11. Superficial 12. Lacking in courage 	<ol style="list-style-type: none"> 1. Increasing expectation 2. More onerous responsibilities 3. More accountable 4. Empowered 5. Prepared 6. Pro-active 7. Not dominated by management 8. Focused on appropriate, not minimum requirements 9. Focused on relationships 10. Educated and current with developments (inside and outside the corporation) 11. Insistent on high quality and timely materials and presentations 12. Willing to commit the time required 13. Insistent on candid and direct communication 14. Independent 15. Financially literate 16. Demanding 17. Courageous

Sourced: Sabia M.J. and J. L. Goodfellow. 2005. *Integrity in the Spotlight – Opportunities for Audit Committees*. Canada: The Canadian Institute of Chartered Accountants.

2.15 SUMMARY – LITERATURE REVIEW

This chapter searched the literature for information on the makeup of audit committees, and their relationships with the board, management, internal audit, external audit, governance and performance. The majority of literature examined addressed material written about the private sector shareholder and investor funded sector organisations and it will be interesting to find out what happens within the Victorian government public sector. The literature suggests that audit

committees provide an oversight role. An audit committee cannot achieve its role all on its own. It is suggested that oversight is achievable if the audit committee works together with management, internal audit and external audit (IIA 2009, Cameron 2003). Audit committees are subcommittees of the board with a specific role of overseeing financial reporting. To achieve this, audit committees monitor governance and provide assurance to the board. The purpose of an audit committee is to assist in resolving the agency problem of the potential conflict of interests between a board and its management. A governance, assurance and audit perspective for researching audit committees addresses the major activities of audit committees. Adopting good governance guidelines and performing it in the proper manner suggests that there is a high probability that it logically leads to the achievement of desired outcome. The factors following what is covered in the literature suggests that in order for an audit committee to achieve performance it should have a defined role, have the right competent personnel, and perform the functions in accordance with professional standards. Performance of audit committees professionally relying on the roles played by the board, management, internal auditors and external auditors, is most likely to assure their effectiveness. In specific environments such as listed companies and the government sector their existence is a regulated requirement acknowledging their contribution to the oversight, governance and assurance.



3. CONTEXT

3.1 INTRODUCTION

The previous chapter reviewed the literature on audit committees and revealed that there was limited research conducted into audit committees in government funded public sector organisations. The objective of this chapter, in setting the context of this research, is to examine the business environment in which government funded public sector audit committees operate in.

This chapter:

1. describes the situation of governance failures and shortcomings that provided an impetus for this study, recognising that failures occur in both private and public sector organisations;
2. examines the changes in the government funded public sectors;
3. describes the setting for this thesis - the Victorian Government environment;
4. describes financial management legislation in Federal government and in other Australian State and Territorial governments.
5. describes audit committee activities in the United States of America (USA) and the United Kingdom (UK).

As a recognised independent organisational unit, an audit committee's performance should be evaluated as an independent body. The role of audit committees is to ensure effective financial governance (Victorian Standing Directions of the Minister for Finance 2008: 2.2) and exists in order that financial

reports may reflect a true and fair view of the organisation's financial position. Business performance is influenced in an environment that changes frequently. Thus strategic plans, employing competent operators, and making appropriate decisions to manage business operations tactically seems a logical approach to adopt to achieve the desired level of performance.

3.2 ORGANISATION FAILURES

The purpose of the first part of this chapter is to identify and recognise failures in organisations which may have been caused by lapses or absence of the practice of good governance. Changes that addressed improvements to the effectiveness of audit committee governance practices have happened in most situations as a response to these financial failures. Literature and research on audit committees have focused on organisations in the private sector. The examples provided below indicate that private as well as public sector organisations are equally likely to experience financial failure if governance is weak.

3.2.1 Private Sector Failures

This section examines corporate failures in the private sector. The failure to recognise and comply with governance is a reason used to explain the corporate disasters in the early twenty first century. As a result, audit committees were created and promoted to improve governance and be accountable through its financial reporting. However, even with highly reputable audit committees, there were times that some were found wanting.

Summarising observations from the following contributors - IIA & PWC (2005), Wayne (2003), Turley & Zaman (2004), DeZoort et.al (2002), Public Oversight Board (2000), Sabia & Goodman(2005), Spira (2002), it is noted that organisations with audit committees who failed had audit committees that lacked independence through their composition of members; some audit committee members were professionally incompetent on financial knowledge or inadequately trained for the job; some audit committees met infrequently; and some lacked support and cooperation to adequately oversee and analyse the

major contributing stakeholder partners (e.g. management, internal audit and external audit) that interact with and support audit committees. Dominant authoritative chief executive officers (CEO) and senior management have also been known to overshadow and hinder audit committees, internal auditors and external auditors from performing their professional services. Innovative management consultants were known to have developed innovative ways of management. In one instance the management consulting firm was also the engaged external auditor, compromising its ability to provide an independent opinion on accounting practices and reports. These management practices have not worked out well even though they seem perfectly logical and acceptable and income for these firms were substantial. The Auditors would be loath to express negative opinions when Consultants from the consulting branch of the same firm provided and were paid large sums of money for business solutions to the same client e.g. ENRON.

Audit committees and their stakeholder partners are directly related and influence the performance of organisations. Stakeholder partners include internal and external organisational units or individuals. Ultimately their individual professional roles contribute to effective performance. Major internal organic units within organisations include the Board of directors, management and internal audit. Major external organisation include internal and external audit. Whistle blowers are another valuable source of information that audit committees should have access to. Emerging from the incidences of corporate collapses, the literature on audit committees focused on the effectiveness of audit committees. There is also greater interest on the relationships, governance, performance and value that audit committees play in overseeing governance, assurance, compliance, accountability.

Academic literature on the topic of audit committees featured topically when there was a spate of failures in recent times. Significant examples of such occurrence in the investor funded private sector include HIH, AWA and ENRON provide additional information of the situation, which will be explored below.

3.2.1.1 Liquidity Issues at HIH

Phillip Lipton, Associate Professor of Corporate Law, RMIT (2003) analysing the HIH failure noted that the HIH Insurance audit committee's terms of reference and minutes indicated that the audit committee was almost entirely concerned with matters directly concerning the accounts and the figures. The audit committee was not interested in risk management and internal control. The audit committee comprised of executive and non-executive directors. The HIH audit committee was regularly attended by all directors including executive directors. The non-executive directors rarely met with the auditors in the absence of management to discuss contentious matters or areas of concern. It is necessary for such meetings to take place so as to enable the board to determine whether it can safely rely upon what management is telling it and such meetings should occur regularly so that the board can consider the issues carefully. It seems the HIH audit committee could not and did not ask the "right" questions (Lipton 2003:274). HIH entered into voluntary administration in March 2001.

Some of the accounting and auditing issues that may have led to the voluntary administration of HIH include: The auditors adjusted figures after meetings with HIH directors. Losses from HIH's Lloyd's business in London were revised down from \$40 million to \$9 million. In addition, the auditors suggested that net assets should be written-down by \$100 million, but the adjustment made was \$57 million by the time the final report was prepared (Hapworth 2001:5); The auditors held "reasonable suspicions" of HIH's insolvency, but did not communicate this to HIH directors prior to the eventual demise. In their defence, the auditors stated that a lack of financial details were provided by HIH, that management accounts for HIH's subsidiaries did not exist and, hence, a firm conclusion could not be reached. The independence of HIH's external auditors is compromised by having three former partners in the HIH Board and the Chairman of the Board continued receiving consultancy fees whilst chairing the board (Lipton2003:276).

3.2.1.2 Weak internal control and insufficient oversight at AWA

In 1987 AWA reported \$49 million in foreign exchange losses due to unauthorized trading in 1986 and 1987 (Malane 2004 citing AWA Appeal Judgement 620). Over the next decade, in what developed into a landmark case in Australia, there were legal proceedings against auditors for failing to identify the trading, as well as cross claims against the company's directors, the foreign exchange trader and the banks involved (Wang 1992).

3.2.1.3 Financial Statement Fraud at ENRON

At ENRON accounting and audit issues perpetrated included: 1. Off-balance sheet entities were omitted from Enron's consolidated financial statements. 2. Failure to consolidate investments in Chewco investments, a related party that invested in Joint Energy Developments. 3. Investments Limited Partnership (JEDI), and JEDI resulted in Enron understating debt by \$2.585 billion between 1997 and 2000. 4. Failure to consolidate JEDI, Chewco and LGM Limited partnerships resulted in Enron overstating net income by \$591 million between 1997 and 2000 (CPA Australia 2002:40).

ENRON's audit committee was headed by a prestigious Accounting Professor from Stanford University. Members of the Enron audit committee resided in various countries and did not meet regularly (although there are no requirements on the number meeting of audit committees that audit committee members should meet). There was conflict of interest with Arthur Anderson providing consulting services, internal and external auditing. Thus in truth the ENRON audit committee provided little protection against management's financial manipulation.

3.2.2 PUBLIC SECTOR FAILURES

This section examines organisational failures in the government funded public sector. The Public taxpayer funded government sector faces similar issues and

failures. In contrast, when government taxpayer funded public sector organisations fail financially, the consequence is that the services they provided may be absorbed into another public sector organisation or stopped altogether. Disasters of a larger scale in the government sector may lead to a country being labelled a 'failed State'. Governments may experience slow economic growth, and register a bad credit rating which could curtail their borrowing capability and the trust of internal as well as overseas investors. When this happens, a massive restructure, controlled spending, and assistance from other Governments or international bodies, like the International Monetary Fund may be required. Significant examples of such occurrence include Victoria (Australia) (Armstrong & Gross 1995), New York (USA) (UPI Radio 1975), and European Countries (Greece, Iceland, and Portugal) (Paris & Granitsas 2010).

3.2.2.1 High risk ventures in Victoria (Australia)

The Australian State of Victoria, which operated a State Bank, faced a financial crisis in 1991 when the State Bank Victoria (SBV) and related finance company, TriContinental experienced financial liquidity problems. The board of TriContinental lost control of the chief executive. The chief executive lost control of the agenda and it lent profligate amounts of money foolishly. Thus the primary source of SBV's problems was losses in its subsidiary, Tricontinental, which was more than 3.5 times greater than the value of SBV's capital. The SBV lost around \$2429million (Armstrong and Gross 1995:242). The State Government invested \$2.7 billion in the SBV Group largely in connection with Tricontinental (ABC News 2008). Following a change of government, radical cost cutting and sale of government assets occurred in order to reduce debt and to regain an AA credit rating, a performance target set.

3.2.2.2 Liquidity problems in New York (USA)

The US City of New York experienced financial crisis in 1975. New York City improved its financial practices, and recovered an AA rating from the credit rating agencies (UPI Radio 1975).

3.2.2.3 Banking risks and liquidity in European Countries 2010

A number of European countries are experiencing financial difficulties as a result of the global financial crises. These include Iceland, Portugal, Ireland, but none more critical than Greece. The Greek Government in 2009 experienced liquidity problems for not managing their fiscal spending and their monetary position. The Greek Government faced financial management crises because of overspending, and alleged corruption. The government responded by reducing government expenditure and seek support by Euro currency countries in the European Union and the International Monetary Fund (Paris and Granitsas 2010).

Summarising the first part of this chapter, it is noted that financial reporting fraud and poor internal control systems (e.g. poor organisation structures, corrupt controlling executives, and less than independent and querying audit committees) have been identified as major causes of failures of these organisations – a reflection of poor governance and performance monitoring practices as demonstrated from the cases discussed and listed below:

1. Liquidity, insolvency issues e.g. One Tel in 2001, HIH Insurance in 2000.
2. Management, internal audit and board oversight weakness e.g. AWA in 1987.
3. Financial Statement Fraud/Reporting Weakness e.g. ENRON in 2001, WorldCom in 2001, Lehman Brothers in 2009.
4. Banking activities and risky business ventures in the Australian State of Victoria. (Armstrong and Gross 1995:242).
5. Debt crisis at New York City, USA in 1975.
6. Debt control in Greece, Portugal and other European countries in 2011.

3.3 CHANGES & REFORMS IN PUBLIC SECTOR MANAGEMENT

PHILOSOPHY

The second part of the chapter examines changes to public sector management that link the use of audit committees as a logical organisational unit empowered to ensure governance. Reforms in the government funded public sector have changed the way governments conduct business. The previous simple cash basis government processing and accounting practices, have been changed to accrual accounting be aligned more closely with private sector practices. Where cash accounting was previously the preferred method of reporting for the public sector, it is now accrual accounting and has been adopted to provide realistic descriptions and matching of revenues and expenditure (OECD 2002).

Reforms labelled 'New Public Management' (NPM) characterised the adoption of private sector management concepts and styles, the introduction of quasi-markets and contracting process, and the application of explicit standards and measures of performance were introduced (Borden et al 1998: 267). The logic behind this approach and view of government is that the best form of accountability is a market accountability, where at least in principle the 'invisible hand' of the marketplace will provide the accountability mechanism – such that if policy and programme provision is not what the end-user wants they will exercise their market power and go elsewhere, leaving providers with unwanted, overly expensive or inappropriate services facing insolvency, a novel concept, at least for public sector providers. Where clear truly competitive markets did not exist or could not be readily created in the true economic measuring of the term, governments have introduced proxies to achieve the same end. These include regulated markets (e.g. private monopoly utilities); managed markets (e.g. in health and education) and/or other market simulating mechanisms such as market testing and compulsory competitive tendering (Osborne and Gaebler 1992:291).

The emphasis on doing more with less represents a response by governments to the problem of ever increasing demands by citizens for quality public services in the context of declining revenues. In response to this dilemma, governments

have focused on increasing the productivity of their public sectors through the introduction of NPM techniques that emphasise efficiency and cost-effectiveness (Aucoin 1995:9-10).

Table 3.1 New Public Management Changes that affect public sector management.

REFERENCE: Ferlie et.al. (1996) IDENTIFIED FOUR DISTINCTIVE NPM MODELS. This table also include characteristics of Hood's NPM model.	OBSERVED AUDIT COMMITTEE RESPONSE TO CHANGES THAT AFFECT GOVERNANCE & PERFORMANCE TO THE VICTORIAN GOVERNMENT PUBLIC SECTOR
<p>The first NPM model, '<i>The Efficiency Drive</i>' model implemented, involved the introduction of private sector management practices into the public sector in Britain in the first half of the 1980s. The emphasis was on increased financial controls and the monitoring of performance, the introduction of benchmarking, a greater customer focus, a shift in power from professionals to management and attempts to marginalise trade unions.</p> <p>Increased control over outputs, with an emphasis on the results achieved rather than the process involved (Hood 1991).</p> <p>Emphasis on cost-cutting and rationalisation, or 'doing more with less' (Hood 1991: 4-5).</p>	<p><i>"increased financial controls and the monitoring of performance"</i> meant creating internal audit units and audits to improve Internal Control Systems.</p> <p>Emphasis on Performance Management and Managerialism</p>
<p>The second NPM model, '<i>Downsizing and Decentralization</i>', involved reducing workforce numbers, decentralisation of financial budgets and contracting-out. It also involved a more concerted focus on the introduction of quasi-markets and distinctions between purchaser and provider organisations (Ferlie et. al.1996:10)</p> <p>Breaking-up of parts of the public sector into agencies that relate to one another on a user-pays principle (Hood 1991).</p> <p>Emphasis on increased competitive pressures within the public sector through tendering processes the development of quasi-markets for those areas not privatised and the introduction of short-term contracts of employment (Hood 1991).</p>	<p><i>"decentralisation of financial budgets and contracting-out"</i> meant decentralising financial management – Budgeting and Accounting.</p> <p>Decentralising financial reporting making Departments responsible for their financial management and reporting required under an Annual Reporting Act.</p>

<p>The third NPM model, '<i>In Search of Excellence</i>', represented a focus on changing the organisational culture of the public sector. On the one hand, a 'top-down' approach viewed a public sector organisation's culture as malleable and capable of being altered by a charismatic leader spousing a new vision. An alternative 'bottom-up' approach emphasises introducing concepts from the organisational development literature such as the 'learning organisation'.</p> <p>Increased emphasis on introducing management techniques and practices from the private sector and increasing management's ability to hire and fire and reward public service workers (Hood 1991).</p>	<p><i>"a focus on changing the organisational culture of the public sector"</i> meant changing to a client/customer focus.</p> <p>Empowering staff</p> <p>Bottom up approach</p>
<p>The fourth NPM model, '<i>Public Service Orientation</i>', seek to bring together a range of public and private sector management approaches. One variant of this involved Osborne and Gaebler's attempts to 'reinvent' the public sector by extolling managers to be more entrepreneurial, results-oriented and mission-driven (1992:108). This model also emphasised the provision of quality public services and total quality management initiatives. The focus is believed to be on citizens rather than customers, however, and proponents of the model are critical of the introduction of market-based solutions into the public sector. Returning power to elect rather than appointed local councils is advocated as is an awareness of the distinctiveness of public sector tasks and values (Ferlie et al, 1996: 13).</p> <p>Increasing the freedom of professional elite of public sector managers to manage in place of the traditional concerns with policy skills (Hood 1991)</p> <p>Focus on measuring performance through the establishment of goals, targets and indicators that can be measured quantitatively (Hood 1991)</p>	<p><i>"Bringing together public and private sector management approaches"</i> meant adopting a common financial reporting standard.</p> <p><i>"entrepreneurial, results-oriented and mission-driven"</i> meant focussed delivery of services through efficient and effective programmed planning and budgeting.</p> <p>Social accountability</p> <p>Market solutions</p>

According to Turley and Zaman (2004) researching private sector organisations audit committees in the United Kingdom, audit committees were initially a non-mandatory within organisations, however audit committees have now been widely promoted as relevant to corporate governance (Turly & Zaman 2004:2).

Reforms labelled ‘New Public Management’, changing managerial philosophy in how government taxpayer funds are managed, administered and reported through the adoption of private sector management practices; explain why audit committee structures could also follow a similar trend of the value of audit committees in the government public sector.

3.3.1 CHANGES TO THE ROLE OF AUDIT COMMITTEES

Audit Committees are expected to play a vital oversight role in the process of producing financial information (AICPA (USA) 2009). Following much publicised corporate failures from organisations experiencing liquidity problems, ‘creative accounting’ treatment and reporting of investments, and increasing concerns about management ethical and integrity issues, governance reforms including the introduction of legislation (Sarbanes-Oxley Act, CLERP9) demanded audit committees redefine their role. Thus in the shareholder funded private sector as well as the government funded public sector, management were required to provide fiduciary assurance that governance is assured.

3.4 THE STATE OF VICTORIA

This third part of the chapter introduces the context for this research – government in Australia. The Commonwealth of Australia comprises six States and two Territories. The empirical focus of this research is Victoria, a State within the Commonwealth of Australia. In order to understand the concept of governance in government it may help to understand how Australia is governed. It is generally accepted that there are three levels of government in Australia - the Commonwealth Federal government, the State government and the Local government municipalities. There are also numerous public sector agencies created to support these three levels of government Australian Electoral Commission (2011). “*Local government is a distinct and essential tier of government consisting of democratically elected Councils having the functions and powers that the Parliament considers are necessary to ensure the peace, order and good government of each municipal district.*” (Section 74A (1) Constitution Act (Vic) 1975). The topic of this thesis was selected, with a focus

on public sector financial commitment to the operations of the State government and the local government municipalities in Victoria. A judgmental sample of public sector agencies from the Victorian Universities, and Water Bodies and a financial policy making department of the Federal department also participated in the empirical study.

3.5 DEMOGRAPHICS OF THE VICTORIAN PUBLIC SECTOR

3.5.1 Profile of government organizations in Australia

Victoria is a State within the Commonwealth of Australia. The Federal government is the highest level of government in Australia. States and Territories form the next level of government. Victoria, New South Wales, Queensland, Tasmania, South Australia and Western Australia together with the Northern Territory and the Australian Capital Territory together form the Commonwealth of Australia. Local government municipalities follow the States and Territories in providing services to citizens at the grassroots level. Supporting this framework is a large number of public bodies. These usually provide specialist services to citizens thus entitling them to receive government funds (Australian Government Website 2010).

3.5.2 Size of the Victorian State Government Public Sector

The Victorian State government employs around 200,000 people. The State Government of Victoria budget is \$38 billion. Consolidating State government departments with local government and support public body agencies, the Victorian Auditor General audits the third largest number of organisations in Australia (Victoria Year Book 08-09). According to the Victorian Auditor General's Office (VAGO) in a published presentation on its website <http://www.audit.vic.gov.au/> (2011), VAGO legislatively has a monopoly controlling audits of all Government Departments, Municipalities, and Public Agencies; it audits around 650 agencies with assets of \$185 billion; liabilities of \$58 billion; revenue of \$51 billion; and expenses of \$45 billion.

The scale of activities performed is the delivery of a range of services to taxpayers and citizens. Thus financial materiality and the impact it has on taxpayers justifies a reason for conducting a research study in this sector.

3.5.3 Diversity of “business” conducted by the Victorian Public Sector

At any level of government, the scope of public sector organisations providing services to taxpayers is diversified and substantial. The range of organisational units includes departments that functionally provide services to the community. These include amongst others: health, transport, housing, education, policing, consumer affairs, arts, innovation, tourism, agriculture environment, water, sport, small business, roads, youth, children, veterans, treasury and finance. (Victorian Government Directory 2008). The Victorian Auditor-General’s Office publishes a list of organisations that it audits each financial year.

The Victorian Auditor General categorises organisations that it audits into a number of groups. Audit clients are classed under the following categories:

- Departments (which also consolidate portfolio agencies for accountability and reporting purposes);
- Public bodies,
- Universities and other educational institutions;
- Public hospitals and ambulance services;
- community health;
- superannuation funds;
- Companies, trusts and joint ventures;
- Water authorities;
- Regional waste management groups;
- Municipal councils;
- Regional library corporations;
- Public cemeteries; and Municipal Councils.

The Municipal Councils in the State of Victoria comprising of seventy nine councils represent local government sector. Table 3.2 categorises the population of organisations that the Victorian Auditor General audits (30 June

2008) that have to comply with the Victorian Government Financial Management Act 1994 (VAGO 2009).

Table 3.2 *Population – Organisations the Victorian Auditor General audits*

SOURCED: Victorian Auditor General's Annual Report 2008

Parliament	1
State Accounts (Whole of Government)	2
Major Departments	10
Independent budget sector agencies	13
Public Bodies	112
Universities and other educational institutions	22
Public Hospitals and ambulance services	95
Community health	39
Superannuation funds	2
Companies, trusts and joint ventures	183
Water authorities	26
Regional waste management groups	13
Municipal councils	79
Regional library corporations	12
Public cemeteries	14
TOTAL	623

3.5.3.1 Victorian Public Sector Administration

The Victorian Public Administration Act 2004 established the Victorian State Services Authority and creates the role of the Public Sector Standards Commissioner. The Act represents a new direction for public administration in Victoria and reflects the Government's belief that the fundamental role of the public service is to serve the public interest. The Act demonstrates a commitment to sustain an effective and impartial public service; protect public employment from politicisation by reaffirming and promoting the principles of merit and equity; promote the highest standards of public service conduct and integrity thereby strengthening public confidence and trust in government; drive further improvements in integrated delivery of government services; promote career opportunities in the public sector by ensuring a more coherent approach to workforce management and professional development; ensure the public

sector workforce is capable of delivering high quality services to the Victorian community, both now and into the future; promote good governance in public entities; and clarify the accountability relationship of public entities to a responsible minister who, in turn, is accountable to the Parliament.

3.5.3.2 Victorian Public Sector Accountability

In gathering information about audit committees in Victoria, it was noted that the Victorian Government under the Financial Management Act 1994, created a Financial Compliance Framework and produced a set of financial rules and regulations calling the document the Victorian Standing Directions of the Minister for Finance 2008. It is a document that is revised when required in order to ensure that financial compliance measures of accountability is up-to-date and can be observed in a changing environment. Changes reflect responses to address changes in accounting treatment, and system weakness, as a move towards improving accountability and financial management. The changes brought about by the introduction of the *Financial Management Act* and the *Audit Act* in 1994 resulted in changes in accounting practices, financial responsibility and financial reporting. Victoria changed by moving from centrally controlling all transactional financing and accounting activities with a central Department controlling all financial management activities, to delegating finance (budget); recording accounting transactions; and reporting summarised transaction activities and the preparation of annual financial reports to Departments and public agencies. This move has empowered these organisations to deliver government products and services, and have made management more accountable by requiring them to report annually summaries of their financial activities in professionally sanctioned financial reports that are audited by the Office of the Victorian Auditor General (Financial Management Act (1994), Audit Act (1994)).

In 1994, Victoria introduced changes to its financial management and auditing practices by reviewing legislation and issuing modern and practical legislation. What followed was the introduction of a Financial Management Compliance

Framework (Victorian Standing Directions of the Minister for Finance 2008) listing detailed rules and requirements, one of which was the requirement to establish audit committees. Heads of departments and agencies are required to provide annual certification that they comply in maintaining an effective system of internal control, tax, risk management, and compulsory reporting of assets (e.g. cash) of a certain value which are stolen or lost.

Delegating responsibility to service delivery centres accompanied by legislatively requiring them to prepare financial reports and to maintain proper accounting systems and accountability framework, meant that departments are responsible for their own budgeting, accounting, and reporting for monies expended each financial year. Financing comes centrally from the Victorian Department of Treasury and Finance via the budgeting process as dictated by the (DTF) Victorian Department of Treasury and Finance (2009).

3.6 FINANCIAL COMPLIANCE

3.6.1 Victoria Public Sector Legislation

The Victorian Department of Treasury and Finance developed and issued a Financial Management Package (FMP) in 1994, comprising a Financial Management Act 1994 (FMA), Audit Act 1994, Financial Management Regulations 2004, Audit (Public Bodies) Regulations 2005, Standing Directions of the Minister for Finance (the Directions) 2008)

The Directions form the basis of sound financial management for the State and are applicable to all agencies meeting the “public body” definition contained within section 3 in the Financial Management Act 1994 (FMA). The Directions are updated from time to time to reflect changing financial management requirements.

3.6.2 Purpose of the Victorian Standing Directions of the Minister for Finance

The Victorian Standing Directions of the Minister for Finance was designed to supplement the Victorian Financial Management Act (1994) (FMA) by prescribing mandatory elements (procedures) that must be complied with by Public sector agencies (all Victorian public sector agencies that apply the Victorian Financial Management Act (1994) to implement and maintain appropriate financial management practices; and to achieve a consistent standard of accountability and financial reporting.

The Victorian Standing Directions of the Minister for Finance (2008) prescribe best practice, high-level requirements for financial management documented in a document titled Financial Management Control Framework (e.g. internal control, information technology systems and governance, fraud deterrence, whistle-blowing procedures, loss and theft of cash and assets). The Victorian Standing Directions of the Minister for Finance (2008) require Public Sector Agencies to develop agency specific systems, procedures and practices, which must be tailored to their own business, approved and monitored within their own agency requirements.

3.6.3 Review of the Victorian Government's Directions of the Minister for Finance

In 2002-2003, external consultants were engaged to undertake an independent review of the Victorian Standing Directions of the Minister for Finance (Directions). The Directions include requirements on the existence of Audit Committees, internal transactional procedures and controls (such as revenue and expenditure management), Information Technology (IT), contract management and are based on three key components of leading edge financial management, namely financial management governance and oversight; financial management structure, systems, policies and procedures; and financial management reporting.

The Victorian Standing Directions of the Minister for Finance are subject to ongoing updates to ensure that they continue to prescribe modern best practice financial management standards and principles.

Each Direction contains the following:

- A description of the Direction, which is mandatory;
- A Procedure, which is mandatory in order to achieve compliance with the Direction;
- Where relevant, Guidelines which are not mandatory but will assist in applying the procedure; and
- Where relevant, additional Supplementary Material which is not mandatory but assists in the practical implementation of the Direction

The revised Victorian Standing Directions of the Minister for Finance became applicable from 1 July 2003 and have been amended from time to time.

3.6.4 Financial Management Structure and Contents of the Victorian Government

The Victorian Standing Directions of the Minister for Finance (2008) are based on three high-level principles: (A) Financial Management Government and Oversight comprising Financial Code of Practice, Financial Governance, Financial Risk Management; (B) Financial Management Structure, Systems, Policies and Procedures comprising sound financial management structure, information technology systems, education and training and policies and procedures; and (C) Financial Management Reporting comprising internal financial management reporting, reporting requirements in accordance with Part 7 of the Financial Management Act 1994, external reporting, financial performance management and evaluation, compliance obligations (including financial management, taxation, purchasing card and theft and losses) (Victorian Standing Directions of the Minister for Finance 2008).

3.7 VICTORIAN PUBLIC SECTOR AUDIT COMMITTEES

The Victorian Financial Management Compliance Framework (Appendix 2.1) requires audit committees (or Responsible Body in its absence) to assume a leading role in the governance and oversight matters of the agency. Audit committees are expected to be actively involved in the monitoring of financial management compliance issues and in particular the monitoring of rectification action plans in order to achieve compliance over time. Extract from the Victorian Standing Directions of the Minister for Finance (2008) relating to audit committees is attached as Appendix 3.1.

Table 3.3 Factors and Elements affecting audit committees

ROLE & AUTHORITY
<p>REFERENCE: Financial Management Act (Victoria) 1994's Standing Directions of the Minister for Finance 2008</p> <p>Summarised from the Directions (Appendix 3.2, 3.3, 3.3):</p> <p>(a) Under the Directions, each Public Sector Agency must, unless an exemption has been obtained, appoint an audit committee to oversee and advise the Public Sector Agency on matters of accountability and internal control affecting the operations of the Public Sector Agency. Government Departments are not eligible for an exemption. (Direction Guideline 2)</p> <p>(b) The Directions require that audit committees have at least two independent members. To ensure that this happens, these members are to be identified as independent in the Public Sector Agency's annual report. (Direction Guideline 3)</p> <p>(c) Where the Responsible Body is a board the Audit Committee is to be comprised of at least three members all of whom are non-executive directors and a majority of whom are to be independent.</p> <p>(d) If the Responsible Body is supported in its financial management responsibilities by an audit committee and/or any other committee:</p> <ul style="list-style-type: none"> • The committee should have a Charter (Appendix 3.2) that clearly sets out the role and responsibilities, composition, structure and membership requirements; • The Charter must be approved by the Responsible Body and provided to each member of the Committee; and • The Charter must be formally reviewed by the audit committee periodically, but at least every three years, with recommendations for updates approved by the Responsible Body. <p>(e) Each committee is to:</p> <ul style="list-style-type: none"> • Be adequately resourced; • Be of sufficient size, independence and technical expertise to discharge its mandate effectively; • Undertake an annual review of its own performance and report the results of that review to the Responsible Body; • Be fully accountable to the Responsible Body;

- Meet often enough to discharge its role and responsibilities effectively and no less than four times a year; and
- Minute the meetings reflecting work done by the committee to address its roles and discharge its responsibilities. The minutes are to be provided to the Responsible Body at the next meeting or, where the Responsible Body is not a board, a defined and agreed interval, after each Audit Committee meeting. (Direction Guideline 4).

(f) Where the Responsible Body has been exempted from creating an audit committee the Responsible Body must:

- Actively assume all the usual roles and responsibilities of an Audit Committee including those responsibilities specifically set out in these Directions; and
- Take appropriate steps to ensure these responsibilities are fully discharged. (Direction Guideline 5)

(g) The Accountable Officer (Departmental Secretary or Chief Executive Officer) and the Chief Financial Accounting Officer (CFAO) are not to be members of their own Public Sector Agency's audit committee but are to attend relevant aspects of audit committee meetings by standing invitation.

(h) Unless an exemption has been obtained the Chairperson of the audit committee is to be one of the independent members of that committee.

(i) Unless an exemption has been obtained the Chairperson of the Responsible Body must not also be the Chairperson of the audit committee.

ATTRIBUTE OF MEMBERS

REFERENCE: Financial Management Act (Victoria) 1994's Standing Directions of the Minister for Finance 2008

(j) All members of a Public Sector Agency audit committee must have and maintain financial literacy;

- Reasonable knowledge of the Public Sector Agency's own risks and controls;
- Integrity, objectivity, honesty & openness;
- Accountability
- Dedication of time and effort;
- An enquiring mind;
- Independence of judgement;
- Relevant industry knowledge; and
- Business experience in the public or private sector.

(k) Members of an audit committee who do not have the requisite level of financial literacy and/or industry knowledge at the time of their appointment must undertake induction training before attending an audit committee meeting and additional training, as appropriate, to raise their competency. As a minimum requirement the prescribed level of competence must be achieved within the first six months of membership of that committee. (Direction Guideline 6)

(l) At least one member of an audit committee must have appropriate expertise in financial accounting or auditing. (Direction Guideline 7)

(m) All members of audit committees are required to take appropriate and timely action to ensure they have the requisite understanding of the Public Sector Agency's structure, operations and financial management risks to enable them to discharge their responsibilities.

(n) The Chief Financial Accounting Officer (CFAO) is to provide all newly appointed audit committee members with all necessary and relevant information regarding the Committee's responsibilities and the Public Sector Agency's operations and background to enable them to understand the Public Sector Agency and their duties and responsibilities. The CFAO is to agree which information is necessary and relevant with the audit committee Chairman.

(o) Membership of the audit committee is to be reviewed by the Responsible Body on a periodic basis, and at least every three years.

FUNCTIONS, ACTIVITIES, PROCESSES

REFERENCE: Financial Management Act (Victoria) 1994's Standing Directions of the Minister for Finance 2008

(p) The audit committee must have direct access to the internal and external auditors without management present.

(q) The audit committee must have:

- Direct access to the Accountable Officer, the CFAO and the Public Sector Agency's management, through the Accountable Officer, when required; and
- The right to seek explanations and additional information.

(r) The audit committee must be able to seek independent, expert advice to assist it in undertaking its oversight responsibilities.

3.8 GOVERNANCE IN THE VICTORIAN PUBLIC SECTOR

A governance framework is the structure upon which to build and develop the strategies of the public entity to reach the agreed objectives and monitor the performance outcomes (Victorian Public Administration Act 2004, and Victorian State Services Authority fact sheet) It is thus critical that Parliament, ministers, the Board, audit committee members, management, internal audit, and external audit must understand all their obligations, policies to ensure that they are accountable to operate lawfully and effectively. In Victoria, governance is addressed in Victorian Public Administration Act 2004. A government agency, the Victorian State Services Authority issue Guidelines over the code of conduct of public sector management and governance.

3.9 ASSURANCE IN THE VICTORIAN PUBLIC SECTOR

Assurance is provided by auditors, mainly internal auditors. Their objectivity is observed by their professional pledge to be independent in the performance of their audit assignments. In the Victorian government public sector, assurance is provided by external as well as internal auditors. External audit of Victorian government organisations are required by legislation to be audited by the Victorian Auditor General (Victorian Audit Act 1994, and Victorian Standing Directions of the Minister for Finance 2008:2.6). The scope of the role of the Victorian Auditor General's activities focuses on financial reports as well as performance audits. The conduct of their work is governed by Australian Auditing Standards. Financial reports are prepared in accordance with templates provided by the State's Department of Treasury and Finance. Generally these are consistent with generally accepted accounting standards. Internal auditors are employed by the organisation they audit. Their role would be to ensure that systems of internal control exist and management ensures that these controls are monitored (Victorian Standing Directions of the Minister for Finance 2008:2.5).

3.10 AUDITING THE VICTORIAN PUBLIC SECTOR

Audits provide audit committees with independent opinions independently arrived at as a result of professional standards. These professional standards are promulgated either through legislative backing or through what is commonly termed ‘generally accepted accounting principles’. In the Victorian environment the Victorian Auditor General has statutory obligations assigning his Office to be the sole independent external auditors reportable directly to Parliament (Victorian Audit Act 1994:S8). The audit committee is required to take appropriate steps to ensure all members have a clear and detailed understanding of and are satisfied with the (i) scope of work to be undertaken by the external auditor; (ii) audit process; and (iii) overall audit approach (Standing Directions of the Minister for Finance 2008:2.5(a)).

3.11 PERFORMANCE – ACCOUNTABILITY AND IMPLICATIONS OF VICTORIAN GOVERNMENT REQUIREMENTS

The Victorian Government has a well-documented set of legislative requirements (Victorian Financial Management Act 1994, Victorian Audit Act 1994, Victorian Public Administration Act 2004). It has implemented audit committees with the objective of improving governance and accountability (Victorian Standing Directions of the Minister for Finance 2008: 2.2(e)). The then Auditor-General Wayne Cameron in 2003 identified critical stakeholders, working in cooperation and coordinated by the audit committee, give the implemented system a reasonable degree of assurance through internal and external audits that these objectives are achieved (Cameron 2003).

3.12 AUSTRALIA

AUSTRALIAN FINANCIAL AND AUDIT LEGISLATION

The fourth part of this chapter explores what is available on matters relating to financial management and auditing in published official websites of other Australian States and Territories. The information gathered can be used to

compare practices between Victoria and the Federal, and other State and Territorial governments in Australia were conducted (Refer Table 3.4). It is noted from these comparative data that Victoria appears to be an innovative leader in promoting the use of audit committees in government organisations.

Table 3.4

Australian Federal, State and Territory Financial and Auditing requirements

Sourced from the official websites of the States and Territories of the Australian Commonwealth, this table lists the financial and audit legislative role and authority that Australian Federal, State and Territories Departments and agencies have to comply with:

	FINANCIAL MANAGEMENT	AUDIT
AUSTRALIAN FEDERAL GOVERNMENT	<p>Treasury focuses primarily on economic policy.</p> <p>The department is divided into four groups, Fiscal, Macroeconomic, Revenue and Markets with support coming from the Corporate Services Group. These groups were established to meet four policy outcomes:</p> <p>Sound macroeconomic environment The Treasury monitors and assesses economic conditions and prospects, both in Australia and overseas, and provides advice on the formulation and implementation of effective macroeconomic policy, including monetary and fiscal policy, and labour market issues.</p> <p>Effective government spending and taxation arrangements The Treasury provides advice on budget policy issues, trends in Commonwealth revenue and major fiscal and financial aggregates, major expenditure programmes, taxation policy, retirement income, Commonwealth-State financial policy and actuarial services.</p> <p>Effective taxation and retirement income arrangements The Treasury provides advice and assists in the formulation and</p>	<p>The Auditor-General is responsible, under <i>the Auditor-General Act 1997</i> (the Act), for providing auditing services to the Parliament and public sector entities. The Australian National Audit Office (ANAO) supports the Auditor-General, who is an independent officer of the Parliament</p> <p>http://www.anao.gov.au/director/aboutus.cfm</p> <p>Audit Committee The Audit Committee reviews audit issues by:</p> <ol style="list-style-type: none"> 1. supporting and enhancing the control framework; 2. providing assurance on published financial information; 119 Part 3 Management and accountability 3. monitoring, reviewing and reporting on compliance; and 4. assisting the Chief Executive to comply with all legislative and other obligations. <p>For example: The Treasury's Audit Committee</p>

	<p>implementation of government taxation and retirement income policies and legislation as well as providing information on material changes to taxation revenue forecasts and projections.</p> <p>Well-functioning markets The Treasury provides advice on policy processes and reforms that promote a secure financial system and sound corporate practices remove impediments to competition in product and services markets and safeguard the public interest in matters such as consumer protection and foreign investment.</p> <p>Reference:</p> <p>http://www.treasury.gov.au/content/about_treasury.asp?ContentID=316&titl=About%20Treasury</p>	<p>follows the recommended best practice guidelines issued by the Australian National Audit Office (ANAO) and reviews internal and external audits relating to the Treasury. The ANAO also attends the Treasury's Audit Committee meetings as an observer.</p> <p>Audit committee members as at 30 June 2009 were Mr David Parker (Chair), Ms Luise McCulloch, Mr Geoff Miller, Ms Deidre Gerathy, Mr Michael Willcock, Mr Tony McDonald and Mr Bruce Jones (the external representative). The committee met seven times during 2008 - 09.</p>
<p>NEW SOUTH WALES GOVERNMENT</p>	<p>The Office of Financial Management is the arm of NSW Treasury that advises the Treasurer and Special Minister of State and the NSW Government on state financial management policy and reporting, and on economic conditions and issues.</p> <p>The other arm of Treasury, the Office of State Revenue, administers and collects taxes, implements legislation relating to State revenue, makes the payment of various grants, subsidies, and rebates, and collects various outstanding state debts.</p> <p>NSW Treasury was established in April 1824. It is the oldest continuing Government agency in Australia.</p> <p>Public Finance and Audit Act 1983 No 152</p> <p>Reference:</p> <p>http://www.treasury.nsw.gov.au/Home</p> <p>http://www.treasury.nsw.gov.au/Links_Page#legislation</p>	<p>The <u>New South Wales Auditor-General</u> is responsible for audits and related services under the <u>Public Finance and Audit Act 1983</u>, the <u>Corporations Act 2001</u>, and other New South Wales Acts. The Auditor-General also provides certain assurance services in respect of Commonwealth grants and payments to the State under Commonwealth legislation.</p> <p>Reference:</p> <p>http://www.audit.nsw.gov.au/</p>

<p>QUEENSLAND</p> <p>GOVERNMENT</p>	<p>Financial Accountability Handbook</p> <p>The Financial Accountability Handbook (the Handbook) has been designed to assist accountable officers and statutory bodies discharge their obligations under the <i>Financial Accountability Act 2009</i> (the Act), the <i>Financial and Performance Management Standard 2009</i> (the Standard), and the <i>Financial Accountability Regulation 2009</i> (the Regulation).</p> <p>Section 15(2) of the Standard states that Accountable officers and statutory bodies must have regard to the Financial Accountability Handbook published by the treasury department'. This means that agencies must comply with the Handbook processes when those processes are applicable to agency circumstances.</p> <p>Agencies are encouraged to advise Treasury (Financial Management Branch) of any improvements to the contents of the Handbook for processes that may benefit other agencies in meeting their obligations under the current financial framework. Any feedback or suggestions should be emailed to fmbregistrations@treasury.qld.gov.au.</p> <p>The Handbook consists of:</p> <p><u>Volume 1: Introduction</u> Volume 1 discusses the principles underlying the Act and its subordinate legislation, its general purpose and scope, the framework within which it has been developed and its application to the various forms of government entities.</p> <p><u>Volume 2: Governance</u> Volume 2 discusses the application of fundamental governance requirements, including the implementation and review of systems of internal controls, agency management, internal and external audit and risk management.</p>	<p>Financial Administration and Audit Act 1977</p> <p>Queensland Audit Office is independent office assisting the Auditor-General conduct annual audits of more than 800 diverse public sector entities across Queensland. These entities include departments, statutory bodies, government owned corporations, local governments, Aboriginal shire councils and Island councils and their controlled entities.</p> <p>Reference: http://www.qao.qld.gov.au/pages/about/about.html</p>

	<p><u>Volume 3: Designing internal controls</u> Volume 3 provides guidance to agencies on the fundamental elements supporting the design and implementation of internal control systems.</p> <p><u>Volume 4: Monitoring/assessment</u> Volume 4 discusses the range of monitoring and assessment processes, tools and reports that should be employed in assessing an agency's performance in the delivery of its services, the effectiveness of outsourcing arrangements, machinery-of-Government changes and consideration of internal/external audit findings.</p> <p><u>Volume 5: Reporting systems</u> Volume 5 details reporting obligations under the Act and its subordinate legislation, the roles of internal and external audit functions in the reporting process and guidance on the development and production of effective management reports for use by agency management.</p> <p><u>Volume 6: Grant management</u> The objective of Volume 6 is to achieve a whole-of-Government approach to grant program development and administration while maintaining some flexibility to suit an individual agency's specific grant program requirements.</p> <p>The <u>Financial Management Tools</u> contain a number of examples and consideration points to assist agencies in assessing their obligations under the current financial legislation and Financial Accountability Handbook.</p> <p>Financial Accountability Act 2009</p> <ul style="list-style-type: none"> • Financial and Performance Management Standard 2009 • Financial Accountability Regulation 2009 • Financial Accountability Handbook <p>Reference:</p> <p>www.treasury.qld.gov.au</p>	
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<p>SOUTH AUSTRALIAN GOVERNMENT</p>	<p>Public Finance and Audit Act 1987.</p>	<p>The Public Finance and Audit Act 1987 provide the statutory mandate for the Auditor-General to conduct the audits of Public sector agencies. The major principles embodied in that Act provide for:</p> <p>The appointment of an Auditor-General;</p> <p>The Auditor-General to be independent of the Executive Government;</p> <p>The Auditor-General to audit the accounts of the Treasurer, Government Departments, Statutory Authorities and other public sector agencies, i.e. the public accounts and the accounts of public authorities;</p> <p>The Auditor-General to examine the efficiency and economy with which Government Departments, Statutory Authorities and other public sector agencies use their resources;</p> <p>The Auditor-General to report audit findings and other stipulated matters to both Houses of Parliament;</p> <p>The Auditor-General to have full and free access to all accounts, records, documents and information required for the discharge of the audit function;</p> <p>The Auditor-General, with the approval of the Treasurer, to charge fees for conducting audits.</p> <p>The Act specifically precludes the Auditor-General from conducting the audit of the Auditor-General's Department. In fact the Act requires that the accounts of the Auditor-General's Department be audited by an auditor appointed by the Governor. Reference: http://www.audit.sa.gov.au/overview.htm</p>
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<p>WESTERN AUSTRALIAN GOVERNMENT</p>	<p>Treasury plays a central role in managing Western Australia's public sector finances and in providing expert analysis and advice on the strategies and frameworks necessary for maintaining the State's economic and financial position.</p> <p>Reference::</p> <p>http://www.dtf.wa.gov.au/cms/section.aspx?id=550&linkidentifier=id&itemid=550</p> <p>Financial Management Act 2006,</p> <p>Financial Management Regulations 2007,</p> <p>Treasurer's Instructions (TI) and the</p> <p>Government Financial Responsibility Act 2000.</p>	<p>The Auditor General's role is to audit the finances and activities of the Western Australian public sector. In undertaking this task, the Auditor General will scrutinise the public sector for potential instances of wastage, inefficiency or ineffectiveness, and report his findings to Parliament.</p> <p>Reporting directly to the Parliament, The Auditor General is an 'ally of the people and Parliament'. He must act independently in carrying out all his powers and duties.</p> <p>Independence is the cornerstone of public sector audit. The Auditor General must be free from pressure, influence or interference from any source that may erode that independence.</p> <p>http://www.audit.wa.gov.au/rolesandresponsibilities.php</p> <p>The Office of the Auditor General operates under relatively new legislation. In July 2006 new Auditor General and Financial Management bills were tabled in Parliament. The new bills provided for separation of audit and financial management legislation in order to enhance the independence and structure of the Office.</p> <p>The Auditor General is appointed by the Governor under the <i>Auditor General Act 2006</i>.</p> <p>The Office of the Auditor General is established as a department of the public service under the FMA <i>Public Sector Management Act 1994</i>. As Chief Executive Officer, the Auditor General is also responsible for a range of staffing functions under this Act.</p> <p>As the accountable Authority, the</p>

		<p>Auditor General must discharge responsibilities under the <u><i>Financial Management Act 2006</i></u>.</p> <p>For a list of all legislation affecting the Office's activities, <u>2008-09 Annual Report</u>.</p> <p>Reference:</p> <p>http://www.audit.wa.gov.au/legislation.php</p>
<p>NORTHERN TERRITORY GOVERNMENT</p>	<p>The role of the Public Accounts Committee allows it to examine the accounts of the receipts and expenditure of the Northern Territory, and each statement and report tabled in the Legislative Assembly by the Auditor-General, pursuant to the <i>Financial Management Act</i> and the <i>Audit Act</i>. The committee may also be directed by the Legislative Assembly, the Administrator, or a Minister, to inquire into and report on any question relating to the public accounts of the Northern Territory.</p> <p>Reference:</p> <p>http://www.nt.gov.au/lant/parliament/committees/pac/pac.shtml</p> <p>http://www.nt.gov.au/ntt/index.shtml</p> <p>Financial Management Act 2009</p>	<p>Financial Management Act 2009</p> <p>s15 Internal audit</p> <p>(1) The Accountable Officer of an Agency shall ensure that the Agency has an adequate internal audit capacity to assist the Accountable Officer in the performance of his or her functions under this Act.</p> <p>(2) The person in charge of an internal audit of an Agency shall, as soon as practicable after completing the internal audit, report to the Accountable Officer of the Agency the result of the audit.</p>
<p>AUSTRALIAN CAPITAL TERRITORY GOVERNMENT</p>	<p>Financial Management Act 1996</p> <p>Financial Management Regulation 2005</p> <p>Triple Bottom Line Report The ACT Government is committed to initiatives to shape the development of a sustainable ACT, with sustainable ACT Government operations</p>	<p>Auditor-General Act 1996</p> <p>The Auditor-General is responsible for the audit of all ACT public sector agencies.</p> <p>The main functions of the ACT Auditor-General's Office, as set out in the Auditor-General Act</p>

	<p>at its heart. The ACT Government framework for sustainability is laid out in <i>People, Place, and Prosperity</i>, which was updated in 2009. <i>People, Place, Prosperity</i> uses a triple bottom line approach to sustainability, recognising the interdependence of social, economic and environmental well-being.</p>	<p>1996, are:</p> <ul style="list-style-type: none"> ▪ to promote public accountability in the public administration of the Territory; ▪ to audit annual financial statements of the Territory, departments and Territory authorities; and ▪ to conduct performance audits. <p>The Auditor-General also has responsibilities under the Public Interest Disclosure Act 1994, the Government Procurement Act 2001 and the Territory-Owned Corporations Act 1990.</p> <p>Reference: http://www.audit.act.gov.au/</p>
<p>VICTORIAN GOVERNMENT</p>	<p>Financial Management Act 1994</p> <p>n.b. This has been included to identify legislation in Victoria. Salient aspects of this legislation are highlighted in this thesis.</p>	<p>Audit Act 1994</p> <p>n.b. This has been included to identify legislation in Victoria. Salient aspects of this legislation are highlighted in this thesis.</p>

3.12.1 Australian Federal Government

In the Federal public sector the Australian National Audit Office in 1997 released a Better Practice Guide on Audit Committees in recognition of the introduction of the Financial Management and Accountability Act 1997 (FMA Act) and the Commonwealth Authorities and Companies Act 1997 (CAC Act) which require entities subject to these Acts to have an Audit Committee. Section 46 of the Financial Management and Accountability Act, provides for each chief executive to establish and maintain an audit committee. The broad functions of the audit committee are to enhance our control framework; improve

the objectivity and reliability of externally published financial and other information; and assist the Auditor-General to comply with all legislative and other organisational objectives.

3.12.2 Australian States and Territories

New South Wales – In 2005 the New South Wales Public Accounts Committee conducted a Review of Operations of Audit Committees. Its major recommendation was that all NSW government agencies should have an operating audit committee.

Queensland – Queensland produced in December 2009 a comprehensive set of audit committee guidelines. Titled Audit Committee Guidelines – Improving Accountability and Performance, it is by far the most comprehensive government set of guidelines in Australia.

Tasmania – The Tasmanian Government Treasurer's Instruction No 108 requires internal auditors to assist its audit committees.

South Australia – The Government of South Australia produced a Financial Management Toolkit requiring the Chief Executive to observe governance matters. Audit Committees are referred in the context of internal control.

Western Australia – The Western Australian Treasury Corporation published a document addressing audit committees which they recognise as a sub-committee of the Board and created to give the Board additional assurance regarding the quality, integrity and reliability of information systems and the adequacy of accounting and control systems to allow the Board to fulfil its responsibilities.

Northern Territory – The Northern Territory Auditor-General's Office published in 1997 a review of audit committees in Northern Territory public sector entities. They addressed the issue of independence where management are appointed into the audit committees. They addressed situations where boards do not exist and suggested that management takes responsibility and in these situations the Chief Executive Officer may be a member of the audit committee; or appoint

someone from management or an external representative. For organisations with larger board's wider representation and the audit committee is required and the Chief Executive Officer should be a customer and would not need to be a member. Another observation noted was that some audit committees approve the internal audit plan and commented that the CEO should be responsible. They want the audit committee to review how the code of conduct is communicated to personnel and to review code of conduct enquiries.

Australian Capital Territory – In 2007 the ACT Government published a document titled "Internal Audit Framework" This document also addresses audit committees requiring the Governing Body of each agency establish Audit Committee that would be responsible to the Governing Body.

The Queensland Audit Committee Handbook has recently been updated and will be used to compare with the Victorian Government audit committee requirements.

3.13 THE INTERNATIONAL ARENA

The fifth part of this chapter explores relevant audit committee matters addressed in the United States and the United Kingdom.

3.13.1 USA

Following the notable failures of a number of US companies including ENRON, WorldCom, the US government introduced the Sarbanes-Oxley Act in 2002. Targeted at "public companies" (preferred terminology in US to investor funded businesses) the Act established new or enhanced standards for US public company boards, management and public accounting firms. It also created the Public Company Accounting Oversight Board (PCAOB) to oversee, regulate, inspect and discipline accounting firms in their role as auditors of public companies. Sections 301 and 407 of the Sarbanes-Oxley Act (2002) contain standards related to the AC of publicly traded firms. These standards concern the following issues: responsibilities of the audit committee (AC), independence

and financial expertise, ability to handle complaints, authority to engage advisors, and funding support.

In essence, they prescribe:

- the role in which the AC contracts and interacts with external independent auditors;
- the composition of the AC; and
- the process and procedures through which the AC gathers information both within the organization as well as from outside sources.

Hoi, Robin, Tessonni (2007) summarised these standards below.

“Hiring, firing and compensating the auditor - Section 301 (2) of the Act requires ACs to be “directly” responsible for hiring, firing, and compensating external auditors, a function previously performed by top executives. It is noteworthy that the Act repeatedly stresses the direct link between the AC and the accounting firm. This excludes the possibility of the AC using an agent or intermediary to fulfil this function. Such strong language serves to emphasize the responsibility, and, therefore, the liability of the AC concerning this function.”

Responsibilities relating to registered public accounting firms – The audit committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee.

Independence and financial expertise - Section 301 (3) of the Act requires AC members to be independent and provides a fairly comprehensive definition of independence. More importantly, this section of the Act establishes the key responsibility of the AC: it is directly responsible for the appointment,

compensation, and oversight of the work of any registered public accounting firm employed by that issuer.

“Independence - In General – Each member of the audit committee of the issuer shall be a member of the board of directors of the issuer, and shall otherwise be independent. Criteria – In order to be considered independent for purposes of this paragraph, a member of the audit committee of an issuer may not, other than in his or her capacity as a member of the audit committee, the board of directors or any other board committee accept any consulting, advisory, or other compensatory fee from the (i) issuer; or be an affiliated person of the issuer or any subsidiary thereof. (ii) Section 407 contains rules regarding the disclosure of whether the AC has at least one financial expert.

Rules defining “financial expert” – The Commission shall issue rules, as necessary or appropriate in the public interest and consistent with the protection of investors, to require each issuer, together with periodic reports required pursuant to sections 13(a) and 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reasons therefore, the audit committee of that issuer is comprised of at least 1 member who is a financial expert, as such term is defined by the Commission.

Considerations – In defining the term “financial expert” for purposes (B) of subsection (a), the Commission shall consider whether a person has, through education and experience as a public accountant or auditor or a principal financial officer, comptroller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions. – an understanding of generally accepted accounting principles and (i) financial statements; experience in. – (ii) the preparation or auditing of financial statements of generally (a) comparable issuers; and the application of such principles in connection with the accounting (b) for estimates, accruals, and reserves; experience with internal accounting controls; and (c) an understanding of audit committee (d) functions (SOX 2002).

Internal control: complaint, counsel and funding - In addition, to audit oversight and AC composition, the Act contains other significant provisions in Section 301(4-6). These relate to procedures for treating complaints (the whistle-blower provision) and resources (human and material) for discharging AC responsibilities.

Complaints – Each audit committee shall establish procedures for – the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

Authority to engage advisers – Each audit committee shall have the authority to engage independent counsel and other advisors, as it determines necessary to carry out its duties.

Funding – Each issuer shall provide for appropriate funding, as determined by the audit committee, in its capacity as a committee of the board of directors, for payment of compensation – to the registered public accounting firm employed by the issuer for the purpose of rendering or issuing an audit report; and to any advisors employed by the audit committee (Sarbanes- Oxley Act 2002)

The American Institute of Certified Public Accountants (AICPA) produced an Audit Committee Toolkit 2004 designed to provide illustrative information which is not considered as standards or preferred practices. The toolkit addresses the Charter (authority, relationships), financial expertise, internal audit, independent audit, internal control, fraud, evaluating audit committees, and resources for audit committees, off-balance sheet. This is a comprehensive set of advice but does not specifically address risk management (AICPA 2004).

3.13.2 UK

In 2003 the Financial Reporting Council (FRC) published Audit Committees Combined Code Guidance designed to assist company boards in making

suitable arrangements for their audit committees and to assist directors serving on audit committees in carrying out their role. The six main role and responsibilities are :firstly to monitor the integrity of the financial statements of the company; secondly to review the company's internal financial control system and, unless addressed by a separate risk committee or by the board itself, risk management systems; thirdly to monitor and review the effectiveness of the company's internal audit function; fourthly to make recommendations to the board in relation to the appointment of the external auditor and to approve the remuneration and terms of engagement of the external auditor following appointment by the shareholders in general meeting; fifthly to monitor and review the external auditor's independence, objectivity and effectiveness; and lastly to develop and implement policy on the engagement of external auditor to supply non-audit services. Where the audit committee's monitoring and review activities reveal cause for concern or scope for improvement, it should make recommendations to the board on action to address the issue or to make improvements.

On the attribute of membership, the FRC states that there should be at least three members, who should be independent non-executive directors. The chairman of the company should not be an audit committee member. Appointments of audit committee members should be made by the board on the recommendation of the nomination committee (where there is one), in consultation with the audit committee chairman. Appointments should be for a period of three years, extendable by no more than two additional three year periods, so long as members continue to be independent.

On audit committee "standing orders", the FRC recommended that there should be no more than three meetings during the year but stated more meetings as required should be organised by the audit committee chairman and company secretary. No one other than the audit committee chairman and members is entitled to be present at a meeting of the audit committee. Attendance of external auditor and finance director should be based on invitation. The audit committee, without management, should meet the at least annually the external and internal auditors. FRC acknowledges that formal meetings may not be

sufficient and recognises that the audit committee keep in touch on a continuous basis with key people involved in the company's governance (board chairman, CEO, CFO, Lead Partner External Audit, and CAE Internal Audit).

The FRC maintains that audit committees should be provided with sufficient resources, supported by the company secretary and funds available to enable audit committees to take independent legal, accounting or other advice when the audit committee reasonably believes it necessary to do so. FRC also addressed remuneration to audit committee non-executive directors and to include compensation for additional responsibilities. FRC also reiterated that at least one member of an independent audit committee should have significant, recent, and relevant financial experience. Induction, training and written terms of reference to formalise relationships with the board were also stressed.

The Independent Commission for Good Governance in Public Services produced a publication titled *The Good Governance Standard for Public Services* in 2004. It acknowledges that public sector organisations spend a material amount of money. As most of the money is derived from taxpayers governance over public service has to be of a high standard. Good governance leads to good management, good performance; good stewardship of public moneys; good public engagement; and ultimately good outcomes.

“Good governance means six things:

- 1. Focusing on the organisation's purpose and on outcomes for citizens and service users.*
- 2. Performing effectively in clearly defined functions and roles.*
- 3. Promoting values for the whole organisation and demonstrating the values of good governance through behaviour.*
- 4. Taking informed transparent decisions and managing risk.*
- 5. Developing the capacity and capability of the governing body to be effective.*

6. Engaging stakeholders and making accountability real" (Independent Commission for Good Governance in Public Services 2004:5)

The Scottish Government's Audit Committee Handbook published in 2008 is an example of a comprehensive guidance for audit committee members. The Scottish government requires that good practice in relation to corporate governance requires that each organisation should be independently advised by an audit committee. The Scottish Government Audit Committee Handbook published in 2004 to compare with the Victorian Government's audit committee requirements.

3.12 SUMMARY - CONTEXT

In summary, this chapter described the context of this research.

- The first part of this chapter described the environment that audit committees generally operate in. It noted that failures of a number of notable organisations in the shareholder funded private sector as well as the government funded public sector and made the point that irrespective of which sector organisations operate in, failure in their ability to manage their finances may result in the failure of the organisation. Responses to these failures have lead regulatory bodies to the creation of audit committees to improve and to contribute to compliance with the principles of governance, accountability and performance.
- The second part of this chapter identified the differences in business environments and the changing management philosophy that evolved universally within the government public sector including the relevance of the use of audit committees; and
- The third part of this chapter identified the background, salient regulatory requirements on how audit committees are expected to operate in the Victorian government environment. The characteristics of functional audit committee; performed by members with the right qualifications and

qualities; in order to fulfil a mandated role has documented and promulgated by the Victorian government. What is not known is how it is applied in Victorian government organisations and this is why this research seeks knowledge of what is expected will be tested against what it is in practice.

- The fourth part of this chapter explored what was available on matters relating to financial management and auditing in published official websites of other Australian States and Territories.
- Finally, the fifth part of this chapter explores relevant audit committee matters addressed in the United States and the United Kingdom.



4. CONCEPTUAL FRAMEWORK

4.1 INTRODUCTION

An accounting conceptual framework can be defined as:

“a coherent system of inter-related objectives and fundamentals that should lead to consistent standards that prescribe the nature, function and limits of financial accounting and financial statements.”

Foulks Lynch (1998: Chapter 2).

A conceptual framework can establish the shared vision that outlines possible courses of action or present a preferred approach to an idea or thought (Berlin 1953). A conceptual framework also links a set of agencies and or a group of concepts that are broadly defined and specifically organised to provide a focus, a rationale and a tool for integrating and interpreting how audit committees achieve governance and business goals.

Audit committees are empowered to provide oversight over the integrity of financial reporting. Literature addressing the role of audit committees, the attributes of members of the audit committee and the functions they perform highlights the need to provide audit committees with recognised authority by legislation and charter; and audit committee members with the professional qualifications and experience

Not having the personnel to conduct the required collection and testing of data and information, audit committees rely on a number of organisational “players” and units. Audit committees must address the relationships that audit committees have with stakeholders (partners) with the Board (Minister,

departmental secretary, and chief executive officer), management, internal audit and external audit(paragraph does not add value unless point out main points discerned in each issue).

The model illustrated below (Figure 4.1) forms the general skeletal framework for this thesis. In the next chapter this model that has evolved by adapting the Institute of Internal Auditors' framework of good governance and Victorian Auditor General's (Cameron 2003) governance framework. The model incorporates organisation structure (board, audit committee, management, internal audit, external audit) with principles (governance), outputs (assurance, audit opinion) and the desired outcome (enterprise performance). The model highlights the high volume of communications and interaction between stakeholder partners is required for it to be effective. The connections do not represent the reporting structure of organisation structures rather they illustrate independent units communicating and interacting with each other.

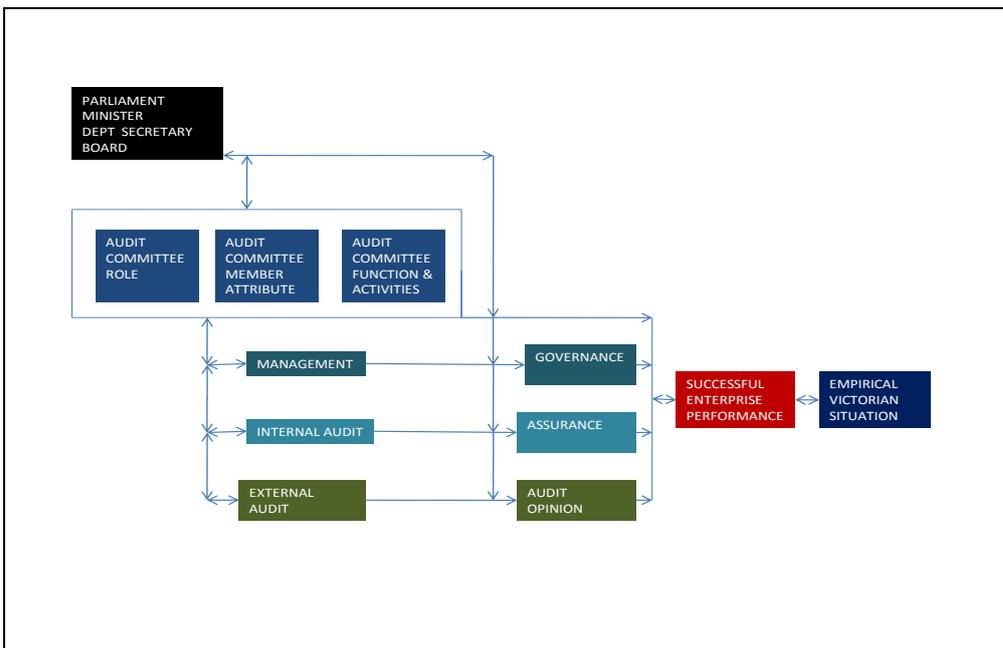


Figure 4.1 Suggested general operating framework of an audit committee

The general operating framework of an audit committee (see Figure 4.1) identifies the roles played by management, internal audit and external audit acknowledging that these organisational units provide the best source of information for audit committees to undertake their oversight function. The audit

committee is a sub-committee of the Board or in the case of government public sector organisations, the departmental secretary or chief executive officer. The audit committee in the diagram is dissected into three components – its role signifying its authority; its members and the professional attributes they should have; and its functions and activities that it conducts to obtain information for its oversight decision making processes and procedures. The interactive sharing nature between the audit committee, management, internal audit, and external audit is indicated by the directional arrows. The practices and deliverables expected from the main “partners/ stakeholders” indicate that from management, reports summarising organisational activities must be ethically executed within a governance framework. Assurance that risks and internal control systems are reviewed and weaknesses in systems addressed contributed by the professional independent assessment of internal auditors and the verification of figures presented in reports, financial or operational produced for internal and external “consumption” and the annual audits and audit opinion of the statutory financial statements delivered by the independent, statutorily appointed external auditors.

4.2 AUDIT COMMITTEE ROLE, ATTRIBUTE OF MEMBERS, FUNCTIONS – RESEARCH QUESTION 1

Research Question 1: What is the actual role of an audit committee; the attributes of its members; and the functions (activities, procedures, process) when such a committee operates in government public sector organisations?

An audit committee is a sub-committee of the organization’s responsible body comprised of knowledgeable individuals, created with specific roles, authority and functions to oversee financial and operational activities. Audit committees must rely on other organization units to provide information needed to fulfill its oversight duties.

For this thesis the model for an audit committee developed to operate within an organization consists of three functional components. Firstly, an audit

committee has to have a recognized existence, an organizational unit sanctioned by legislation, professional recognition, policy, with a structure and charter. Secondly, the audit committee members must be technically competent and independent. Thirdly, the audit committee must perform functions, activities professionally. These propositions lead to the first research question: What are the roles attributes and functions of an audit committee that enable it to perform successfully.

Audit committee role functions & member attributes Illustrated diagrammatically in Figure 4.2:

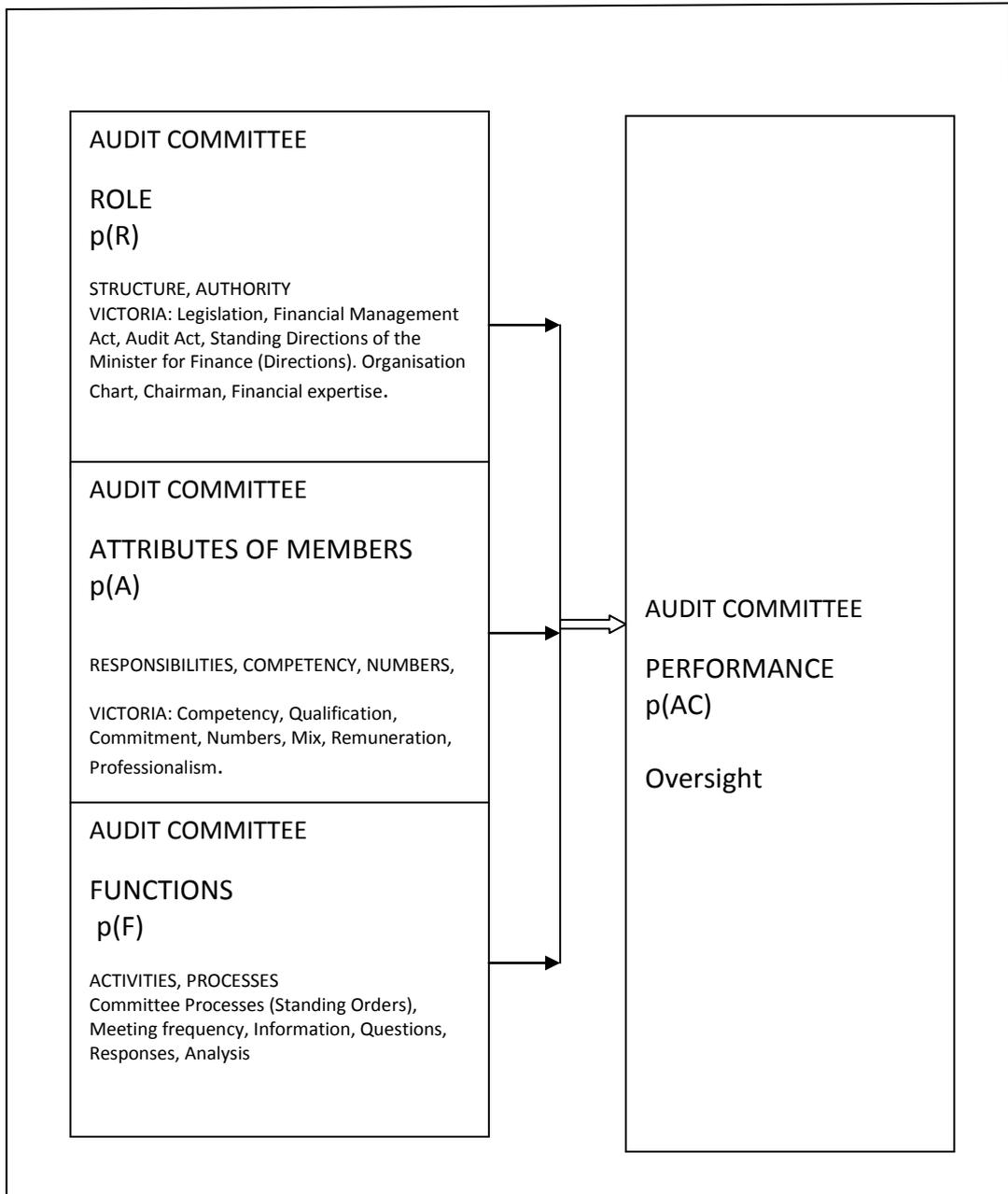


Figure 4.2

Audit committee - conceptually in a stand-alone framework.

SOURCE: Developed for this research

Illustrated as a formula:

$$p(AC) \propto f\{p(R) + p(A) + p(F)\}$$

where,

p(AC) represents performance of the Audit Committee.

p(R) represents the ROLE, authority, and mission of the audit committee.

p(A) represents the ATTRIBUTES of competent members of the audit committee.

p(F) represents the FUNCTION, process, procedures, and activities undertaken.

\propto represents the performance of the audit committee is proportional to the role, attributes of its members and the functions that it performs.

4.3 RELATIONSHIPS - STAKEHOLDER PARTNERS (MANAGEMENT, INTERNAL AUDIT, EXTERNAL AUDIT) – RESEARCH QUESTION 2

Research Question 2: What relationship and contribution do management (ethical practices, risk management, accountability, records and reports); internal auditors (internal control, risk assessment, evaluating assurance); and external auditors (verifying financial reports, providing assurance to other stakeholders), to assist audit committees to oversee governance (enterprise, corporate and business performance)?

There are a number of influential stakeholders that affect the performance of audit committees. These are represented in Table 4.1 drawn from the literature review.

Table 4.1 Major Stakeholder partners that influence Audit Committee performance

SOURCE: Developed for this research

	STAKEHOLDER	ROLE	EXPECTATION	
1	Parliament	Government Leadership Management Supplier of Funds	Outcome Output Accountability	
2	Board / Departmental Secretary	Management Leadership Systems & Processes for delivery of goods and services Accountability	Business Performance Governance	
3	Audit Committee	Governance Accountability Assurance Auditing	Oversee or Oversight Supervise or Omission	
4	Management	Accountability Stewardship Governance	Delivery of Services	
5	Internal Audit	Assurance Risk Management Internal Control Systems	Independent assurance about the adequacy of the internal control system and assessment of risk analysis.	
6	Auditor General	Accountability Auditing	Independent audit opinion of financial reports	
7	Government Policy making bodies	Accountability Processes Government Policies & Procedures	Financial policy – Department of Treasury and Finance Staffing policy – State Services Authority	

The main role of audit committees is to coordinate the activities of management, the internal audit process and the Auditor General (external audit), with a view to achieving overall organisational objectives in an efficient and effective manner. The ability of the audit committee to influence the performance of its immediate partners, namely the external auditors, internal auditors, and management (Cameron 2004). This accountability of an audit committee and its ability to influence performance and governance can be incorporated into the functional working model of an audit committee. This leads to the second research question - what relationship and contribution do management (ethical practices, risk management, accountability, records and reports); internal auditors (internal control, risk assessment, evaluating assurance); and external auditors (verifying financial reports, providing assurance to other stakeholders), assist audit committees to oversee governance (enterprise, corporate and business performance)?

Key Stakeholder partnerships are illustrated diagrammatically in Figure 4.3.

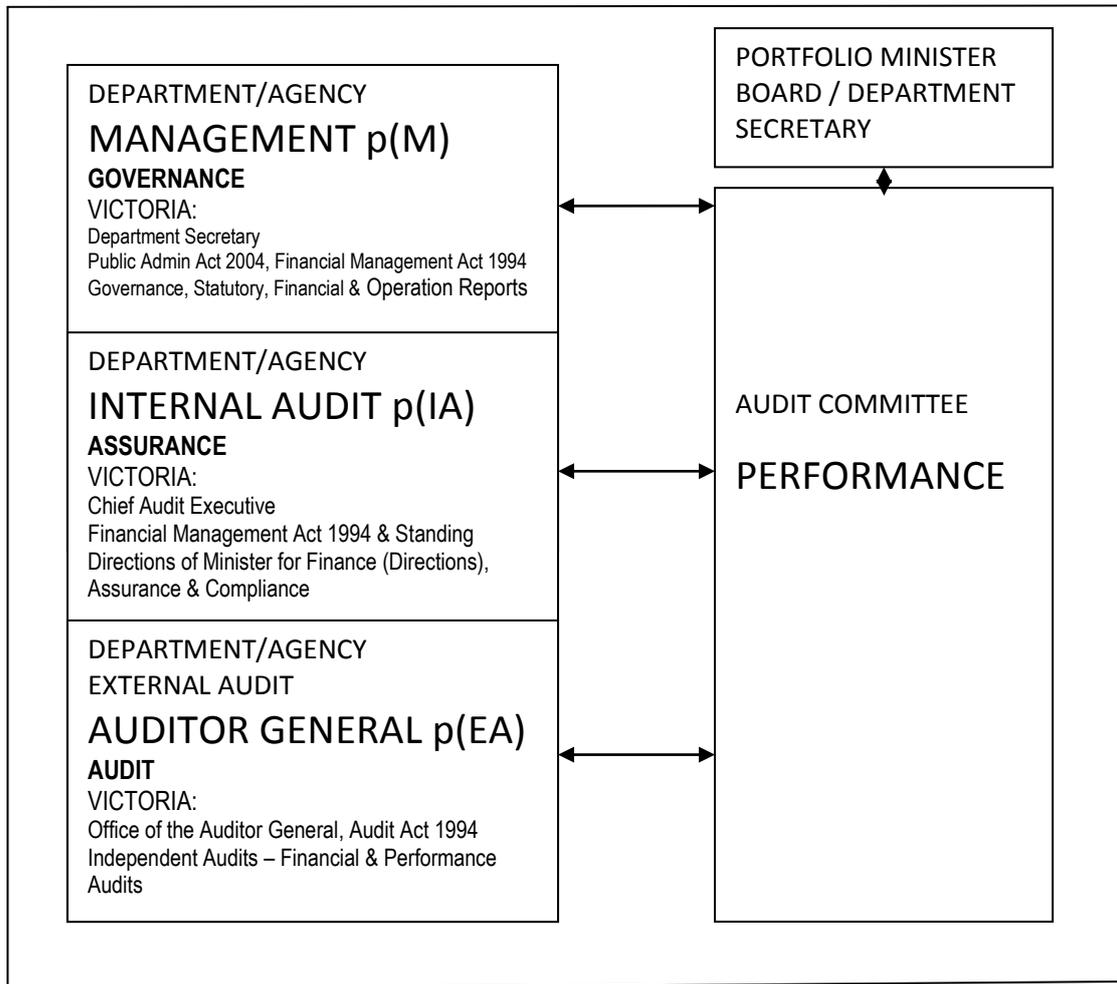


Figure 4.3

Audit committee interacting with major stakeholders in a dynamic framework.

SOURCE: Developed for this research.

Key stakeholder partnerships illustrated as a formula as follows:

$$p(AC) \propto f\{p(EA) + p(IA) + p(M)\}$$

where,

$p(AC)$ represents performance of the Audit Committee.

$p(EA)$ represents the performance of External Audit.

$p(IA)$ represents the performance of Internal Audit.

$p(M)$ represents the performance of Management.

\propto represents the performance of the audit committee is proportional to the performance of the external auditor, internal auditor and management.

The aggregate contribution of this partnership (EA, IA, M), incorporating the contribution and competence of their members and their unique professional activities together with those members of the audit committee would determine the performance of the audit committee and the degree of assurance and corporate governance that can be relied upon by stakeholders.

In the Victorian Public Sector the Victorian Auditor-General (VAGO) has “monopolistic” control over the external audit of Victorian Public bodies as sanctioned by legislation. This is documented under the Audit Act 1994 and reciprocated in the legislation that was passed in the creation of the public body. The Victorian Auditor General delegates and outsources a number of audits to accredited auditing firms and individuals. Outsourced audits are reviewed by the staff of the Victorian Auditor General.

4.4 SUCCESSFUL AUDIT COMMITTEES – RESEARCH QUESTION 3

Research Question 3a. What is success for an audit committee?

Research Question 3b. What are the characteristics of an audit committee that contribute to its successful performance?

The third research question looks at the indicators that enable successful performance outcomes of audit committees. The possible indicators, drawn from the literature review, include:

1. Availability of relevant information
2. Prompt answering of queries
3. Ready access to external auditors
4. Ready access to internal auditors
5. Continuity of membership
6. Written statement of objectives and responsibilities.
7. Prompt notification of problems by management.
8. Provision of an agenda and timely releases of material in advance of meeting.
9. Rotation of membership
10. Careful selection of members.
11. Independence from management
12. Review internal audit performance annually.
13. Report frequency and attendance at meetings in Annual Report.
14. Review external audit performance annually
15. Report Audit Committee activities in Annual Report.

4.5 FUNCTIONAL PERFORMANCE FRAMEWORK – RESEARCH

QUESTION 4

Research Question 4: What is an appropriate governance framework that enables audit committees to be successful?

The fourth research question examines the combined activities of the audit committee, management, internal audit and external audit in deriving a functional performance framework that would achieve true and fair reporting. The factors that influence the performance of audit committees in gaining assurance of governance are multiple, and it is the intent of this research to identify the factors that impact on the performance of audit committees in Victorian government organisations. The same factors can be contrasted with the influence and impact of audit committees in the private corporate sector which has been identified in prior research (Collier (1991), Kohler (2005), Canadian Institute of Chartered Accountants (1981), and Porter & Gendall (1998)). Audit Committees are accountable for ensuring a reasonable degree of assurance on the issue of governance. As suggested in the literature review cited above, good governance means focusing on the organisation's purpose and on its outcomes for citizens and service users. Good governance also means performing effectively in clearly defined functions and roles; promoting values for the whole organisation, and demonstrating them through its behaviour; taking informed, transparent decisions and managing risks; developing the capacity and capability of the governing body to be effective, and engaging stakeholders and making accountability real (OPM and CIPFA 2004). The success and issues encountered and question the theoretical operational relevance of audit committees in the public sector is explained in the context of stakeholder theory, stewardship theory and agency theory.

Performance is also dependent on the ability of organisational units to identify, and analyse perceived risks (AS/NS 4360-2004 Australian Standard on Risk

Management), in order that action can be initiated to mitigate the risks and allow the organisation to achieve performance indicators, output and outcome statements (Crawford & Stein 2002). The role as articulated by objectives of audit committee, chief executive officer (CEO), chief financial officer (CFO), external audit, internal audit, government legislation, etc.) evolve with the model to frame an evaluation of performance of audit committees in the Victorian Public Sector.

A governance framework is the structure, which is basically an organisational structures' upon which to build and develop the strategies that a public entity needs to reach planned objectives and to monitor performance (organisational programs, outputs, outcomes and public value) (Victorian State Services Website 2009). The fourth research question asks if the derived framework/model is an appropriate governance framework/model that enables audit committees successful performance.

4.6 OLD OR NEW TYPE AUDIT COMMITTEE – RESEARCH QUESTION 5

Research Question 5: What is the perceived role of audit committees as perceived by audit committee members?

The fifth research question looks at the operations of audit committees over time. Audit committee operations have changed over time. Sabia and Goodfellow (2002) identified characteristics peculiar to audit committees distinguishing the old form of audit committee to the new form. Using characteristics Sabia and Goodfellow identified, respondents were asked to determine how their audit committees operate at the time of responding to the questionnaire. The results will benchmark the situation of how audit committees operate in the public sector compared to the traits identified by Sabia and Goodfellow.

4.7 SUMMARY – CONCEPTUAL FRAMEWORK

The literature review identified that an audit committee must be competent in order to achieve its desired goal. In this chapter a detail organisational structure of interrelated organisational units were linked to form a functional working model of an audit committee and its major stakeholder partners. That means having an audit committee that has a clear role, qualified people, and performing meaningful functions. Performance is also shaped by the identification of stakeholders, more critically the vital stakeholders that will contribute to the achievement of the performance of audit committees to be assured that governance is complied with to contribute to the overall performance of the organisation.



5. RESEARCH DESIGN

5.1 INTRODUCTION

Research design is the science and art of planning procedures for conducting studies so as to get the most valid findings (Vogt 1993:196). A research design provides the plan to guide and focus this research. The conceptual framework was addressed in chapter 4, which suggested the factors influencing the performance of audit committee and the stakeholder partners that interact with it. The objective of chapter 5 is to document the research design applied to gather and analyse data that provides insight into audit committees of public sector organisations in Victorian.

The steps in the study are:

- Literature search including ProQuest, Emerald databases,
- Secondary data from books, websites, and journal articles written on audit committees, governance, performance, accounting, and auditing.
- Primary data collected in a survey.

The major source of empirical primary data came from the distribution of a survey questionnaire sent to the heads of departments requesting that they, their internal auditors, independent chairs/members, managerial appointed members of the audit committee or administrators of their audit committees respond to that questionnaire. This research also gathered knowledge, from the

official web sites, of financial management, auditing and audit committees in the other Australian States and Territories, USA and UK.

The Web-based survey was selected as the main method of data collection.

The advantages of the Web-based survey are:

- Convenience: This technique represents a convenient and efficient way of reaching potential respondents. They are able to receive the questionnaire and complete it in the privacy of their home or office. Government organisations can be contacted via emails.
- Rapid data collection: Information is efficiently transferred electronically.
- Cost-effectiveness: This method is more effective than mail-out surveys as there is no need for postage or paper supplies.
- Ample time: Respondents can reply to the survey before a due date and can consult their records before responding.
- Easy to follow-up: Reminders and clarification can be communicated efficiently.
- Confidentiality and security: Personal or sensitive information supplied by the respondents can be protected on a secured server.
- Specialised populations: The Government sector is a specialised and well-defined population whose email addresses are readily available.
- Complexity and visual aids: These can be utilised in web-based surveys to explain more complex questions.

Web-based surveys have certain disadvantages:

- Limited respondent bases: This method is limited to populations that have access to email.
- Self-selection: Those not comfortable with email may not respond. This survey provided respondents with the option of printing and responding to the questionnaire on hard copies and an address to mail-in their responses.
- Lack of interviewer involvement: Since there was no interviewer involvement in Web-based survey, unclear questions cannot be explained. This survey provided phone and email access to respondents who needed clarification.

Web-based surveys are not complex to administer, especially in comparison to the traditional mail –out technique (Rea & Parker 2005:11-13). This survey selected the use of a commercial product branded ‘Survey Monkey’ (www.surveymonkey.com).

5.2 RESEARCH DESIGN

5.2.1 Type of research

This research of audit committees in the public sector is exploratory and pioneer in approach (Creswell & Clark 2007). According to Sekaran (2000), an exploratory study is undertaken when not much is known about the situation at hand, or when no information is available on how similar problems or research issues have been solved in the past (Sekaran 2000:123). This is the situation with audit committees in government taxpayer-funded public sector organisations. The research design in this situation included the formulation of a functional framework based on qualitative information and the design of measures or instruments to test the identified variables (Creswell & Clark 2007:75).

5.2.2 Unit of Analysis

The unit of analysis is the variable under study and the research questions about which data are collected and analysed (Collis & Hussey 2003:357). The unit of analysis for this research is the audit committee (factors within an audit committee – role member attributes, functions performed), and its relationship with the stakeholder partners (management, internal audit, external audit) that interact with the audit committee to enable it to perform its mandated role, through its members, adopting professional functions and procedures. These stakeholder partners include internal auditors, management and supporting administrators of audit committees. The Victoria Auditor General represents a critical stakeholder and is appointed by legislation to be the external auditor for all Victorian State government taxpayer funded departments, the local government municipal councils in Victoria, and a small sample of public

agencies including universities and water bodies. A response was also requested and received from a management member of an audit committee in the Commonwealth Federal government financial policy department. The five research questions in this research query the role of the audit committee, its relationship with its partners, issues on success factors, a framework of an effective audit committee, and a situational picture of audit committees in Victoria.

5.2.3 Time horizon

The survey questionnaire was distributed and responses received in 2009. Data about governments and professional bodies were obtained from their official websites extracted in 2009 and 2010. The information available during 2009 and 2010 included knowledge of the purpose of the organisation, their activities, and copies their publications of Best Practice Guides and Annual Reports.

5.3 SECONDARY DATA COLLECTION

Data collected was used for comparing and benchmarking the Victorian regulations against government regulations in practice from other Australian States and Territories and other countries (USA & UK). The Victorian government requirements are documented in the Victorian Government Financial Management Compliance Framework. This framework is issued under the authority of the Minister for Finance in the Standing Directions of the Minister for Finance. The Standing Directions support the legislative principles in the Financial Management Act 1994 and the Audit Act 1994. The literature review documented in chapter 2 identified theories which were helpful when consideration was made of the data required for this research. There were a number of other sources of information that provided valuable information for comparing the role, functions performed and audit committee attributes that provided a good reflection of audit committees in the Victorian government environment. These included books, journal articles, and websites.

5.4 PRIMARY DATA COLLECTION

5.4.1 Selection of the sample

The empirical data was collected from Victorian Government sources. Information was sourced from websites, annual reports, and special reports. Information was also obtained through direct discussions with officials from the Victorian Government Departments and agencies. The researcher worked as an external auditor in the Office of the Auditor-General Victoria; as an internal auditor in a Victorian semi-government body and an internal auditor in two Victorian organisations at State Government Departmental level. The researcher also worked as financial accountant in a Commonwealth statutory body. The researcher having worked in the government sector since 1975 was reasonably well informed and knowledgeable of the business of the government public sector. This included legislation, regulations, policy from the Victorian Government's central agency department the Department of Treasury and Finance, the major government departments. Similar enquiry was made by obtaining information from the Office of the Victorian Auditor General via the use of an email request to the Office.

The population of organisations funded by the Victorian government and legislated to be audited by the Auditor-General Victoria include departments (10 major Departments), public bodies (112 Agencies), universities and educational institutions (24 organisations), public hospitals and ambulance services (94 organisations), community health (39 organisations), superannuation funds (2 organisations), water authorities (28 organisations), regional waste management groups (13 organisations), and local government municipal councils (79 Councils), regional library corporations (12 organisations and public cemeteries (14 organisations) (VAGO Annual Report 2008). Points of contact in these organisations were published in the Victorian Government Directory.

This research project sent questionnaires to the ten major departments and all of the seventy nine local government municipal councils. The State government

structured these ten departments as “parent companies” for services they deliver via a host of “subsidiaries”. For reasons of protocol the questionnaires were addressed to the heads of the Departments with the recommendation that respondents to the questionnaire must be involved stakeholders, be they departmental secretaries, chief executive officers, chair of audit committees, internal auditors, external auditors, coordinators/administrators of audit committees.

5.4.2 Design and pilot testing the Questionnaire

A questionnaire was structured to capture information about government audit committees.

Stakeholders in Victorian government organisations were invited to participate who were involved with chairing of audit committees, administrating and supplying information to audit committees. They were asked to express their perception of the role they aim to accomplish, and how they are achieving their objectives, including assurance (risk) and corporate governance. The questionnaire was designed to seek responses to salient issues that affect performance, corporate governance, role, communications, stakeholder relationships between the Audit Committee management, internal audit and external audit, and issues identified from literature and from legislation (Audit Act – Victoria 1994, Victorian Financial Compliance Framework 2008, Sarbanes-Oxley 2002, CLERP9 2004); professional bodies (Institute of Internal Auditors, AICPA – Audit Committee Effectiveness Centre 2000); and private sector surveys (Collier 1991) .

The questionnaire items were selected from questions from the Victorian government performance assessment questionnaire (Appendix 3.4) and issues identified in the literature review. The factors within an audit committee were identified as their mandated role, attributes of members and the functions performed. The questionnaire also requested information about the audit committee’s major stakeholder partners – management, internal auditors and external auditors.

The questionnaire was designed to include open and closed questions. Closed-ended questions provide a fixed list of alternative responses and ask the respondents to select one or more of the alternatives as indicative of the best possible answer (Rea & Parker 2005:259). Respondents are provided with opportunities to contribute additional information and to voice their views. The majority of answers to questions were closed questions. Questions also provided a scaled response continuum measured from extreme strongly agree to extreme strongly disagree to be answered in accordance with a five-point Likert type scale in order to elicit attitudinal information from respondents (Rea & Parker 2005:68). This turns the question into a statement and asks the respondent to indicate their level of agreement with the statement by ticking a box or circling a response. (Collis & Hussey 2003:184). Likert scale provides a greater range of answers for respondents.

Questions for this research were pilot tested in conjunction with the Victorian Government's Audit Committee Self-Assessment Questionnaire (Appendix 3.4) with the Audit Committee at Victoria Police.

Table 5.1 Data requested

SOURCE: From the Survey Questionnaire

<p>GENERAL INFORMATION OF RESPONDENT'S ORGANISATION</p> <ul style="list-style-type: none"> • Name of the organisation. • Gender of respondent - male or female. • Organisation's role (as classified by the Victorian Auditor General). • Number of people employed in the respondent organisation. • Annual budget of the respondent organisation. • Existence of an audit committee. • Date of creation of audit committee. • Number of independent members in the audit committee. • Number of audit committee who are internal managers/Directors. • Respondent's role (position title) in the organisation. • Independence of the Chairperson of the audit committee.
<p>AUDIT COMMITTEE</p> <ul style="list-style-type: none"> • Define the role of the audit committee. • Reporting chain of command for the Chairperson of the audit committee. • Audit committee Charter. • Attributes of audit committee members. • Remuneration of external audit committee members. • Amount each external independent Audit Committee member is paid each financial year. • Audit Committee member's engagement, induction, briefed on ethic, covered by insurance. • Functions/Activities assigned to audit committee. • Issues/practices are important in contributing to the success of audit committees. • Performance reviews of the audit committee. • Person performing Quality Assessment reviews.
<p>INTERNAL AUDIT</p> <ul style="list-style-type: none"> • Chief Internal Audit Executive chain of command. • Internal audit internally sourced, co-sourced or completely outsourced. • Audit committee and the objectivity of the internal audit team. • Audit committee and constructive feedback to the Chief Internal Audit. • Audit committee and Internal Auditor services.
<p>MANAGEMENT</p> <ul style="list-style-type: none"> • Managerial Head of the organisation. (Departmental Secretary, CEO, Chair of Board) • Chief Financial Officer's role. • Management support of the audit committee. • Audit committee's relationship with management.
<p>EXTERNAL AUDITORS</p> <ul style="list-style-type: none"> • Victorian Auditor General. • Audit Committee discuss issues with the external auditors. • Audit committee's relationship with external auditor.

<p>GOVERNANCE</p> <ul style="list-style-type: none"> • Audit committee numbers, independence, charter, resources. • Audit committee corporate governance activities of oversight of attributes of internal control, risk, and budget. • Audit committee reviewing corporate risk management evaluations • Audit committee oversee corporate performance.
<p>ASSURANCE</p> <ul style="list-style-type: none"> • Audit committee overseeing the program and reports of the Internal Auditor. • Audit committee ensure that the external auditors deliver professional service.
<p>PUBLIC VALUE</p> <ul style="list-style-type: none"> • Audit committee influence over the achievement of public value on the following issues – transparency, compliance, stakeholder interest, resources, community, honesty, ongoing service, managing operations, internal control and environmental issues.
<p>PERFORMANCE</p> <ul style="list-style-type: none"> • Current characteristics of the audit committee based on Sabia and Goodfellow's classification of old or new type of audit committees.

5.5 ANALYSIS

The gathering of primary empirical data involved the use of an on-line questionnaire. The questions within the questionnaire were developed based on the conceptual model explained in the Conceptual Framework chapter of this dissertation.

The empirical data from the survey questionnaire was collated within the Survey Monkey software. SPSS version 18 was used to analyse the data. Data analysis included descriptive statistics (frequency, means) and inferential statistics (regression, ANOVAs, t-tests, exploratory factor analysis). These statistical analytical tools were selected to analyse the data collected to determine their reliability and consistency, considering the variety of responses received.

5.6 ETHICS

The Victoria University Ethics Committee approved the conduct of the survey and the questionnaire used to gather data from targeted sources (Appendix 0.2). Confidentiality was assured in the questionnaire.

5.7 RESEARCH - PROBLEMS, EFFECTS & SOLUTIONS

A large number of public agencies in Victoria receive taxpayer budgeted funds and by legislation are required to be audited by the Victorian Auditor General under the Audit Act of 1994. The names of these organisations are reported in the Annual Report of the Auditor General to Parliament. The size of the population meant that classification and sampling techniques had to be applied. The report of the Victorian Auditor-General provided categorisation of these organisations in his audit of these organisations. The decision in gathering data was based on materiality - to classify the organisations according to the amount of public moneys they receive. The Victorian government's budget papers indicated that government departments received the major portion of taxpayer funds. Thus, using that criterion the research focused on the ten major state government departments and local government municipalities. In addition to this a small judgemental random sample of other public agencies, Universities and Water Bodies were requested to respond to the questionnaire to gain an appreciation of audit committees in public agencies. A response was sought from an audit committee of the Federal government's financial policy department and the response was statistically analysed and compared to the responses received from the state government organisations. In taking this sampling approach, the research was able to focus on the organisations that utilise material amounts of public funds, focusing on two levels of government, namely State government and local government. The response from the financial policy development department of the Federal government provided an opportunity to compare Victoria's policy against the Federal government's policy on audit committees. Validity and reliability are discussed in chapter 7 of this thesis.

5.8 SUMMARY - RESEARCH DESIGN

Research design adopted an approach on who, what, where, when and how data were to be collected. The data collection technique was made using of the web based package called Survey Monkey. Survey Monkey has basic tools for analysis and good graphical capabilities for presenting results. SPSS was used for analysing responses because it was able to analyse the issues raised.

The empirical data for this research came from the Victorian State government departments, the State's local government municipal councils, a small sample of State government public agencies and a response from a financial policy making Federal department. These organisations were selected because they receive and utilise material taxpayer and user pay sourced public moneys. There are numerous other public agencies that receive public moneys but for the purpose of this research the researcher is confident that the selected categories of State government departments and local government municipalities provides a fair representation of the targeted respondents – namely the role of audit committees at the State and local government level with spot comparisons to some State public agencies and a Federal government department.



6. DESCRIPTIVE ANALYSIS OF SURVEY RESULTS

6.1 INTRODUCTION

This chapter presents the results of (a) the response rates to the survey, and (b) the answers to the research questions. This survey targeted government departments that functionally provide services to the State and liaise with the federal government to develop policies and distribute taxpayer generated funds to States and Territories of the Commonwealth. The survey was sent to the major departments. Nine departments out of the ten major departments responded. The Victorian Department of Treasury and Finance declined the offer to respond. The Victorian Department of Treasury and Finance provide the policy and procedural matters relating to finance and accounting. Their policies are well developed and documented in government websites. The researcher met on two separate occasions with the coordinator of the Department's audit committee and a management member of their audit committee and noted they reiterated that there was a strong desire to comply with what have promulgated in the Standing Directions of the Minister of Finance – the source for procedures in the administration of audit committees for all Victorian state government funded agencies.

This survey also targets local government municipalities that service the whole state and are geographically located in towns and cities around the state. The survey was sent to the seventy nine municipal councils. Thirty six responses were received.

6.2 EMPIRICAL PROFILE OF A SELECTED SAMPLE OF VICTORIAN GOVERNMENT AUDIT COMMITTEES SURVEYED.

6.2.1 SURVEY PARTICIPANTS

This survey is exploratory in nature and aimed at determining the role and activities of audit committees in government organisations. The focus of the survey, targets state level government departments and the next level of government, local government municipalities. State government departments are organisations funded from taxes and redistributed through State budget allocations announced annually and published in the Treasury's Budget Papers (DTF 2010).

Parts of the survey questionnaire were pilot tested on the audit committee in the State organisation that the researcher worked. Questions that were not included in the Victorian Audit Committee Self-Assessment Questionnaire (Appendix 3.4) were included in the pilot test. Results of the Self-Assessment was collated and reported to the audit committee.

The following categories of Victorian Government organisations were amongst the sample of Victorian government organisations invited to participate in the survey:

1. Victorian government departments;
2. Victorian local government municipal councils;
3. Victorian public bodies, universities and water bodies.

Financially, departments and councils are the two major levels of government. Public agencies are established to further deliver services but departments are generally responsible for the management of the major portion of budgetary financial resources. A response was also requested and received from an audit committee member of a financial policy making Australian federal government department.

6.2.2 RESPONSE RATES

This Survey targeted two major levels of government – the State government departments and the Local government municipal councils. Responses were acquired from a small sample of Victorian Government funded public agencies and from a Federal financial policy development government department. Email requests were sent to all the departmental heads/secretaries of major state government department and all the chief executive officers of local government municipalities, requesting responses from those involved with their audit committees.

Responses from State government departments, local government municipalities, and public sector agencies indicate that audit committees since 1994 is now an established organisational unit within Victorian Government organisations. All respondents to the survey acknowledged that they have audit committees. Twenty six per cent had audit committees before the implementation of the 1994 Financial Management Act. That means the majority of respondents only established their audit committees following the 1994 legislation.

Fifty four per cent of the respondents had three independent members, and twenty seven per cent had two independent members. One had greater than five independent members. Forty per cent of respondents' audit committees do not have members who are internal managers/directors. The results question their status, and whether these audit committees are totally independent after all (Refer to Table 6.1).

Table 6.1

SOURCE: VAGO Annual Report

**THE RESPONSES RECEIVED - ORGANISATIONS AUDITED BY THE AUDITOR
GENERAL VICTORIA**

	Responses Received	Percentage of total Responses received
Department (90% of Departments (10) responded)	9	17.0%
Public Body (3% of Public Bodies (112) responded)	3	5.7%
University & Educational Inst (13% of Unis (24) responded)	3	5.7%
Water Authority (7% of Water Bodies(28) responded)	2	3.8%
Municipal Council (46% of Councils (79) responded)	36	67.9%
TOTAL	53	

6.2.3 HOW THE DATA IS COLLATED IN SURVEY MONKEY.

Data automatically downloaded from responses and a small number of punched into Survey Monkey is allocated values that allows calculations of means and ranking to occur.

6.3 AUDIT COMMITTEES - ROLE - ATTRIBUTES - FUNCTIONS

Research Question 1: What is the actual role of audit committees; the attributes of members; and the functions (activities, procedures, process) of an audit committee when they operate in government a public sector organisation?

In this research, responses from three sets of questions asked in the Questionnaire were selected as factors (role, attributes and functions), for detailed analysis as they provided an insight into the workings of audit committees in the Victorian public sector. These evolved from the review of literature identified as possible critical aspects that contribute to the success (as an outcome variable) of effective governance. The three factors (role, attributes,

and functions) and the elements that support them provide answers to better evaluating audit committees.

The role of audit committees; the attributes (knowledge and quality) of audit committee members; and the functions (activities) that audit committees perform provides valuable insight into what happens in government audit committees. The questionnaire asked what the objectives of the audit committees were; what the recipients perceived audit committees do; and who is responsible for the people that can make it happen.

6.3.1 Role of audit committees

Referring to Table 6.2 on the role of audit committees addressing the question on the role of their audit committee, respondents collectively agreed that audit committees are strengthened by the inclusion of non-executive members. They also were of the consensus that audit committees assist management on good governance practices and audit committees preserve and enhance the independence of auditors (Refer to Table 6.2).

Table 6.2

SOURCE: Responses from Question 12 of the Survey Questionnaire

ROLE OF AUDIT COMMITTEES -50 RESPONDENTS RANKED	MEAN
1. Strengthened by the inclusion of non-executive (independent) members	4.86
2. Assist management on good governance practices	4.6
3. Preserve and enhance the independence of internal auditors	4.56
4. Challenge management, internal auditors and external auditors with the audit committee's own view on issues	4.54
5. Discharge responsibilities for prevention of fraud, other irregularities, and errors.	4.5
6. Assist management to discharge their statutory responsibilities with regard to internal control	4.48
7. Preserve and enhance the independence of external auditors	4.47
8. Assist management discharge their statutory responsibilities with regards to financial reporting	4.38
9. Scrutinise the organisation's compliance with legislative requirements (Financial Management Act 1994)	4.32
10. Respect the difference between oversight and line management Increase the confidence of Parliament and Public on the credibility and objectivity of financial statements	4.24
11. Assist auditors in the reporting of serious deficiencies	4.18
12. Improve communication between internal organisation committees and the external auditor	4.14
13. Improve communications between management and the external auditor	3.82
14. Provide a forum for arbitration between management and auditors (internal and external)	3.76
15. Engage outside experts when required.	3.56
	3.55

Likert scale: 5=strongly agree to 1=strongly disagree

Referring to Table 6.3 regarding the role that an audit committee performs is ultimately to ensure that governance is observed by management and assurance is provided by internal and external auditors (Refer to Table 6.3). Of concerns expressed by the respondents include the ability of audit committees to engage outside experts when appropriate; ability to provide a forum for arbitration between management and auditors (external and internal); improving communications between internal organisation committees with external auditors; and improving communications between management and external auditors.

Table 6.3

Role of your audit committee

SOURCE: Responses from Question 12 of the Survey Questionnaire

<i>What is the role of your Audit Committee? In your opinion:</i>							
<i>Answer Options</i>	<i>Strongly disagree</i>	<i>Disagree somewhat</i>	<i>Neither agree nor disagree</i>	<i>Agree somewhat</i>	<i>Strongly agree</i>	<i>Rating Average</i>	<i>Response Count</i>
<i>1. Does it assist management on good governance practices?</i>	0	0	0	20	30	4.60	50
<i>2. Does it scrutinise your organisation's compliance with legislative requirements - Financial Management Act 1994?</i>	0	0	6	22	22	4.32	50
<i>3. Is it strengthened by the inclusion of non-executive (independent) members?</i>	0	0	2	3	45	4.86	50
<i>4. Is it discharging its responsibilities for the prevention of fraud, other irregularities, and errors?</i>	0	0	4	17	29	4.50	50
<i>5. Does it preserve and enhance the independence of external auditors?</i>	0	0	9	8	32	4.47	49
<i>6. Does it preserve and enhance the independence of internal auditors?</i>	0	0	5	12	33	4.56	50
<i>7. Does it improve communication between internal organisation committees and the external auditor?</i>	0	3	19	12	16	3.82	50
<i>8. Does it improve communication between management and the external auditors?</i>	0	2	17	22	9	3.76	50
<i>9. Does it provide a forum for arbitration between management and auditors (internal and external)?</i>	4	3	15	17	11	3.56	50

10. Does it increase the confidence of Parliament and Public in the credibility and objectivity of financial statements?	0	2	7	21	20	4.18	50
11. Does it assist the auditors in the reporting of serious deficiencies?	0	2	6	25	17	4.14	50
12. Does it assist management to discharge their statutory responsibilities with regard to internal control?	1	0	4	14	31	4.48	50
13. Does it assist management discharge their statutory responsibilities with regards to financial reporting?	1	0	3	21	25	4.38	50
14. Does it challenge management, internal auditors and external auditors with the Audit Committee's own view on issues?	0	1	2	16	31	4.54	50
15. Does it engage outside experts when appropriate?	6	5	8	16	14	3.55	49
16. Does it respect the difference between oversight and line management?	0	1	8	19	22	4.24	50
Other (please specify)							3
						answered question	50
						skipped question	3

6.3.2 Attributes of audit committee members

On the characteristics of audit committee members it is noted that although independent appointments have been made, most audit committee members do not know the length of their tenure. Most do not receive induction or an orientation program to the organisations. Most members are not personally

covered by indemnity insurance and a slight majority have not been briefed on ethics, care and diligence. (Refer to Figure 6.1)

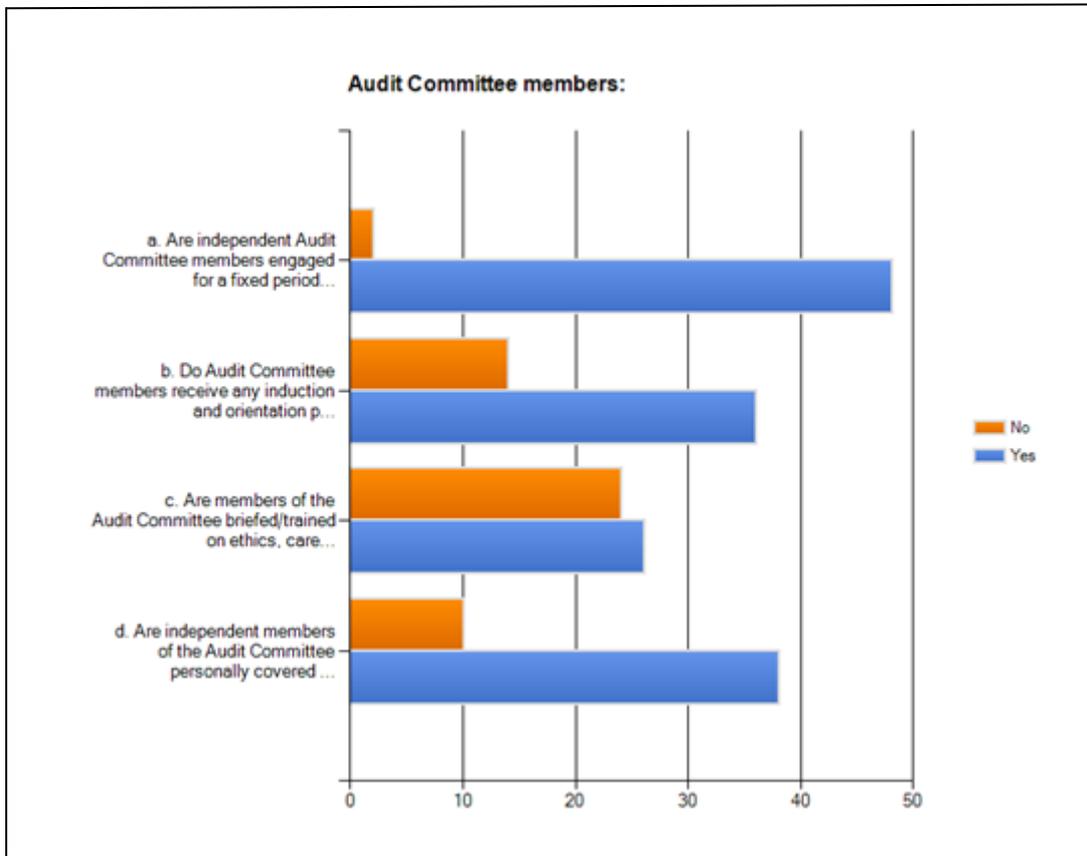


Figure 6.1
 Audit Committee Members
 SOURCE: Responses from Question 18 of the Survey Questionnaire

Table 6.4

Attributes of audit committee members

SOURCE: Responses from Question 15 of the Survey Questionnaire

<i>What attributes of Audit Committee members are important in contributing to the success of Audit Committees?</i>							
<i>Answer Options</i>	<i>Strongly disagree</i>	<i>Disagree somewhat</i>	<i>Neither Agree nor Disagree</i>	<i>Agree somewhat</i>	<i>Strongly agree</i>	<i>Rating Average</i>	<i>Response Count</i>
<i>1. Knowledge of the organisation's business.</i>	0	1	0	22	26	4.49	49
<i>2. Knowledge of finance and accounting.</i>	0	0	2	20	28	4.52	50
<i>3. Knowledge of auditing.</i>	0	2	4	23	21	4.26	50
<i>4. Variety of backgrounds among AC members</i>	0	0	4	18	28	4.48	50
<i>5. Enthusiastic Chairman.</i>	0	0	1	15	34	4.66	50
<i>6. Ability to devote the necessary time.</i>	0	0	0	13	37	4.74	50
<i>7. Sound judgement.</i>	0	0	0	5	45	4.90	50
<i>8. Full understanding of AC's purpose and responsibilities.</i>	0	0	0	5	45	4.90	50
<i>9. Independence from management.</i>	0	0	0	6	44	4.88	50
<i>Other (please specify)</i>							4

Respondents were of the opinion that the following are perceived as important attributes that audit committee members should have to contribute in running a successful audit committee. Respondents rated the following attributes may contribute to the effective performance of audit committees:

1. Sound judgement
2. Full understanding of the purpose and responsibilities of the audit committee
3. Independent from management
4. Ability to devote the necessary time
5. Enthusiastic Chairman
6. Knowledge of finance and accounting
7. Knowledge of the organisation's business
8. Variety of backgrounds among the committee
9. Knowledge of auditing

The majority of independent members responded that they are paid \$1000 up to \$4000 each financial year. Three respondent organisations indicated they do not remunerate their independent external audit committee members. The reasons for not paying are not known. There is no government guideline on this issue. (Refer to the Figure 6.2)

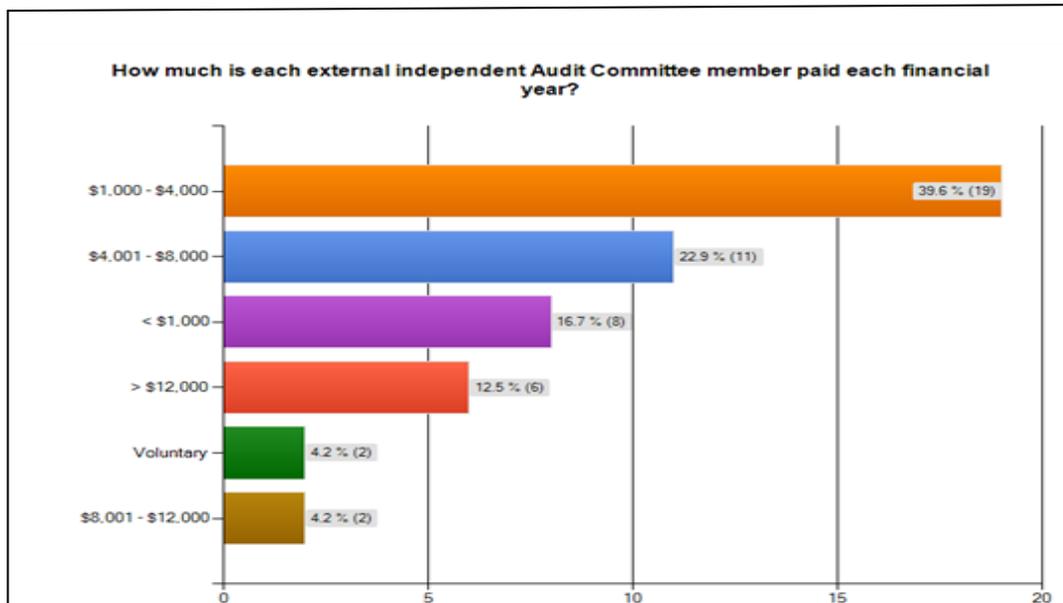


Figure 6.2
Remuneration
SOURCE: Responses from Question 17 of the Survey Questionnaire

The Attributes that an audit committee possess is reflected on the competency of its members, their contribution and their relationship with the major stakeholders (Refer to Table 6.4). The findings indicate that audit committees have the required knowledge to perform their duties.

6.3.3 Functions performed by audit committees

The respondents were asked to determine what were the functions assigned to their audit committees. Respondents rated the review of the annual financial reports as the highest, followed by approving the internal audit program and then review of accounting practices, principles, policies and significant changes that happen during the financial year (Refer to Figure 6.3).

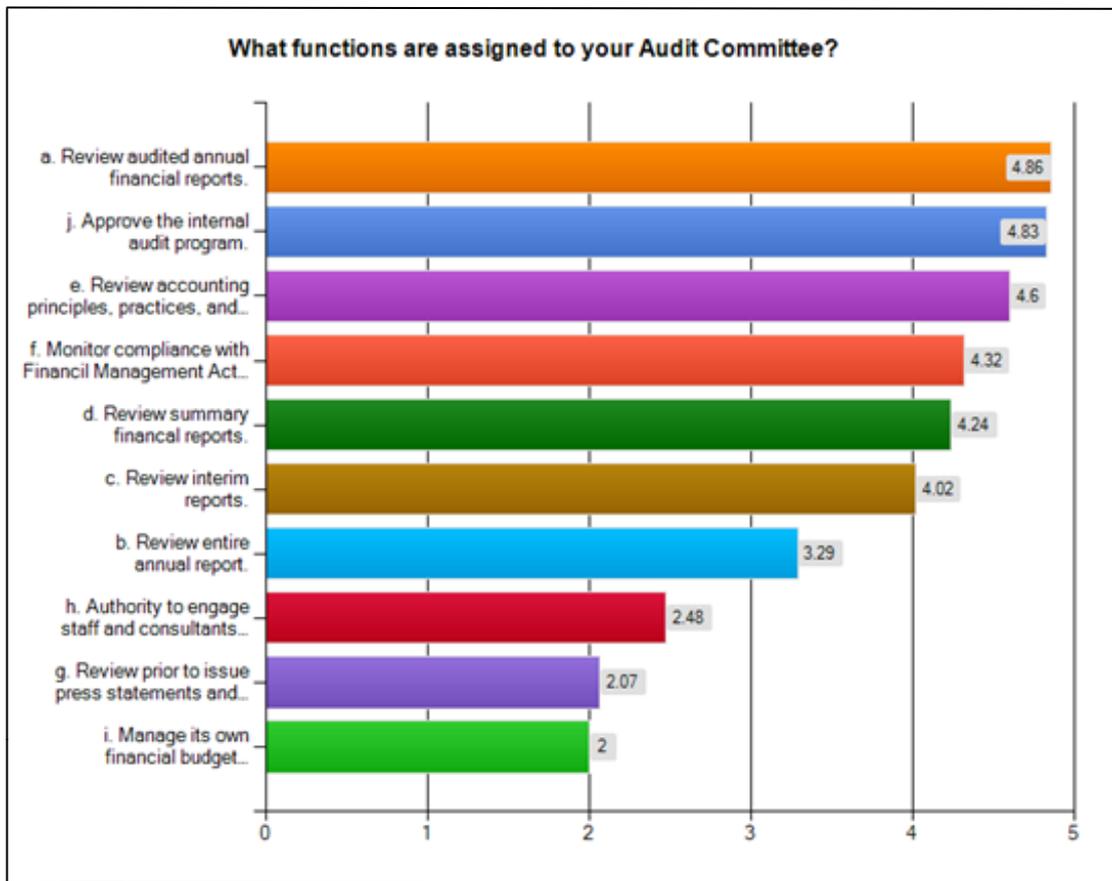


Figure 6.3
 Functions assigned to audit committees
 SOURCE: Responses from Question 19 of the Survey Questionnaire

Chairing audit committees is important. According to the respondents the majority of chairpersons of respondent organisations are independent members and only one respondent is chaired by a management member. In this sample chairpersons report to individuals like the departmental secretary, chair of the board and chief executive officer (Refer to Figure 6.4).

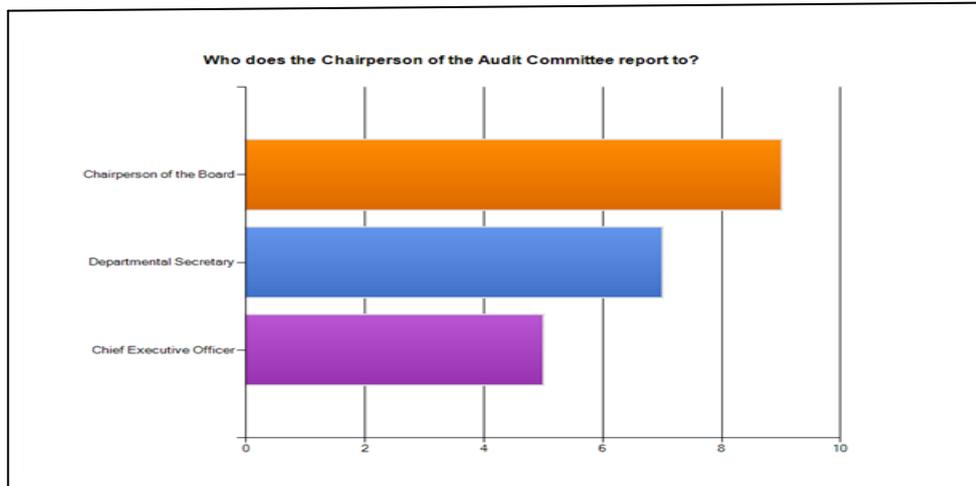


Figure 6.4
Reporting lines of Chair of Audit Committee
SOURCE: Responses from Question 13 of the Survey Questionnaire

The Function that audit committees perform includes the successful and consistent application of all ethical activities through professional procedures, using proper systems and processes (Refer to Table 6.5). Responses indicate that audit committees have no control over their funding and are not involved in making press statements.

Table 6.5

SOURCE: Responses from Question 19 of the Survey Questionnaire

Functions (Activities) assigned to your audit committee

What functions are assigned to your Audit Committee?								
Answer Options	Strongly disagree	Somewhat disagree	Neither Agree Nor Disagree	Some what agree	Strongly agree	N/A	Rating Average	Response Count
1. Review audited annual financial reports.	1	0	0	3	46	1	4.86	51
2. Review entire annual report.	7	9	5	12	12	6	3.29	51
3. Review interim reports.	4	1	7	12	22	5	4.02	51
4. Review summary financial reports.	3	2	3	11	27	5	4.24	51
5. Review accounting principles, practices, and significant changes during the year.	1	0	3	10	36	1	4.60	51
6. Monitor compliance with Financial Management Act 1994 (Directions & Financial Management Compliance Framework).	0	2	3	18	21	6	4.32	50
7. Review prior to issue press statements and publicity material relating to financial matters.	20	9	8	3	3	8	2.07	51
8. Authority to engage staff and consultants as required.	18	8	4	7	7	7	2.48	51
9. Manage its own financial budget and expenditure.	21	5	6	3	3	13	2.00	51
10. Approve the internal audit program.	0	0	1	5	35	10	4.83	51
Other (please specify)								4
						answered question		51
						skipped question		2

6.4 AUDIT COMMITTEES INTERACTING WITH ITS MAIN STAKEHOLDER PARTNERS

Research Question 2: What relationship and contribution does management (ethical practices, risk management, accountability, records and reports); internal auditors (internal control, risk assessment, evaluating assurance); and external auditors (verifying financial reports, providing assurance to other stakeholders), assist audit committees to oversee governance (enterprise, corporate and business performance)?

6.4.1 Empirical profile of management interacting with audit committees

Asked if the managerial head of the organisation was a member of the audit committee, six respondents reported that they were. Asked if the Chief Financial Officer (CFO) was a member of the audit committee, four out of the fifty respondents reported that their CFOs were. These organisations venture out of the template of ideal audit committees and weaken the concept of having truly independent audit committees that operate without the influence of management. Generally management support the activities of their audit committees.

6.4.2 Empirical profile of internal audit interacting with audit committees

The environment for internal auditors appears to be changing with the appointment of outsourced internal auditors. Ideally internal auditors coordinate the requests and administer the audit committees. Asked who does your Chief Audit Executive (CAE) report to fifteen respondents skipped this question. In the Victorian government, internal auditors report to the heads of their organisation and not the chair of their audit committees. This makes them an arm of management which could be perceived as limiting their ability to be independent. Audit committees are presented with management's view of the organisation (Refer to Figure 6.6).

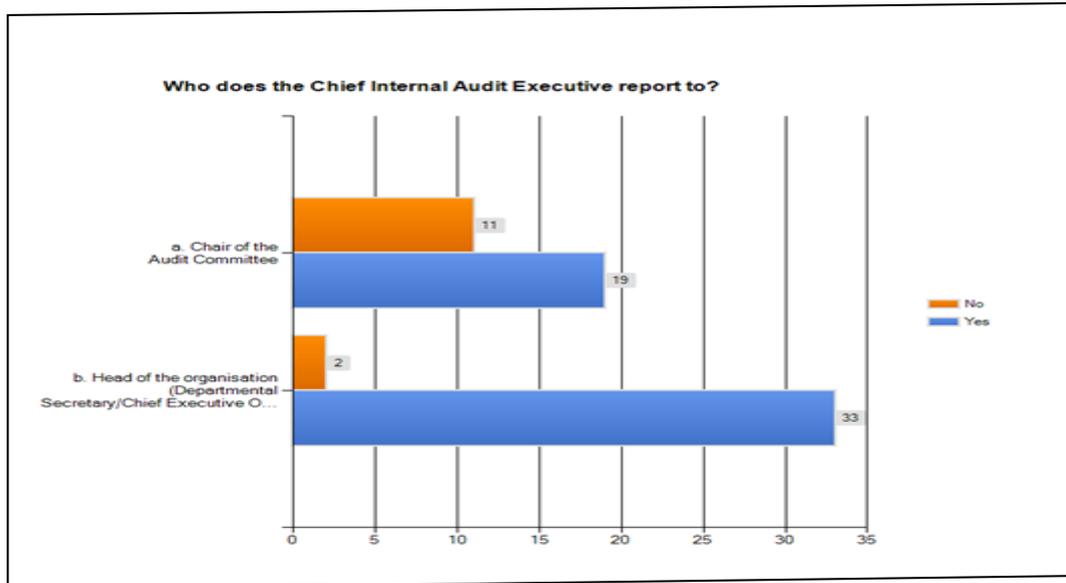


Figure 6.6
 Chief Audit Executive's reporting line
 SOURCE: Responses from Question 23 of the Survey Questionnaire

6.4.3 Empirical profile of external audit interacting with audit committees

The services of the external auditor is provided by the Victorian Auditor General and legislated as such. The Auditor General reports to Parliament but is administratively funded by the Department of Premier and Cabinet. The auditor general uses contracted auditors to conduct smaller audits but conducts major audits. Financial audits are conducted in accordance with profession/legislatively approved accounting and auditing standards. Apart from audit of financial reports, the auditor general conducts performance audits. These are legislative sanctioned and at no cost to the departments and public agencies. (Refer to Figure 6.7)

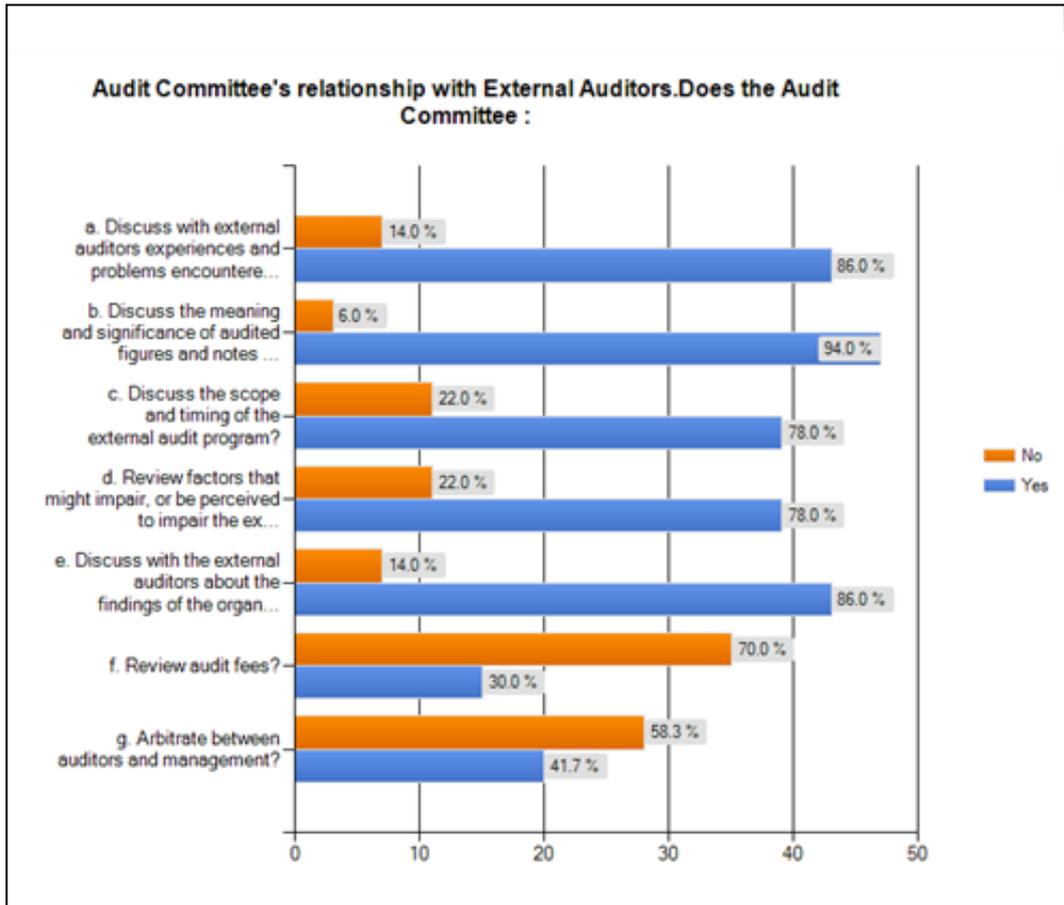


Figure 6.7
 Relationship of Audit Committee with External Auditors
 SOURCE: Responses from Question 33 of the Survey Questionnaire

6.4.4 Opinion of audit committee's relationship with its major partners – management, internal auditor, external auditor

Respondents surveyed were of the opinion that relationships between audit committee and management is generally good. (Refer to Figure 6.8)

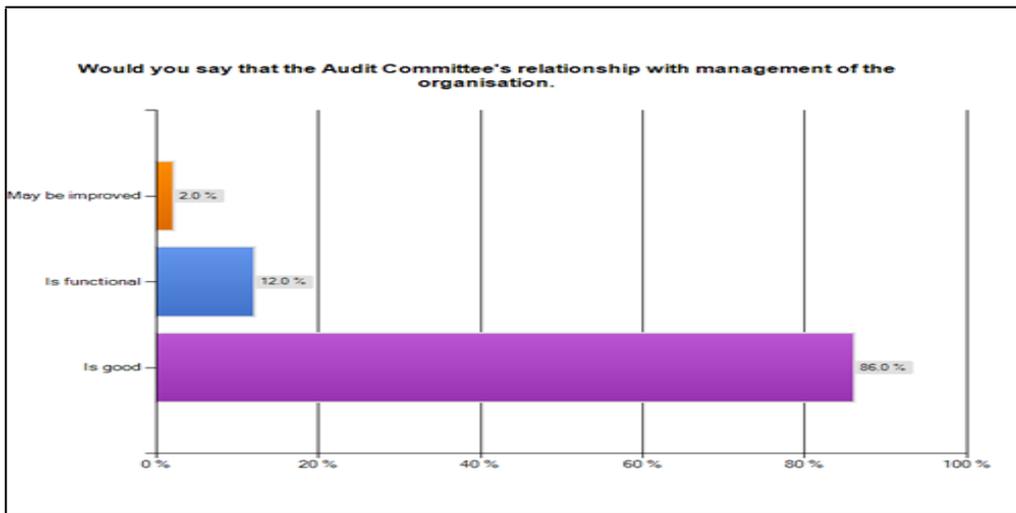


Figure 6.8
 Relationship - Audit committee with management
 SOURCE: Responses from Question 31 of the Survey Questionnaire

Respondents surveyed were of the opinion that relationships between audit committee and internal auditors is generally good. (Refer to Figure 6.9)

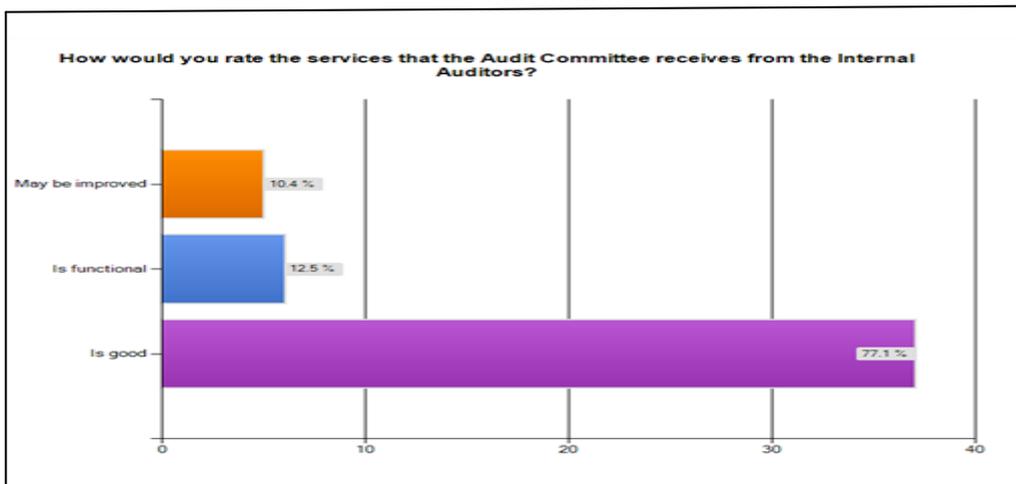


Figure 6.9
 Relationship – Audit committee with internal auditors
 SOURCE: Responses from Question 27 of the Survey Questionnaire

Respondents surveyed were of the opinion that relationships between audit committee and external auditor is generally good. (Refer to Figure 6.10)

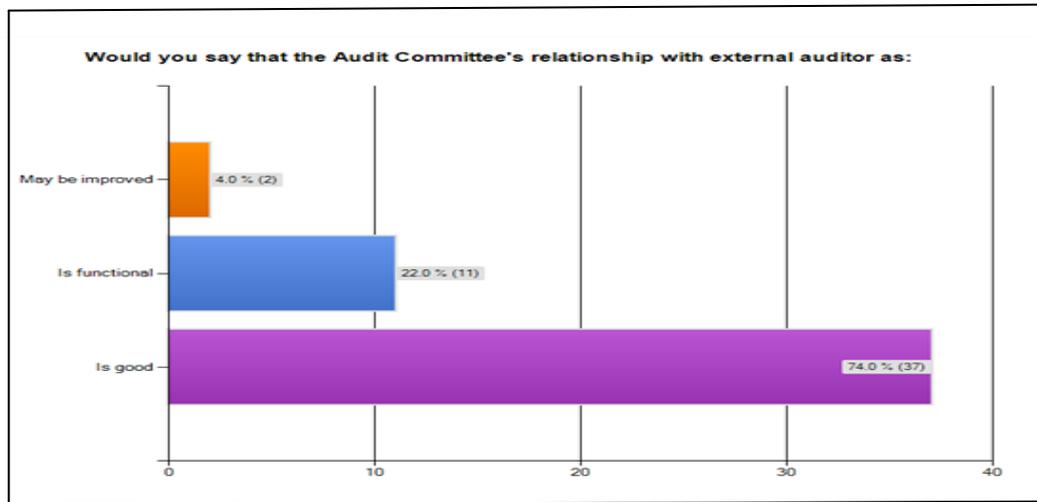


Figure 6.10
Relationship – Audit committees with external auditor
SOURCE: Responses from Question 34 of the Survey Questionnaire

Responses to the survey questionnaire indicate that working relationships between the major “partners” to ensure governance and assurance is generally good. This opinion had to be qualified because the external auditor – the Victorian Auditor General – the external auditor appointed by legislation, did not officially respond to the survey. The author is aware that a number of the responses have come from internal auditors who have previously worked in the Office of the Auditor General. The management and members of the audit committees who have responded to the survey reported that they have worked well with the external auditors.

6.5 ISSUES AND PRACTICES THAT CONTRIBUTE TO SUCCESS

Research Question 3:

3a. What is success for an audit committee?

3b. What are the characteristics of an audit committee that contribute to its successful performance?

Asked what issues and practices were important in contributing to the success of audit committees, respondents stated the issue of the availability of relevant information. Following from that, respondents also required the provision of an agenda and timely releases of material in advance of audit committee meetings and the desired requirement to be independent of management (Refer to Table 6.3).

Table 6.6
Issues/practices important to the success of Audit Committees (ranked responses)

SOURCE: Responses from Question 20 of the Survey Questionnaire

What issues/practices are important in contributing to the success of Audit Committees?							
Answer Options	Strongly disagree	Disagree somewhat	Neither Agree Nor Disagree	Agree somewhat	Strongly agree	Rating Average	Response Count
a. Availability of relevant information.	0	0	0	8	43	4.84	51
h. Provision of an agenda and timely releases of material in advance of meeting.	0	0	0	8	43	4.84	51
k. Independence from management.	0	0	0	8	43	4.84	51
j. Careful selection of members.	0	0	1	9	41	4.78	51
b. Prompt answering of queries.	0	0	0	15	36	4.71	51
l. Review internal audit performance annually.	0	0	2	12	37	4.69	51
d. Ready access to internal auditors.	0	0	1	17	33	4.63	51
f. Written statement of objectives and responsibilities.	0	0	3	14	34	4.61	51
g. Prompt notification of problems by management.	0	0	4	14	33	4.57	51
c. Ready access to external auditors.	0	1	5	17	28	4.41	51
e. Continuity of membership.	0	1	5	25	20	4.25	51
n. Review external audit performance annually.	1	2	7	15	26	4.24	51
o. Report Audit Committee activities in Annual Report.	0	3	8	21	17	4.06	49
i. Rotation of membership.	0	3	12	20	16	3.96	51
m. Report frequency and attendance at meetings in Annual Report.	1	3	17	17	13	3.75	51

6.5.1 Factor - Issues and practices that lead to successful audit committees

Practices that are perceived to contribute to a successful audit committee are termed by the researcher as the variables that could create outcome criteria.

(Refer to Table 6.7)

Table 6.7

Outcome - Issues/Practices that contribute to audit committee success

SOURCE: Responses from Question 20 of the Survey Questionnaire

AC=Audit Committee	Strongly disagree	Disagree somewhat	Neither Agree Nor Disagree	Agree somewhat	Strongly agree	Rating Average
1. Availability of relevant information.	0.0% (0)	0.0% (0)	0.0% (0)	15.7% (8)	84.3% (43)	4.84
2. Prompt answering of queries.	0.0% (0)	0.0% (0)	0.0% (0)	29.4% (15)	70.6% (36)	4.71
3. Ready access to external auditors.	0.0% (0)	2.0% (1)	9.8% (5)	33.3% (17)	54.9% (28)	4.41
4. Ready access to internal auditors.	0.0% (0)	0.0% (0)	2.0% (1)	33.3% (17)	64.7% (33)	4.63
5. Continuity of membership.	0.0% (0)	2.0% (1)	9.8% (5)	49.0% (25)	39.2% (20)	4.25
6. Written statement of objectives and responsibilities.	0.0% (0)	0.0% (0)	5.9% (3)	27.5% (14)	66.7% (34)	4.61
7. Prompt notification of problems by management.	0.0% (0)	0.0% (0)	7.8% (4)	27.5% (14)	64.7% (33)	4.57
8. Provision of an agenda and timely releases of material in advance of meeting.	0.0% (0)	0.0% (0)	0.0% (0)	15.7% (8)	84.3% (43)	4.84
9. Rotation of membership.	0.0% (0)	5.9% (3)	23.5% (12)	39.2% (20)	31.4% (16)	3.96
10. Careful selection of members.	0.0% (0)	0.0% (0)	2.0% (1)	17.6% (9)	80.4% (41)	4.78

11. Independence from management.	0.0% (0)	0.0% (0)	0.0% (0)	15.7% (8)	84.3% (43)	4.84
12. Review internal audit performance annually.	0.0% (0)	0.0% (0)	3.9% (2)	23.5% (12)	72.5% (37)	4.69
13. Report frequency and attendance at meetings in Annual Report.	2.0% (1)	5.9% (3)	33.3% (17)	33.3% (17)	25.5% (13)	3.75
14. Review external audit performance annually.	2.0% (1)	3.9% (2)	13.7% (7)	29.4% (15)	51.0% (26)	4.24
15. Report Audit Committee activities in Annual Report.	0.0% (0)	6.1% (3)	16.3% (8)	42.9% (21)	34.7% (17)	4.06

The outcome factor asked the respondents to evaluate the outcome measure of success. These include issues and practices they believed the audit committees need to do in order to be effective.

6.6 PERFORMANCE OBJECTIVES & FRAMEWORK FOR AUDIT COMMITTEES

Research Question 4: What is an appropriate governance framework that includes audit committees?

Governance is generally defined as "the system by which organisations are directed and managed" (OECD 2004:17). Governments provide the direction and public servants manage and administer the created organisations (Public Administration Act 2004). Governance thus influences how the objectives of the organisation are set and achieved. Governance also involves how risks are identified, assessed and mitigated and how performance outputs and outcomes are optimally achieved. Good governance structure is expected of government

organisations so they may deliver public value services fulfilling the government’s social responsibility. This would include having an accounting and control systems where activities and programs can be successfully delivered.

In this survey respondents agreed that governance activities include oversight of attributes of internal control, management of risk mitigation plans, budgets and economic issues, the efficient and effective use of organisation’s resources, the achievement of outputs and outcomes. The degree of their opinion is demonstrated in Figure 6.11.

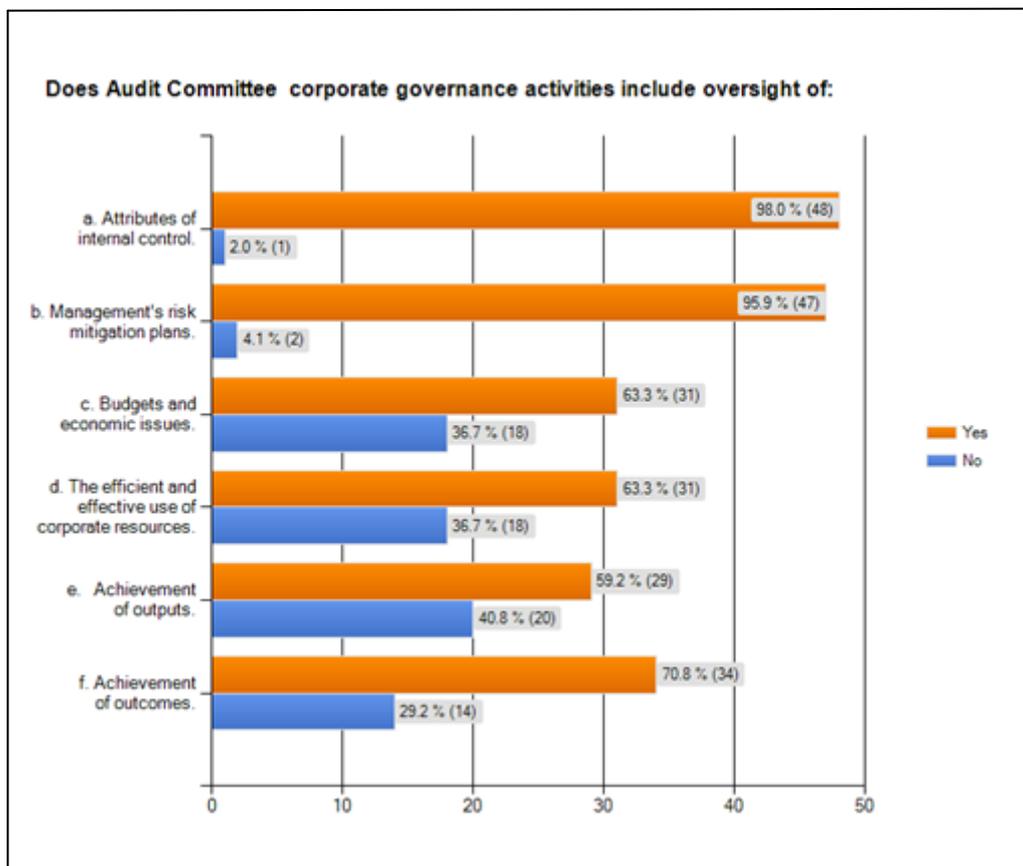


Figure 6.11
 Corporate Governance activities
 SOURCE: Responses from Question 36 of the Survey Questionnaire

Assurance is the satisfaction that information provided is reliable. Assurance is the result of the conduct of independent internal and external audits. Assurance is the process that provides confidence that planned objectives will be achieved within an acceptable degree of residual risk. (Standards Australia HB 158 – 2006:6).

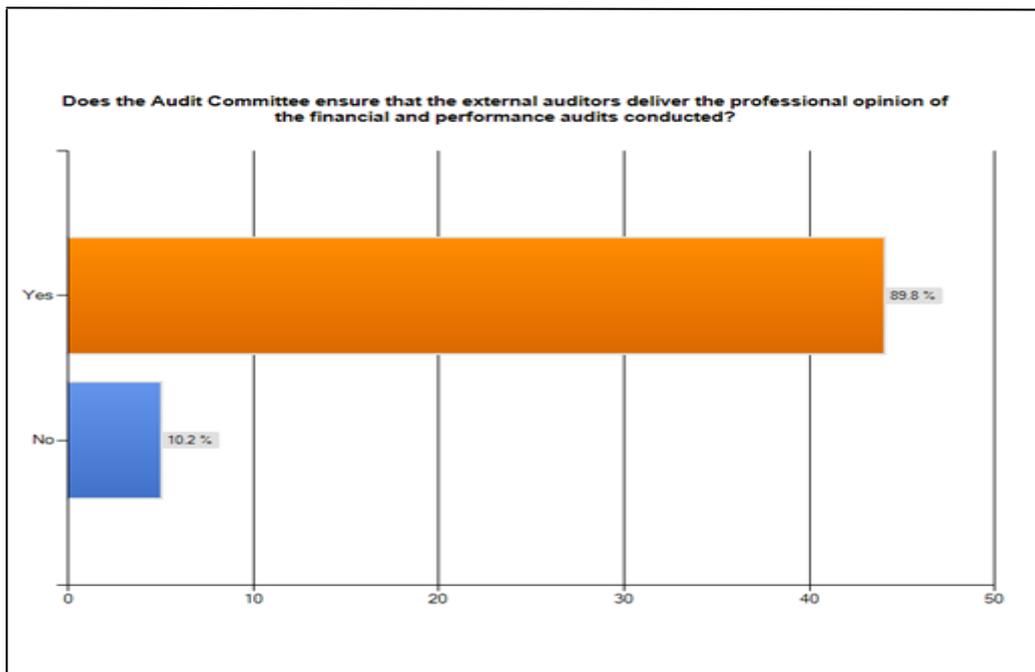


Figure 6.12
External Audit Assurance
SOURCE: Responses from Question 40 of the Survey Questionnaire

Respondents indicated audit committees of organisations surveyed agree that they should ensure that their external auditors deliver professional opinion of the attest and performance audits conducted (Refer to Figure 6.12). The researcher acknowledges that to ensure external auditors deliver a hundred per cent assurance may not be totally possible under their charter. Thus, the researcher examines the responsibility of key participants like management and internal auditor to collectively contribute to provide reasonable assurance of services delivered.

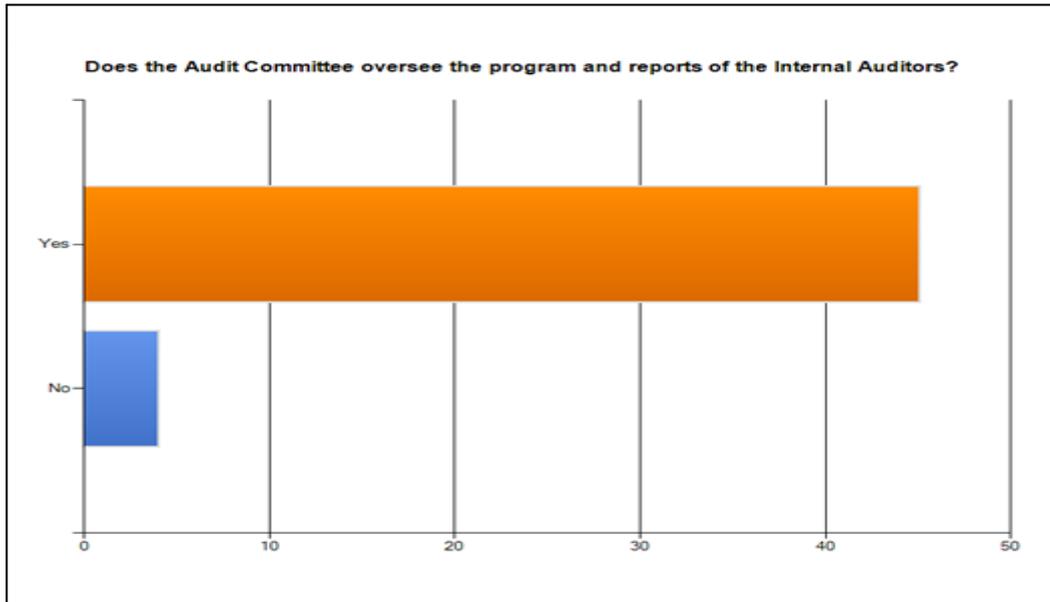


Figure 6.13
Internal Audit Assurance
SOURCE: Responses from Question 39 of the Survey Questionnaire

The majority of respondents report that their audit committees oversee the programs and reports of internal auditors. (Refer to Figure 6.13)

Respondents were split in their confidence that audit committees oversee corporate performance. Corporate performance encompasses a much bigger set of outputs than what is normally entrusted to audit committees.

Respondents must have answered this question in the narrow perspective of the expectations of audit committees to limit their responsibility to purely financial performance whilst others see that the wider operational activities do affect performance. (Refer to Figure 6.14)

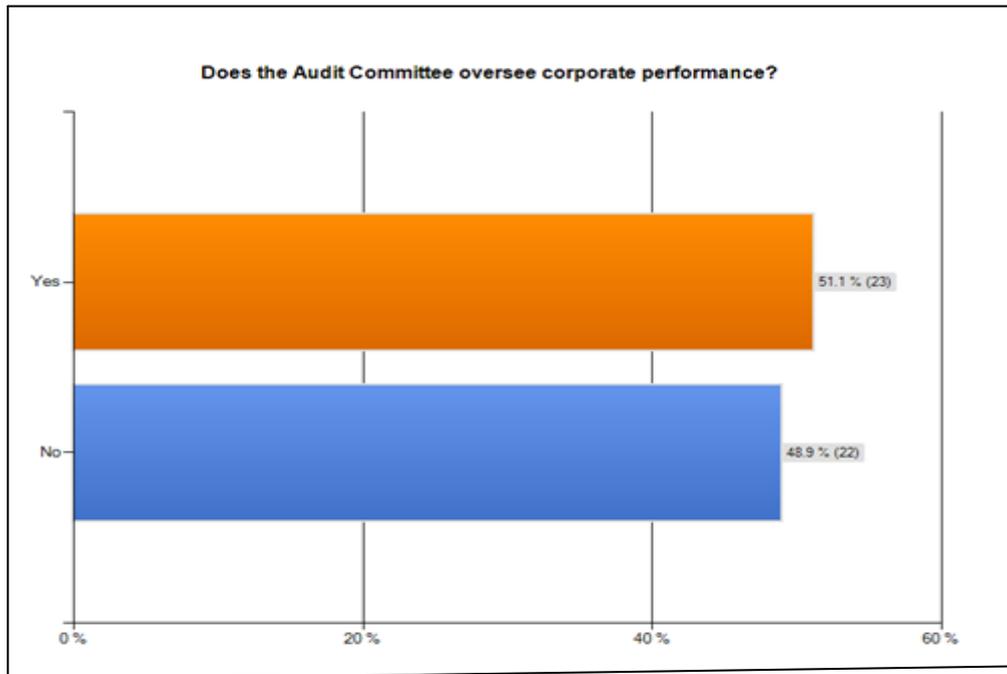


Figure 6.14
Oversight of corporate performance
SOURCE: Responses from Question 38 of the Survey Questionnaire

The majority of respondent audit committees conduct annual performance reviews. However almost a quarter of the respondents never conduct any reviews. (Refer to Figure 6.15)

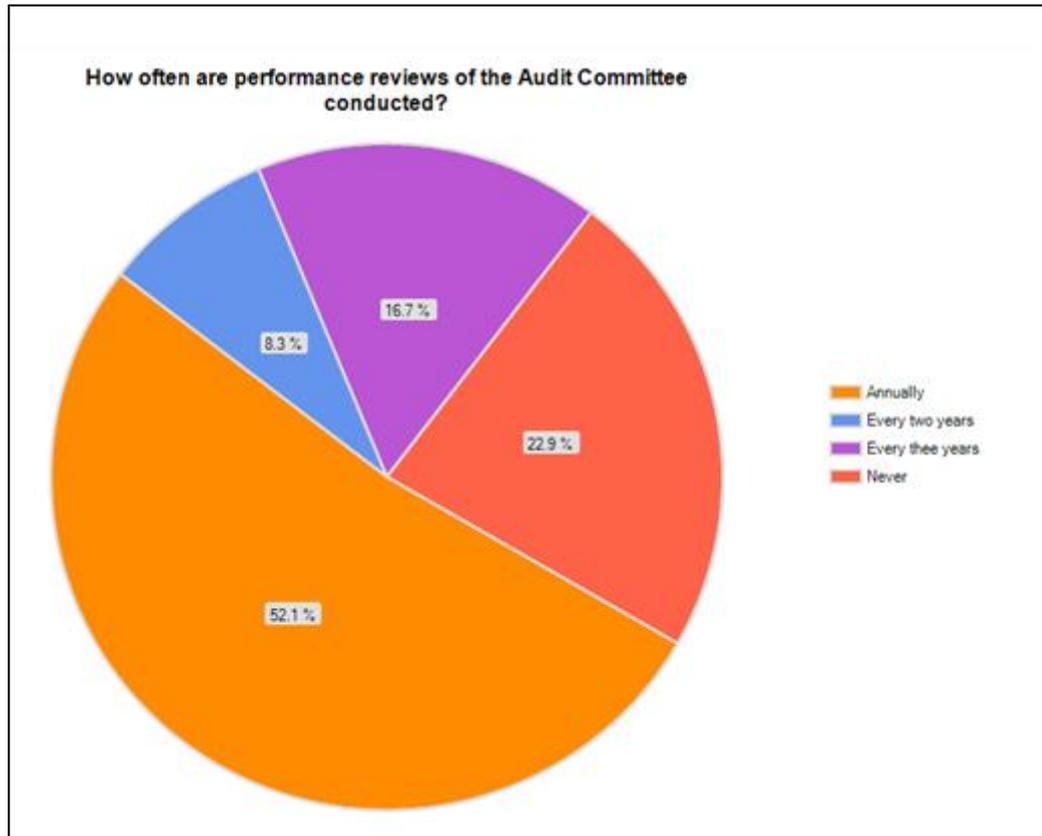


Figure 6.15
 Audit Committee Performance Reviews
 SOURCE: Responses from Question 21 of the Survey Questionnaire

Respondents rated highly the influence of their audit committees on achieving public value. Respondents saw this as being achieved by overseeing that proper internal controls exist; compliance is observed; and by ensuring organisations is being fair and honest in their dealings. (Refer to Figure 6.16)

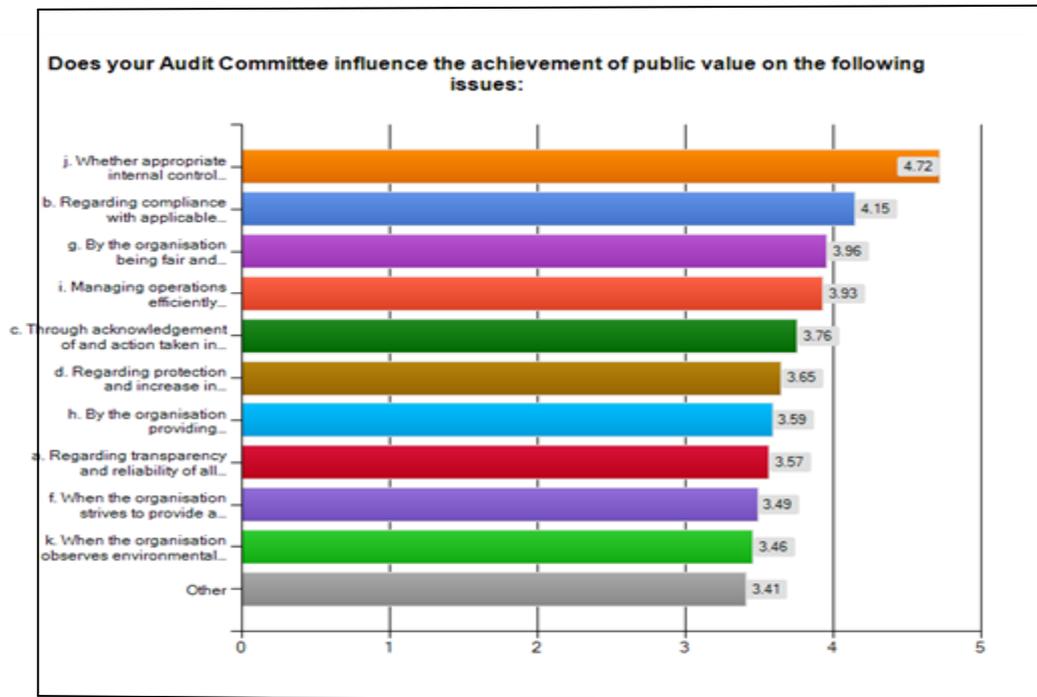


Figure 6.16
Influence over public value
SOURCE: Responses from Question 41 of the Survey Questionnaire

6.7 CHARACTERISTICS OF VICTORIAN GOVERNMENT AUDIT COMMITTEES

Research Question 5: What is the perceived role of audit committees as perceived by audit committee members?

Asked how they rate the role of their audit committees, respondents were positive about its contribution in providing independent oversight and that audit committees were becoming more accountable. In order to achieve their role, audit committees value their independence and that their activities are not be influenced by management. They require high quality and timely information, maintaining good communications, and being financially literate to query and understand presented financial presentations. (Refer to Figure 6.17)

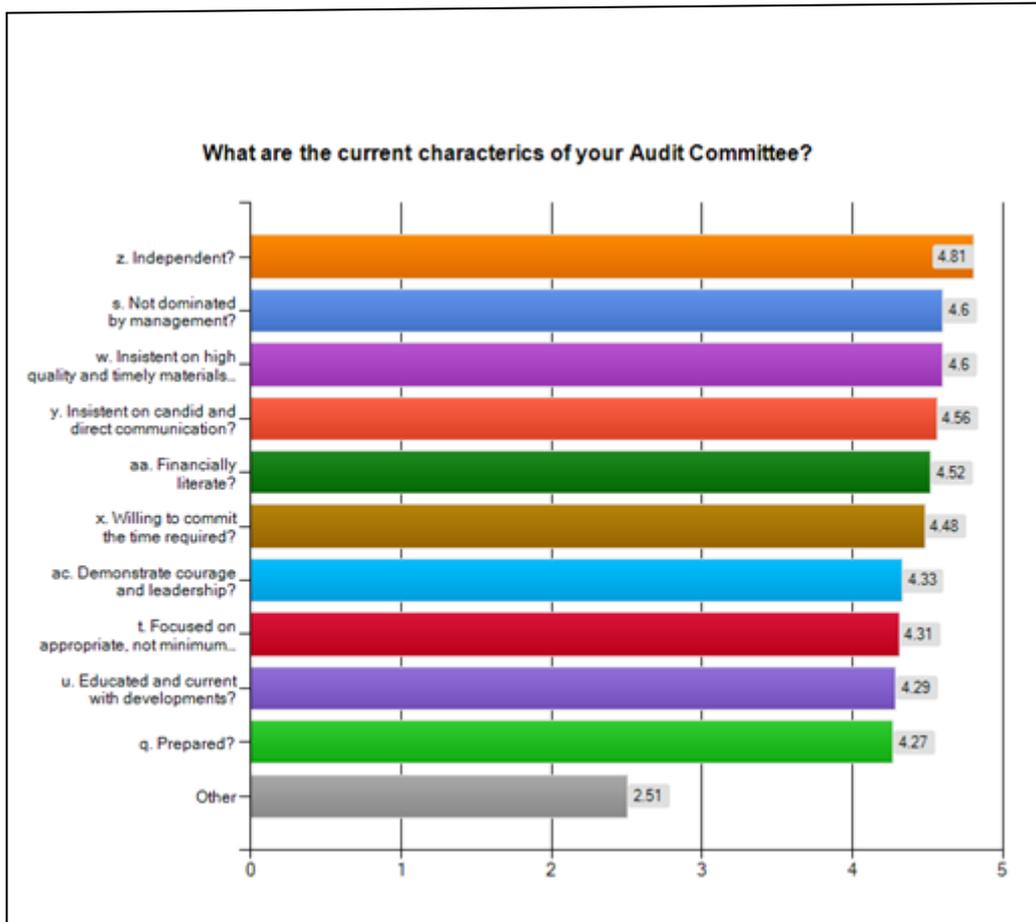


Figure 6.17
Opinion of current characteristics of Victorian Government Audit Committees

SOURCE: Responses from Question 42 of the Survey Questionnaire

Most Victorian government audit committees undergo some sort of review.

Asked how often performance reviews were conducted:

Annually	52%
Every Two Years	8%
Every Three Years	17%
Never	23%

Fifty two per cent of respondents review their performance, however it is also noted that according to the respondents twenty three per cent never review their performance.

6.8 SUMMARY – DESCRIPTIVE ANALYSIS OF SURVEY RESULTS

The Victorian government's guidelines establish a critical reference for the public agencies to follow. The guidelines published by the Department of Treasury and Finance in their document titled "*Victorian Standing Directions of the Minister for Finance 2008*" was developed by a professional accounting practice and adopted by the Victorian government.

The role of audit committees for the responding Victorian government organisations reported is consistent with prescribed regulations and professional expectations as identified in the Conceptual Framework chapter of this thesis. This survey suggested that the major departments and major public agencies are responding to what is expected of audit committees in accordance with literature on its role, attributes of audit committee members, and the functions they perform. This survey also confirmed that the major departments and major public agencies comply with legislation prescribed as well as generally accepted practices adopted by professional groups internationally. Respondents also appear to match characteristics of audit committees as noted by Sabia and Goodfellow (2002) compliance with the promulgated regulatory specifications.



7. PSYCHOMETRICS- RELIABILITY & EXPLORATORY FACTOR ANALYSIS

7.1 INTRODUCTION

The objective of this chapter is to assess the psychometric properties of the measures used, that of the three performance indicators of role, attributes and function as well as the proposed outcome measure of Success. Using Cronbach's Alpha, reliability analyses were undertaken to measure each scale's internal consistency. Exploratory Factor Analysis, specifically Principal Components Analysis was also used to explore the factor structure of the performance indicators of role, attributes and functions. The purpose of conducting psychometric analysis is to determine the reliability of the measurement system and also to assess the underlying structure of the data collected (Hills, 2008). To be able to summarise the essential information within a specific set of principal components the measures have to be both internally consistent and also have at the very least content validity.

Principal Components Analysis (PCA) is a form of exploratory factor analysis that is "concerned with identifying the underlying factors that summarise the essential information contained in the elements." In the process, the researcher's understanding of the research domain should be enhanced. This research aimed to identify the dimensions (i.e. factors or components) that underlie the domain. In essence, these techniques group together those variables that are highly correlated with one another. Each variable grouping is then examined in a subjective process to identify the underlying latent variable – the underlying thing they have in common" (Hills 2008:291).

This process was undertaken to identify the strength of association for each of the three factors (roles, attributes, and functions) of the performance of audit committees.

The validity of a scale refers to the degree to which it measures what it is supposed to measure (Hills 2008) and the validation of a scale involves the collection of empirical evidence concerning its use (Pallant 2009). In this research, content validity was adopted. Content validity looks at the selected factors and elements in the design of the questionnaire from inspection; subjective evaluation then assesses how each item being measured relates to the factors outlined, within the given set investigated. In this instance they were from the “*Victorian Standing Directions of the Minister for Finance of July, 2008*” (Directions 2007). The items were then placed collectively in a Principal Components Analysis to ascertain how well the items clustered together in forming the said factor. The elements within each of the factors that is the mandated authorised role, the attributes of the members and the functions performed and practices that predict the Success of the audit committees were extracted from the Victorian Government’s Department of Finance and Treasury’s enforcement of the Standing Directions of the Minister for Finance sets the benchmark for financial management. These elements include governance, oversight, structure, systems, policies, procedures, and financial reporting. (Appendix 2.1 Financial Management Compliance Framework (FMCF), (Directions of the Minister for Finance Victoria 2008).

Prior to undertaking further analyses on the data-cleaning of the data was undertaken in order to give good representation and an indication of a normal distribution. This was done to allow generalised application of the findings from the questionnaire. Univariate and multivariate outliers in the form of “mahalanobis distance” (Hills 2008) were assessed and none were identified.

7.2 FACTORS THAT AFFECT PERFORMANCE (SUCCESS)

In this research, questionnaire responses from three sets of questions asked were selected as factors (role, attributes of members and functions performed) for detailed analysis. They were used to provide an insight into the workings of audit committees in the Victorian Public sector. These were selected because they were identified as critical aspects that contribute to the Success (as an outcome variable) of effective governance. The three factors (role, attribute, and function) and the elements that support them provide answers to understanding audit committees.

The role (objectives) of audit committees; the attributes (knowledge and quality) of audit committee members requires investigation to provide valuable insight into what happens in government audit committees; and the functions (activities) that audit committees perform. The questionnaire was designed to gauge what the objectives of the audit committees were; what the recipients perceived audit committees do; and who was responsible for the people that can make it happen.

The outcome factor, Success, was rated by the measure on issues and practices they believed the audit committees need to do in order to be effective. These included governance activities that would enable the successful achievement of the goals of the audit committee.

7.2.1 Factor - Role of audit committees

The role that an audit committee performs is ultimately to ensure that governance is observed by management and assurance is provided by internal and external auditors.

7.2.2 Factor - Attributes of audit committee members

The attributes that an audit committee possess is reflected on the competency of its members, their contribution and their relationship with the major stakeholders.

7.2.3 Factor - Functions performed by the audit committees

The function that audit committees perform includes the successful and consistent application of all ethical activities through professional procedures, using proper systems and processes.

7.2.4 Factor - Issues and practices that lead to Successful audit committees

Outcome criteria set the situational conditions that contribute to successful operations of an audit committee.

7.3 RELIABILITY ANALYSIS

Reliability Analysis tests for internal consistency using Cronbach's Alpha (Hills, 2009). This refers to the extent to which items in an inventory or scale are all measuring the same thing. Measures of reliability for internal consistency derive from splitting a scale in half and correlating scores on the two halves. If the test is internally consistent the resulting correlation coefficient should be deemed acceptable when 0.70 or above for research purposes (Hills: 2008). Cronbach's alpha corresponds approximately to the "mean of all the split-half coefficients resulting from different splitting of a test" (Anastasi, 1982, p.116, cited by Hill: 2008) alternatively it is an index of all the item-item correlations.

7.3.1 CRONBACH ALPHA COEFFICIENTS FOR THE EMPIRICAL TESTS

Cronbach alpha coefficients for the factor of Success and the three factors of Roles, Attributes and Function:

7.3.1.1 Reliability Analysis - Role of audit committees

Result for the measures of the Role of audit committees indicated a good inter item correlation with a score of 0.83 for the 16 items included in the measure of Roles.

7.3.1.2 Reliability Analysis - Attributes of audit committee members

Cronbach's Alpha of 0.69 for Attributes of the audit committee was very close to the required reliability of 0.70 and on further examination of all items, deletion of any single item was not found to equate to improving the internal consistency of the measure of Attributes.

7.3.1.3 Reliability Analysis - Functions performed by the audit committees

On initial analysis of the internal consistency of this factor poor reliability was found at 0.53. On closer investigation improvement of the reliability was achieved by deletion of items 9 (*Audit Committee Function 9. Manage its own financial budget and expenditure*) and 10 (*Audit Committee Function 10. Approve the internal audit program*), with a resulting value of 0.70. Further review of the items and statistics found that if any other item was removed, improvement of the structure would not be obtained. These items were interdependent of the factor of Roles. On closer examination of the items it was apparent that the respondents suggested that they did not report they have control of their own budget and expenditure for item 9 or perhaps that they have neither the financial budget to engage staff or consultants when required, nor the authority to do so. Regarding item 10 the clarity of the reporting line for internal auditors and their relationship with the audit committee may be a cause of confusion on whether the audit committee has the authority to demand and approve the audit program.

7.3.1.4 Reliability Analysis - Issues and practices that lead to successful audit committees

Reliability for Success enablers had a scale of 15 items and reported an acceptable Cronbach alpha value of 0.83.

7.4 EXPLORATORY FACTOR ANALYSIS

Exploratory Factor Analysis in the form of Principal Components Analysis was undertaken identifying the measures and clusters from all responses of the items for the selected factors i.e. role, attributes and functions under their appropriate headings according to the responses. SPSS analysed 33 items performing a forced three factor structure using Varimax rotation and found 38.32% of the variance was identified. The proposed performance factor structure investigated, that of roles, attributes and functions was identified.

Three factors emerged that predominantly aligned with the proposed factors of Role (14.26%), Attributes (13.82%) and Functions (10.22%), giving a total variance explained of 38.23%.

Some cross loadings did occur. The rotated components matrix found 3 items *r7 (Role 7. Do audit committees improve communication between internal organisation committees and the external auditor?)*, *r8 (Role 8. Do audit committees improve communication between management and the external auditors?)*, and *r9 (Role 9. Do audit committees provide a forum for arbitration between management and auditors (internal and external?))* With communalities >0.31 cross loaded on the latent construct of Roles as hypothesised as well as on the construct of Functions. There were also some items that appeared in the alternate category. The items were Attribute *att3 (Member attribute 3. Knowledge of auditing)* loaded on the construct of Role; Function *fun5 (Function 5. Review accounting principles, practices, and significant changes during the year)* on the construct of Attribute; Role *r16 (Role 16. Does it respect the difference between oversight and line management?)* on the construct of Attribute; Role *r3 (Role 3. Is it strengthened by the inclusion of non-executive (independent) members?)*. On the construct of Attribute Role *r15 (Role 15. Does it engage outside experts when appropriate?)* loaded on the Attributes construct; and finally Attribute *att1 (Member attribute 1. Knowledge of the organisation's business.)* loaded on the Function construct.

Table 7.1

Factor loadings for the three factors of Performance and their communalities (h²)

AC = Audit Committee		Roles	Attributes	Functions	h ²
Does AC discharge their responsibilities for preventing fraud, irregularities & errors?	r4	0.77			0.60
Does AC increase the confidence of Parliament and Public in the credibility and objectivity of financial statements?	r10	0.74			0.56
Does AC assist auditors in reporting serious deficiencies?	r11	0.66			0.44
Does AC assist management discharge statutory responsibilities on financial reporting?	r13	0.63	-0.59		0.63
Does AC assist management to discharge statutory responsibilities on internal control?	r12	0.60	-0.48		0.51
Does AC scrutinise compliance with legislative requirements?	r2	0.58			0.51
Does AC assist management on good governance practices?	r1	0.57			0.35
Does AC challenge management, internal auditors and external auditors?	r14	0.54	-0.50		0.45
Does AC preserve and enhance the independence of internal auditors?	r6	0.53			0.28
Does AC preserve & enhance the independence of external auditors?	r5	0.52	-0.45		0.41
Does AC improve communication between management & the external auditor?	*r8	0.51		0.35	0.34
AC Members knowledge of the business	*att3	0.40			0.19
Does AC improve communication between internal organisation committees and the external auditor?	*r7	0.39		0.37	0.26
AC Members understanding of the purpose and responsibilities of auditing	att8		-0.85		0.73
AC members have sound judgement	att7		-0.78		0.62
AC members available to devote the necessary time	att6		-0.64		0.42
AC review accounting principles?	*fun5		-0.60		0.38
AC members chaired by enthusiastic chairman	att5		-0.57		0.33
Does AC respect the difference between oversight and line management?	*r16		-0.52		0.33
Is AC strengthened by the inclusion of non-executive (independent) members?	*r3		-0.49		0.40
AC members composed of variety of backgrounds	att4		-0.42		0.18
AC members independent from management	att9		-0.39		0.24
Does AC engage outside experts when appropriate?	*r15		-0.35		0.14
AC members has knowledge of finance and accounting.	att2		-0.32		0.17
AC reviews prior to external release of information	fun7			0.73	0.55
AC reviews entire annual report	fun2			0.64	0.46
AC members make sound judgement	*att1			0.63	0.42
AC reviews financial reports	fun4			0.57	0.40
AC review audited financial reports	fun1			0.53	0.28
AC review interim reports	fun3		-0.38	0.52	0.38

Does AC provide a forum for arbitration between management and auditors (internal & external)?	*r9	0.36	0.47	
AC monitor compliance with FMA 1994	fun6		0.45	0.32
AC has authority to engage staff and consultants as required?	fun8		0.43	0.30
				0.19

*= item either cross loading or emerged as loading on the incorrect sub factor.

r = Role

att = attribute of members

fun = function, activity/ies, procedures

AC = Audit Committee

The communalities indicate the degree of variance explained by each item within the emergent factor (Hills 2008). The cross loadings of r7 (*Role 7 Do audit committees improve communication between internal organisation committees and the external auditor?*), r8 (*Role 8 Do audit committee improve communications between management and the external auditor?*) and r9 (*Role 9 Do audit committees provide a forum for arbitration between management and auditors[internal and external]*) that loaded correctly on the factor of Roles but also loaded on the sub factor Functions may suggest that the participants in this study acknowledged the wording correctly as synonymous, meaning that a Role is also interpreted, in these three questions (see Table 7.1) as a Function. i.e. These items are both practiced as an expected legislated role and also applied as processes and procedures within the respondents' audit committee.

To clarify misallocation of items into non-hypothesised constructs, the following may be explained as follows;

Attribute 1 Knowledge of the organisation (att1) loaded on the factor of Function and for the majority of respondents, this item relates to knowledge of the organisation's business. While it is assumed audit committees should be independent, the respondents were mainly actually internal and in practice apply these principals in their daily work.

Attribute 3 Knowledge of auditing (att3) loading on the factor of Role suggests that a majority of respondents may not have responded or were not auditors.

Role 3 Strengthening of the audit committee with independent members (r3) loaded on the factor of Attributes, suggesting these respondents evaluated whether it is a requirement of the standing directions of non-executive standing members, which are organic to an audit committee. The respondents in this

sample viewed this question as a Role more than as an Attribute. In practice the majority of respondents are non-independent.

Function 5 Review accounting principles, practices and significant changes during the financial year (fun5) loaded on the factor of Attributes suggesting the respondents rely on a specialist area to provide this review them rather than putting it into practice in their own audit committee. This may be a resulting factor relating to the diversity of respondents within this survey. Therefore, for some of the respondents, this is not perceived as their duty.

Role 15 Engagement of outside experts when appropriate (r15) and *Role 16 Respecting the difference between oversight and line management (r16)* loaded on the factor of Attributes. Both these responses indicate that the participants related the items within the questionnaire as being related as a quality they should possess rather than a role. Decision making quality appears to be aspired towards rather than as a requirement under the standing directions and this may be due to the diversity among respondents in the way they define their role as part of the audit committee.

7.5 SUMMARY - PSYCHOMETRICS- RELIABILITY & EXPLORATORY FACTOR ANALYSIS

While the few above mentioned anomalies emerged, it should not be overlooked that in keeping with the original conceptual framework, strong reliabilities were reported through Cronbach's Alpha for each of the factors of performance. Therefore, each of these items was correlated with other items in the original conceptual framework for each factor within the structure. Given the construction of the questionnaire based mainly on the Victorian Standing Directions of the Minister for Finance, the pattern of responses suggests that the responsibilities of the role, attributes and functions may vary due to the respondent's perceptions of their performance within the audit committee.

Given this analysis was the first exploratory analysis of its kind in the available literature, the original framework was kept. The structure appeared to support the proposed factors as Performance indicators of the audit committee in the

Victorian government. The task of the current investigation was to assess the degree to which these three performance factors indicated the outcome measure of Success of the audit committee. Therefore, further analyses were warranted in the form of regression analyses in the next chapter to assist in identifying the overall contribution as well as each performance factor's unique contribution to the outcome variable of success.



8. ANALYSIS OF THE RESULTS

8.1 INTRODUCTION

Given the psychometric soundness on the exploratory analysis from Principal Components Analysis achieved in chapter 7, several analyses were undertaken that included a series of analyses of variance as well as t-tests. Second, a standard multiple regression evaluated the level of predictability of the three performance indicators of role, attributes and functions to account for the measure of success.

The series of analyses to describe in this chapter were as follows;

1. Four Analyses of Variance (ANOVAs) were performed to evaluate whether differences emerged from responses of the Victorian Government Departments, Councils and Public Agencies among the four measures, role, attributes, functions and success.
2. A series of one-sample t-tests were also undertaken to compare the individual Federal department response to responses from Victorian government public sector respondents, departments, councils and public agencies.
3. Four Analyses of Variance were also undertaken on the measures of roles, attributes, functions and the outcome of success across responses classified into six categories of stakeholders. The stakeholders were internal auditors, independent audit committee members, financial

managers CEO/Secretary, Administrative support of Audit Committees and Management members.

4. The fourth set of analyses involved the use of four Analyses of Variance (ANOVAs) to assess whether differences emerged among the three groups of Internal Auditors, Independent Auditors and Management members on their responses to roles, attributes, functions, and success.
5. Standard Multiple Regression was undertaken to evaluate how well the three performance factors of role, attributes and functions could predict the dependent outcome measure of success. That is the degree of relationship between the three factors and the success of the audit committee measured through the amount of variance explained as well as their individual unique contribution.

8.2 ANALYSIS

Table 8.1 *Descriptive statistics for each Factor, mean, standard deviation and number of participants for each analysis.*

	Mean	SD	Number
Success	67.22	5.42	50
Role	68.31	6.92	50
Attribute	41.69	2.63	50
Function	3.81	0.74	50

The descriptive for each of the factors (role, attribute, functions, success), the means, standard deviations and the number of respondents are reported in Table 8.1.

8.2.1 WERE THERE DIFFERENCES BETWEEN VICTORIAN GOVERNMENT DEPARTMENTS, COUNCILS & PUBLIC AGENCIES?

To evaluate whether differences emerged among the Victorian government Departments, Councils and Public Agencies four analyses of variance (ANOVAs) were performed to assess deviations in the character of these organisation's Audit Committees emerged among the four measures. The four measures comprised the three factors roles, functions and attributes as well as the outcome of success. Descriptive statistics in the form of means, standard deviations and number of participants for each of the organisations are presented in Table 8.2. Normality assumptions were met for each of these factors with no violations of the assumption of Homogeneity of Variance identified. On testing all four ANOVAs analysing Role, Function, Attributes and the outcome measure of Success no significant differences were found. That is across Departments, Councils and Public Bodies, the 3 Victorian public categories, no significant differences emerged across the four measures (Refer to Table 8.3 for specific analytical results).

Table 8.2 Categories of organisation and number, mean and standard deviation are presented in four separate ANOVAs for Role, Function, Attribute and Success. These tests were conducted to assess whether differences emerged among the 3 categories of organisations that operate within the Victorian Government.

Factors	Organisations	Number	Mean	SD
Success	Department	9	66.22	5.12
Council	33	67.52	5.78	
Public bodies	8	67.14	4.49	
Total 50	67.22	5.43		
Role	Department	9	68.67	7.25
Council	33	68.39	6.48	
Public bodies	8	65.75	8.88	
Total 50	68.02	6.94		
Attribute	Department	9	40.56	2.92
Council	33	42.33	2.38	
Public bodies	8	41.13	2.17	
Total 50	41.82	2.51		

Function	Department	9	3.67	0.98
Council	33	3.70	0.75	
Public bodies	8	4.35	0.29	
Total	50	3.88	0.74	

Table 8.3 Results of the four Analyses of Variance testing Role, Attributes, Functions and Success evaluating whether differences occurred among the 3 Victorian categories of public agencies.

		Sum of Squares	df	Mean Square	F	Sig
Success	Between Groups	11.88	2.00	5.94	0.20	0.82
	Within Groups	1400.66	46.00	30.45		
	Total	1412.53	48.00			
Role	Between Groups	49.60	2.00	24.80	0.50	0.61
	Within Groups	2313.38	47.00	49.22		
	Total	2362.98	49.00			
Attribute	Between Groups	26.95	2.00	13.48	2.24	0.12
	Within Groups	282.43	47.00	6.01		
	Total	309.38	49.00			
Function	Between Groups	2.89	2.00	1.44	2.58	0.09
	Within Groups	26.89	48.00	0.56		
	Total	29.78	50.00			

8.2.2 WERE THERE DIFFERENCES BETWEEN THE FEDERAL RESPONDENT & VICTORIAN RESPONSES?

A series of one-sample t-tests were undertaken to compare the Federal department with the other Victorian organisations across the four factors - function, role, attribute and success.

Functions audit committees perform

Firstly, one-sample t-tests were performed on the factor of function comparing the Federal department with each of the other 3 grouped Victorian organisations; departments, councils and public agencies. Descriptive statistics are outlined in Table 8.4. As can be seen in Table 8.5 the only deviation between the Federal department's value of function was significantly higher for public bodies with a mean value of 4.35 compared to department's 3.88, $t(7)=4.53$, $p=0.003$. Function was evaluated for Victorian departments compared to Federal department's $t(8)=-0.65$, $p=0.53$ and not found to be significant. Function was also evaluated comparing councils to Federal department, $t(33)=-1.37$, $p=0.18$ and therefore not significant.

Table 8.4 *Function - Means, standard deviations and number of respondents for each of the 3 Victorian agencies and the Federal Department.*

Victorian sectors		N	Mean	Std. Deviation
Department	Function	9	3.67	0.98
Council	Function	34	3.70	0.75
Public Agencies	Function	8	4.35	0.29
Federal Dept	Function	1 ^a	3.88	.

Table 8.5 *Function - One sample T-tests for each of the 3 grouped Victorian agencies comparing evaluation with the Federal Department on the factor of Function*

Victorian sectors		t	df	Sig. (2-tailed)
Department	Function	-0.65	8	0.53
Council	Function	-1.37	33	0.18
Public Agencies	Function	4.53	7	0.003 **

$p=.01$, **

Role of audit committees

Secondly, one-sample t-tests were performed on the factor of role comparing the Federal department with each of the other 3 grouped Victorian organisations, departments, councils and public agencies (Universities & Water Bodies). Descriptive statistics are outlined in Table 8.6. As can be seen in Table 8.7 the only deviation between the Federal department's value of role was identified as significantly lower for Councils with a value of 68.39 compared to Federal department's 73.00, $t(33)=-4.09$, $p=0.001$. Role was evaluated for Victorian departments compared to Federal department, $t(8)=-1.79$, $p=0.11$, therefore not significant. Role was evaluated for public agencies compared to Federal department, $t(7)=-2.31$, $p<.054$ and therefore not significant.

Table 8.6 *Roles - Means, standard deviations and number of respondents for each of the 3 Victorian agencies and the Federal Department for Roles.*

Victorian Sectors		N	Mean	Std Dev
Department	Role	9	68.67	7.25
Council	Role	33	68.39	6.48
Public Agencies	Role	8	65.75	8.88
Federal Dept	Role	1	73.00	

Table 8.7 Role - One sample T-tests for each of the 3 grouped Victorian agencies comparing evaluation with the Federal Department on the factor of Role

Victorian Sectors		t	df	sig 2 tailed
Department	Role	-1.79	8	0.11
Council	Role	-4.09	32	0.000***
Public Agencies	Role	-2.31	8	0.054

*** $p < 0.001$.

Attributes of Members

Thirdly, one-sample t-tests were performed on the factor of attribute comparing the Federal department with each of the other 3 grouped Victorian organisations, departments, councils and public agencies (Universities & Water Bodies). Descriptives are outlined in Table 8.8. As can be seen in Table 8.9 all three categories of Victorian agencies were significantly higher than the Federal department's value of Attribute, $t(33) = -4.09$, $p = 0.001$. Attribute (mean) was significantly higher for departments with a value of 40.56 compared to Federal department's 36, $t(9) = 4.68$, $p = 0.002$. Attribute's mean was significantly higher for Council with a value of 42.33 compared to the Federal department 36, $t(32) = 15.28$, $p < .001$. Attribute (mean) was significantly higher for public bodies with a value of 41.13 compared to Federal department's 36, $t(7) = 6.69$, $p < .001$.

Table 8.8 Attributes - Means, standard deviations and number of respondents for each of the 3 Victorian agencies and the Federal Department for Attributes.

Victorian Sectors		N	Mean	Std Dev
Department	Attributes	9	40.56	2.92
Council	Attributes	33	42.33	2.38
Public Agencies	Attributes	8	41.13	2.17
Federal Dept	Attributes	1	36.00	

Table 8.9 Role - *One sample T-tests for each of the 3 Victorian agencies comparing evaluation with the Federal Department on the factor of Role*

Victorian Sectors		t	df	sig 2 tailed
Department	Attributes	4.68	8	0.002**
Council	Attributes	15.28	32	0.000***
Public Agencies	Attributes	6.69	7	0.000***

*** $p < .001$.

Success indicators

Finally, one Sample t-tests were performed on success as the outcome variable comparing the value the Federal department placed on this factor compared with each of the other Victorian organisations. Descriptive statistics are outlined in Table 8.10. As can be seen in Table 8.11 all three Victorian organisations were significantly higher than Federal department's value of success. Success was significantly higher for Victorian departments with a value of 66.22 compared to Federal department's 62, $t(8)=2.48$, $p=0.038$. Success was significantly higher for Councils with a value of 67.52 compared to Federal department's 62, $t(32) = 5.58$, $p < 0.001$. Success was also significantly higher for Public agencies with a value of 67.14 compared to Federal Department's 62, $t(7)= p < 0.023$.

Table 8.10 *Success - Means, standard deviations and number of respondents for each of the 3 Victorian agencies and the Federal Department for Success.*

Victorian Sectors		N	Mean	Std Dev
Department	Success	9	66.22	5.12
Council	Success	33	67.52	5.78
Public Agencies	Success	7	67.14	4.47
Federal Dept	Success	1	62.00	

Table 8.11 *Role - One sample t-tests for each of the 3 Victorian agencies comparing evaluation with the Federal Department on the factor of Role*

Victorian Sectors		t	df	sig 2 tailed
Department	Success	2.48	8	0.038
Council	Success	5.48	32	0.000***
Public Agencies	Success	3.03	6	0.023

*** $p < .001$.

8.2.3 WERE THERE DIFFERENCES COMPARING RESPONSES FROM STAKEHOLDERS (SIX CATEGORIES – Independent members, Financial Managers, CEOs/Department Secretaries, Management members, Internal Auditors, Administrators?)

The third set of analyses involved Analyses of Variance (ANOVAs) undertaken on each of the four factors ; function, role, attributes and success to evaluate whether differences emerged among the six categories of Victorian Stakeholders; that is: internal auditors, independent members, financial managers, CEO and Department Secretaries, Administrators, and Management members. Significant differences occurred among stakeholders across the four measures. For Function, $F(5,46)=4.167$, $p=0.003$, administrative members were significantly lower than Internal Auditors and Independent members; and Management was significantly lower than Independent members on the Factor of Function. Please see descriptive statistics, mean and standard deviation for each in Table 8.12. The four ANOVA's are sequentially presented in Table 8.13 and Post hoc analyses using Bonferroni t-tests are presented in Table 8.14. A visual representation of the diversity of responses across this measure is highlighted in Figure 8.1.

Table 8.12 Means, standard deviations and number of respondents for each of the 6 Victorian Stakeholders and the Federal Department for Success.

Victorian Stakeholders	N	Mean	Std Dev
<i>Function</i>			
Internal Auditors	13	4.20	0.35
Independent members	5	4.62	0.46
Financial managers	9	3.74	0.90
CEO and Secretariat	8	3.69	0.35
Administrative	11	3.33	0.91
Management	6	3.34	0.70
<i>Attributes</i>			
Internal Auditors	13	41.08	2.66
Independent members	5	44.00	1.22
Financial managers	8	41.88	3.36
CEO and Secretariat	8	41.75	1.16
Administrative	11	42.00	2.65
Management	6	40.33	3.14
<i>Role</i>			
Internal Auditors	13	67.62	7.16
Independent members	5	68.40	6.88
Financial managers	8	67.50	9.80
CEO and Secretariat	8	70.13	5.11
Administrative	11	67.64	7.39
Management	6	68.00	6.91
<i>Success</i>			
Internal Auditors	12	67.33	5.09
Independent members	4	70.50	2.52
Financial managers	9	66.22	7.69
CEO and Secretariat	8	67.13	4.45
Administrative	11	67.36	4.57
Management	6	65.33	6.95

Table 8.13 *Analyses of Variances assessing differences among the 6 stakeholder groups - Internal Auditors, Independent members, Financial Managers, CEO & Secretariat, Administrative and Management members across the four measures of Role, Functions, Attributes and Success.*

Victorian Stakeholders	SS	df	Mean Sq	F	sig 2 tailed
Function – Between gps	9.29	5	1.86	4.167	0.003**
Within gps	20.50	46	0.45		
Attributes – Between gps	43.96	5	8.79	1.33	0.271
Within gps	298.63	45	6.64		
Role – Between gps	41.60	5	8.32	0.16	0.976
Within gps	2345.70	45	52.13		
Success – Between gps	73.30	5	8.79	0.472	0.795
Within gps	1365.98	44	31.05		

**= $p < .01$.

Table 8.14 *Post hoc analyses using Bonferroni t-tests identified where the differences among the 6 stakeholder groups, of Internal Auditors, Independent members, Financial Managers, CEO & Secretariat, Administrative and Management members, emerged in the measure of Function of Audit Committees. Only the 3 significant findings are presented.*

Victorian Stakeholders	Difference	SD	Significance
<i>Function</i>			
Internal Auditors with Admin	0.873	0.273	0.038*
Independent members with Admin	1.288	0.360	0.013*
Independent members with Management members	1.280	0.404	0.041*

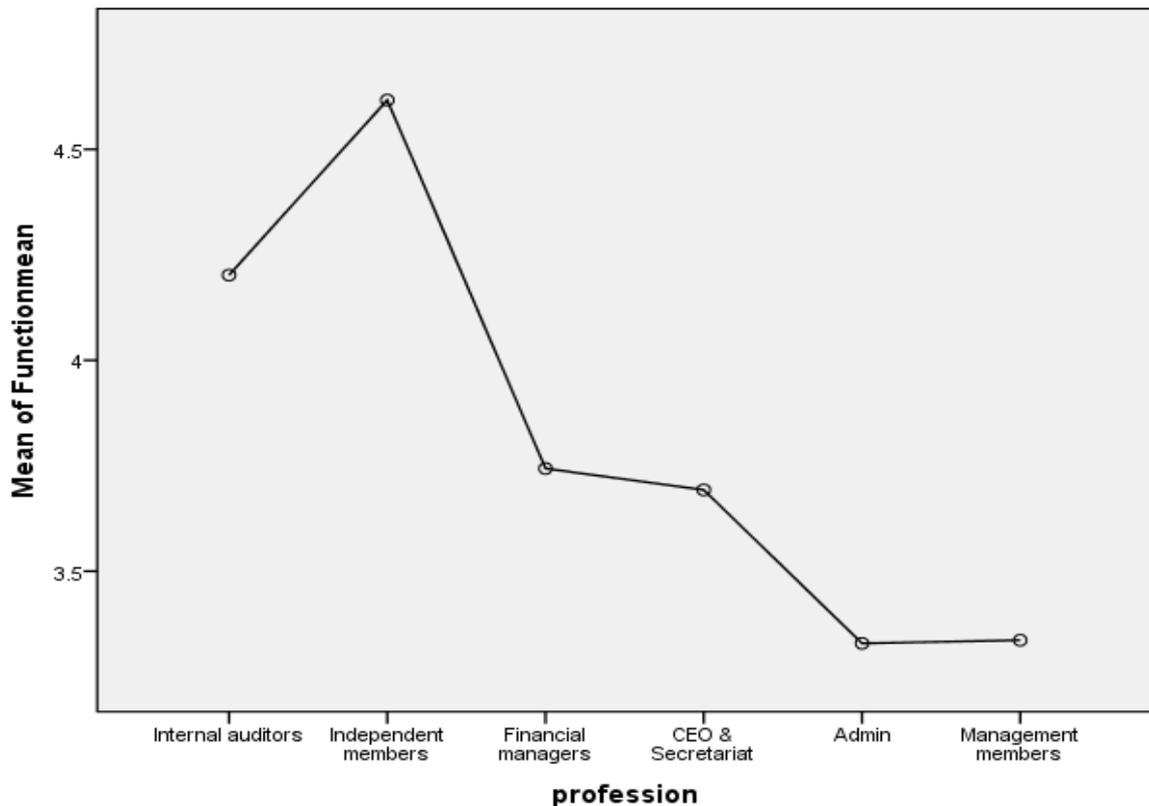


Figure 8.1.

Visual representation of the perception of Functions of the Audit Committee across the six stakeholder groups.

8.2.4 WERE THERE DIFFERENCES BETWEEN INDEPENDENT AUDIT COMMITTEE MEMBERS, INTERNAL AUDITORS & MANAGEMENT?

The fourth set of analyses involved the use of four Analysis of Variance (ANOVAs) to assess whether differences emerged among the three groups of internal auditors, independent members and management members. Each of the four measures, that is function, role, attributes and success were analysed to evaluate whether differences emerged among these three groups.

Descriptive statistics, mean and standard deviation for each are presented in Table 8.15. The four ANOVA's are sequentially presented in Table 8.16.

The only significant difference among the 3 member's positions across all four factors of success, role, attributes and function was again in the measure of

Function, $F(2,49)=6.366$, $p=.003$. Post hoc analyses using Bonferroni t-tests identified that management members were significantly lower than either independent members or internal auditors (Refer to Table 8.17). The mean value of management's perception of the function of the audit committee was significantly lower (3.61) compared to either the internal auditors (4.20) or the independent members (5.00) (for a visual representation see Figure 8.2). A note of caution emerges however, given the small number of independent audit committee members who participated in this study. While the independent audit committee members and internal auditors did not appear to diverge in a significant manner among any of the four measures, they have been included in this set of analyses, although it is acknowledged that the sample size is not indicative of a representative sample.

Table 8.15 Means, standard deviations and number of respondents for each of the 3 Members, Independent Audit Committee (AC) members, Internal Auditors and Management (Management & Administrators) across the four measures, Role, Attributes, Function and Success.

Members	N	Mean	Std Dev
Role			
Internal Auditors	12	67.75	7.46
Independent AC members	2	67.50	12.02
Management	37	68.27	6.72
Total	51	66.12	6.91
Attributes			
Internal Auditors	12	41.50	2.28
Independent AC members	2	44.50	0.71
Management	38	41.62	2.73
Total	52	41.71	2.62
Function			
Internal Auditors	12	4.20	0.37
Independent AC members	2	5.00	0.00
Management	38	3.61	0.77
Total	52	3.80	0.76
Success			
Internal Auditors	11	67.73	5.14
Independent AC members	1	74.00	0.00
Management	38	66.76	5.50
Total	50	67.12	5.43

Table 8.16 Analyses of Variances were undertaken to assess differences among the 6 stakeholders, of Internal Auditors, Independent members,

Financial Managers, CEO& Secretariat, Administrative and Management members across the four measures of Role, Functions, Attributes and Success.

Victorian Members	SS	df	Mean Sq	F	sig 2 tailed
Function – Between gps	6.14	2	3.07	6.366	0.003**
Within gps	23.64	49	0.48		
Attributes – Between gps	56.23	2	28.12	0.96	0.392
Within gps	298.63	48	6.64		
Role – Between gps	3.25	2	1.62	0.03	0.968
Within gps	2384.05	48	49.67		
Success – Between gps	56.23	2	28.12	0.96	0.392
Within gps	1383.05	47	29.43		

**= $p < 0.01$.

Table 8.17 *Post hoc analyses using Bonferroni t-tests identifying where significant differences in responses emerged among Internal Auditors, Independent Members and Management members in the Functions of the Audit Committee.*

Victorian Members	Difference	SD	Significance
<i>Function</i>			
Internal Auditors & Management	0.587	0.531	0.041*
Independent members & Management	1.389	0.504	0.025*

8.2.4.2 FUNCTION - COMPARING INDEPENDENT AC MEMBERS / INTERNAL AUDITORS / MANAGEMENT

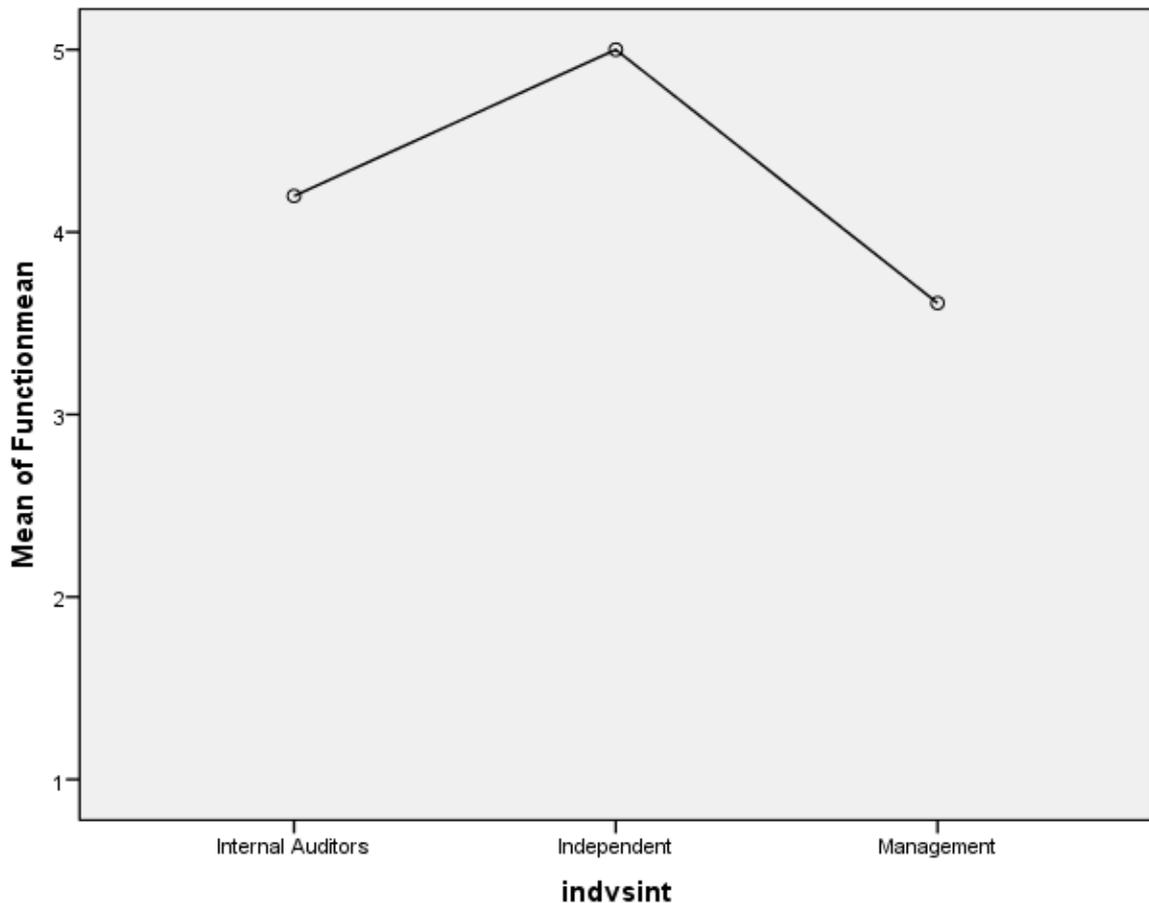


Figure 8.2

Visual representation of the value placed on the perceptions of Functions of the Audit Committee among Internal Auditors, Independent Audit Committees and Management.

8.2.5 HOW WELL THE THREE PERFORMANCE FACTORS OF ROLE, ATTRIBUTES AND FUNCTIONS COULD PREDICT THE OUTCOME MEASURE OF SUCCESS?

The fifth and final set of analyses involved Regression analysis:

First, regression analyses are a form of correlational analysis. The first step then is to see how well the predictors of function, attribute and role correlated with each other but also to the outcome measure of success. The correlations

undertaken for each factor evaluated the strength of association to the outcome measure of success as well as the intercorrelations between the three performance indicators. As outlined in Table 8.18, role was positively and significantly associated with success at 0.61 $p<0.001$. Attributes of the audit committee was positively and significantly associated with success at 0.74, $p<0.001$ and function was also positively and significantly associated with success 0.32, $p=0.014$.

Second in the regression analysis, the three factors predicted the outcome measure of the success of performance of the audit committees by accounting for 64% of the variance explained. Therefore, this supports one of the contentions of this dissertation, that these newly constructed factors were related to and could predict the dependent perception of success with the significant findings of this standard multiple regression.

Table 8.18 *Correlations and intercorrelations for Role, Attributes, Functions and Success.*

	Success	Role	Attribute
Role	0.61***		
Attribute	0.74***	0.50***	
Function	0.32*	0.26*	0.20

* $p<=.05$, *** $p<.001$ significance.

Inter-correlations occurred among the three factors, which are in this sample overlap of the perceptions of the roles, functions and attributes emerged when predicting the outcome variable of success. This was identified in the cross loadings in the Principal Components Analysis, noted in the previous chapter. However, given the nature of the diversity within this sample, this was not an unexpected finding. Due to the variety of stakeholders (groups) that support the framework within the operations of the audit committees, overlap may be an underlying feature of the structure. Ultimately, it was the combination of these 3 factors that were positively and significantly correlated to success with a value of $R = 0.80$. Testing the unique contribution of each factor as a predictor of success, role was significantly related to success at 0.28, $p<0.01$, attribute at

0.58, $p < 0.001$ and each made unique significant contributions to the prediction of the outcome variable. While function was positively correlated to success, it did not provide a significant unique association with the outcome variable, and instead it is suggested that the overlapping variance of function was encapsulated within the other two factors. This claim is supported given the strong intercorrelations reported in Table 8.18. The strong correlation with the outcome variable of success for each of these factors also provides support for its relative inclusion. In addition, while function is not a unique significant predictor, when included with the other factors of attributes and roles the findings suggest that $R = 0.80$, $R^2 = 0.64$, $F(3, 45) = 26.597$, $p < 0.001$. The function of an organisation is an important aspect required within the audit committee and given the relatively small sample size, it is important to retest this inventory with a larger sample, perhaps in future research. Processes do change over time and individual chairs of audit committees may have different approaches that they adopt. The combination of factors provides a strong indication of what elements contribute to this notion of success in the performance of audit committees. The significant unique predictors of these factors suggest that given the skill set (Attributes) and requirements of the audit committee (roles) as stated in the Standing Directions, that the representation in this questionnaire may be measured through the outcome variable of success.

Finally, the beta coefficients provide an indication of the degree of impact that each of these factors individually have for each single unit increase in the outcome of success. That is, for every unit increase in success, role had a 0.28 unit increase; attributes had a 0.58 unit increase and function had a 0.12 unit increase. Again, supporting the basis of this questionnaire as being an instrument to identify aspects of the functionality and success of the governance of the organisation being examined.

8.3 SUMMARY – ANALYSIS OF RESULTS

In summary the tests conducted included a series of ANOVA on whether differences emerged from responses of the Victorian government departments, councils and public agencies among the four factors, roles, attributes, functions and success; t-tests to compare responses from a different level of government (Federal) against the main focus of this thesis the collective next two lower levels of government (State and local government); a series of ANOVA on the six categories of respondents (Internal Auditors, Independent Members, Financial Managers, CEO of Agencies/Secretary of Department, Administrative Support of audit committees, and management members); and a third set of ANOVAs comparing responses from respondents who as main contributing stakeholders represent different levels of independence in the operations of the role, function, attributes and success of audit committees in the Victorian State and local government environment as well as a standard multiple regression which evaluated whether the three factors, role, attributes and functions were able to account for the dependent variable measure of success outcome in the sample of audit committees each of which identified differences in the roles, attributes and function of audit committees. These may have been attributed to the different perceptions of the range of respondents. However these differences can be explained and do not significantly contradict the concept of the role, attributes and functions that were expected of audit committees.



9. DISCUSSION

9.1 INTRODUCTION

This chapter discusses findings, identifying the important strengths and assesses the risks associated with using audit committees in the government public sector. This research analyses a major initiative in government taxpayer funded public sector, namely the use of audit committees as a tool to achieve accountability and governance. The government public sector is a “business” sector that has not been extensively researched. The initiative that the State of Victoria took by establishing audit committees was aimed at obtaining a reasonable assurance of achieving accountability, governance and performance for the Victorian State government. Since 1994 the Victorian government taxpayer funded public sector authorities have been required by statutory financial framework to create audit committees for their organisations.

In this research, the empirical survey conducted on major organisations found the audit committees were perceived by respondents to be successfully implemented. Most of them created audit committees after it became compulsory legislatively to have one. It was also noted that affected organisations could apply for exemptions to the financial policy-making body, the Department of Treasury and Finance. Audit committees operations were consistent with international best practices with a comprehensive set of rules titled the Victorian Standing Directions of the Minister for Finance (2008). Assurance that an enterprise’s governance is recognised as the role of audit committees and it is aimed at overseeing financial governance. It was noted

that the value of audit committee was not confined to and narrowed down to ensuring management keep proper accounts, prepare true and fair financial reports, and liaison with external and internal auditors. Understanding the business and the risks is required, as these have financial implications in financial reporting. The Victorian Auditor General has a mandate to perform financial as well as performance audits and encourages heads of government agencies to use their internal auditors and audit committees to monitor operational as well as financial performance. Business decisions impact on the use of financial resources. Financial implications affect their performance and financial stability of organisations. Audit committees are required to monitor risks that affect the business as well as its financial results.

9.2 RECOMMENDED FUNCTIONAL CONCEPTUAL MODEL

Audit committees play an important role in enabling governance and accountability. They cannot ensure that management will supply them with information. Critical support that enable corroborative assurance are provided through professional audits conducted by internal and external auditors.

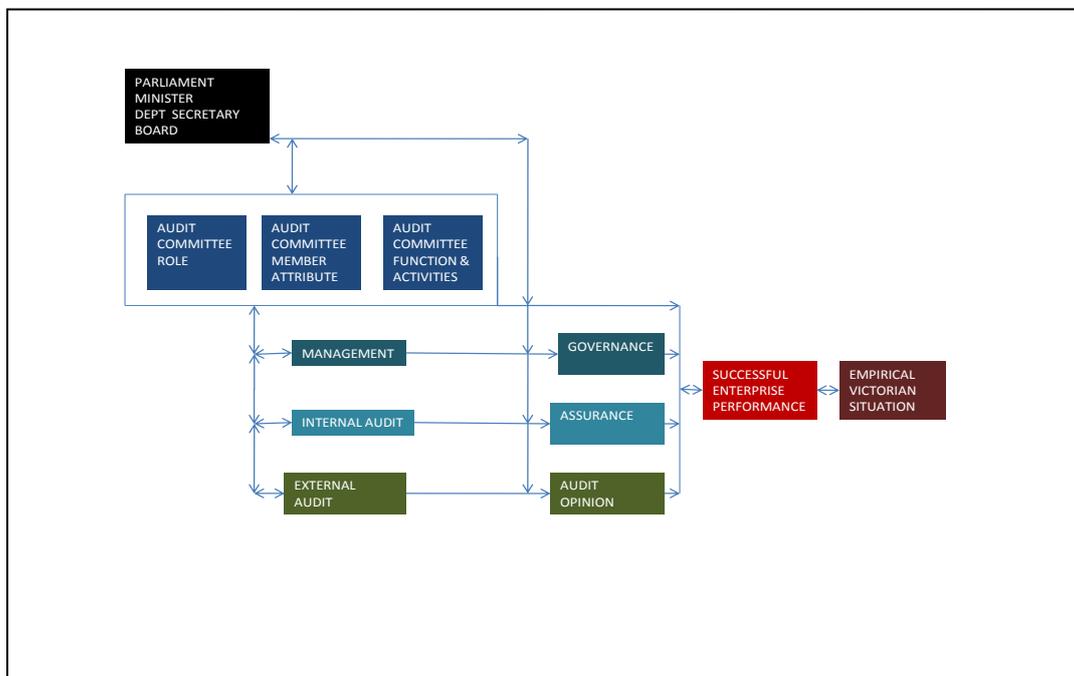


Figure 9.1
Conceptual Framework of the hypothesised role audit committees plays in order to achieve governance and accountability.

9.3 AUDIT COMMITTEE AND STAKEHOLDER PARTNERS - EXTERNAL AUDIT, INTERNAL AUDIT, MANAGEMENT

In the Victorian Government where a Board exists, audit committee members are often part of the Board and are aware of the whole-of-organisation (i.e. enterprise) activities. However in departments, the Departmental head (i.e. Departmental Secretary) is in charge. Also referred to as the Accountable Officer under the Financial Management Act, Public sector Departments appoint top level managers as members of the audit committee in the same way as private sector corporations have executive directors in their audit committees. The chain of command is different in public sector organisations and is perhaps more complicated than that of a private sector Corporation. Public sector organisation heads report to the portfolio government Minister, who in turn reports to the Premier, Cabinet and ultimately to Parliament.

Generally, audit committee members are expected to be knowledgeable of the systems that run programs and projects and also the internal control measures adopted to ensure that activities do not move outside the boundaries of ethical and procedural requirements for operations conducted by management. It is noted that empirically, respondents to the survey in the sampled Victorian government organisations respond that audit committees worked closely with internal auditors, management, and external auditor. Having worked in the Office of the Auditor General Victoria the researcher can confirm that the Victorian Auditor General in their annual financial audits assess systems and internal control measures in organisations they audit in accordance with Australian and International Auditing Standards. For effective enterprise oversight over governance and assurance, an audit committee is very dependent upon the effective performance of the key players – external audit, internal audit and management.

Attributes that audit committees possess include knowledge of financial standards, policies and procedures. To be assured that financial standards, policies and procedures are complied with, audit committees maintain close

liaison with management, internal and external auditors who prepare, assure and audit.

9.4 RESULTS

The validation and reliability testing on the instrument and provision of descriptive information with reference to the sample adopted quantitative analysis (ANOVA) performed on the responses received from Victorian Government organisations indicated that there was no significant differences between the four measures (Refer Chapter 8, Para 8.2.1).

Having recognised that the questionnaire reflected much on the Victorian government framework and knowing that the Victorian financial policy making body decided to decline from responding, confirmation of items raised in the questionnaire were tested against that of a Federal government financial policy body similar in the role of that played by the Victorian body. Quantitative analysis (t test) indicated that for all the measure (role, attribute, functions and indicators of success) there were no significant differences between responses of the Victorian organisations and that of the Federal government department. For the analysis the Victorian government bodies were classified into the categories of those used by the Victorian Auditor General. The results indicated that there were no significant differences between the responses of the categorised Victorian organisations (Department, Council, Public Agencies) (Refer Chapter 8, Para 8.2.2).

Being aware that respondents were different, they were classified into six categories based on their response in the questionnaire. The six categories were independent members, financial managers, CEOs/Departmental Secretaries, Management appointed members of the audit committee, Internal Auditors and Administrators. Quantitative tests (ANOVA) were conducted to see if their responses varied considerably. It was noted that responses to questions on the function of audit committees needed further analysis. Post hoc analyses using Borferroni t-tests revealed that respondents whose role were independent (i.e. independent audit committee members and internal auditors) perceived

some functions that had to be performed differently from the organisation's management and Administrators charged with supporting the audit committee (Refer Chapter 8 Para 8.2.3).

The researcher next examined whether there were differences between the totally independent members of the audit committee, the professionally perceived role of internal auditors and the internal members of the organisation. Acknowledging the limitations that the size is not indicative of a representative sample statistical tests (Descriptive statistics, mean standard deviation, ANOVA and post hoc analyses using Bonferroni tests) indicate internal management were lower than internal auditors and independent members of the audit committee. Independent audit committee members and internal auditors do not appear to diverge in a significant manner among the four measures, This suggests that they share similar perception of the work of audit committees.

Finally Standard Multiple Regression was undertaken to evaluate how well the three performance factors of role, attributes and functions could predict the dependent outcome measure of success. Recognising the limitations of using statistical analysis such as the small sample and possible common method bias, the combination of factors provides a strong indication of what elements contribute to this notion of success in the performance of audit committees and the basis of this questionnaire as being an instrument to identify aspects of the functionality and success of the governance of the organisation being examined.

The empirical results are summarised below:

1. Research question one sought to find out the role; the attributes of members; and the functions and activities audit committees perform when they operate in the taxpayer-funded Victorian (State and Local Government) government public sector organisations.

Research Question 1: What is the actual role of an audit committee; the attributes of its members; and the functions (activities, procedures, process) when such a committee operates in government public sector organisations?

The results that the respondents provided are ranked and tabled as follows:

Table 9.1 Role, Attributes and Functions

ROLE

1. Audit Committees are strengthened by the inclusion of non-executive (independent) members.
2. Assist management on good governance practices.
3. It preserves and enhances the independence of internal auditors.
4. It challenges management, internal auditors and external auditors with the Audit Committee's own view on issues.
5. It is discharging its responsibilities for the prevention of fraud, other irregularities, and errors.
6. It assists management to discharge their statutory responsibilities with regard to internal control.
7. It preserves and enhances the independence of external auditors.
8. It assist management discharge their statutory responsibilities with regards to financial reporting.
9. It scrutinise the organisation's compliance with legislative requirements - Financial Management Act 1994.
10. It respects the difference between oversight and line management.
11. It increases the confidence of Parliament and Public in the credibility and objectivity of financial statements.
12. It assists the auditors in the reporting of serious deficiencies.
13. It improves communication between internal organisation committees and the external auditor.
14. It improves communication between management and the external auditors.
15. It provides a forum for arbitration between management and auditors (internal and external).
16. It engages outside experts when appropriate.

ATTRIBUTES

1. Sound judgement.
2. Full understanding of the purpose and responsibilities of the Audit Committee.
3. Independence from management.
4. Ability to devote the necessary time.
5. Enthusiastic Chairman.
6. Knowledge of finance and accounting.
7. Knowledge of the organisation's business.
8. Variety of backgrounds among the committee.
9. Knowledge of auditing.

FUNCTIONS

1. Review audited annual financial reports.
2. Approve the internal audit program.
3. Review accounting principles, practices, and significant changes during the year.
4. Monitor compliance with Financial Management Act 1994 (Directions & Financial Management Compliance Framework).
5. Review summary financial reports.
6. Review interim reports.
7. Review entire annual report.
8. Authority to engage staff and consultants as required.
9. Review prior to issue press statements and publicity material relating to financial matters.
10. Manage its own financial budget and expenditure.

Research Question 2: What relationship and contribution do management (ethical practices, risk management, accountability, records and reports); internal auditors (internal control, risk assessment, evaluating assurance); and external auditors (verifying financial reports, providing assurance to other stakeholders), to assist audit committees to oversee governance (enterprise, corporate and business performance)?

Research question two sought to determine what roles do management (ethical practices, risk management, accountability, records and reports); internal auditors (internal control, risk assessment, evaluating assurance); and external auditors (verifying financial reports, providing assurance to other stakeholders), contribute in assisting audit committees oversee governance (enterprise, corporate and business performance)? ‘

The majority of respondents to questions relating to working relationships between audit committees and management, internal auditors and external auditors all indicated that working relations were good. The majority found that they discussed the meaning and significance of figures and notes with the external auditors; they discussed experiences and problems encountered; they talked about findings; they discuss the audit program; they talk about problems the external auditor might encounter; they arbitrate between management and external auditors; and they review audit fees.

Research Question 3a. What is success for an audit committee?

Research Question 3b. What are the characteristics of an audit committee that contribute to its successful performance?

Research question three sought to find out the enablers and indicators of successful audit committees.

The Survey package summarised and sorted responses received and found majority of respondents rated success indicators in the following order:

Table 9.2 Outcome Factor - Success

SUCCESS

1. Availability of relevant information.
2. Provision of an agenda and timely releases of material in advance of meeting.
3. Independence from management.
4. Careful selection of members.
5. Prompt answering of queries.
6. Review internal audit performance annually.
7. Ready access to internal auditors.
8. Written statement of objectives and responsibilities.
9. Prompt notification of problems by management.
10. Ready access to external auditors.
11. Continuity of membership.
12. Review external audit performance annually.

13. Report Audit Committee activities in Annual Report.
14. Rotation of membership.
15. Report frequency and attendance at meetings in Annual Report.

Research Question 4: What is an appropriate governance framework that enables audit committees to be successful?

Research question four sought to recommend a governance framework. i. e. a structure upon which to build and develop the strategies that a public entity needs to reach planned objectives and to monitor performance (organisational programs, outputs, outcomes and public value) (*Victorian State Services Website: 2009*). Is there a governance framework that includes audit committees and the role they play assisting in delivery with reasonable assurance that governance is achievable in an objective manner? The resulting framework is documented in figure 9.2 (please see page 172). It provides a comprehensive model for audit committees together with their critical working partners to achieve successful performance in governance, assurance and audit.

Research Question 5: What is the perceived role of audit committees as perceived by audit committee members?

Research question five noted that traditional (old) audit committees were different from modern (new) audit committees. Sabia and Goodfellow (2002) in their book identified characteristics peculiar to audit committees chronologically at these two points in time, now and then. Using these characteristics determine at what phase is the sampled government public sector audit committees in?

The majority of respondents identified that their audit committees with the new audit committee profile (items 1-17 on the Table below) identified by Sabia and Goodfellow in their book titled *Integrity in the spotlight – Audit Committees in a High Risk World*. (Sabia and Goodfellow 2005:7-13). Sabia and Goodfellow suggested that managing the transition from an old to a new type of audit committee requires the selection of the right people, professionally competent and having a competent chair person; forging good relationships with management, external auditors and the Board of directors; hold management

and external auditors accountable; and encourage a culture of candid, open and direct communications. The result of the Survey is summarised in Table 9.3, New and Old designed audit committees.

Table 9.3

New (Items 1-17) and Old (Items 18-29) designed Audit Committees

SITUATION
1. Independent
2. Not dominated by management
3. Insistent on high quality and timely materials and presentations
4. Insistent on candid and direct communication
5. Financially literate
6. Willing to commit the time required
7. Demonstrate courage and leadership
8. Focused on appropriate, not minimum requirements
9. Educated and current with developments
10. Prepared
11. Pro-active
12. Empowered
13. More accountable
14. Demanding
15.. Focused on relationships
16. Facing increasing expectations
17. More onerous responsibilities since the introduction of the Financial Management Act 1994
18. Minimum involvement in the selection of members and chairperson
19. Deal with the external auditor principally through management
20. Reactive
21. Little attention paid to relationships
22. Focused on compliance with minimum legal requirements
23. Under-resourced in personnel and funds
24. Uncertain as to the role beyond legal requirements
25. Superficial in practice
26. Not empowered
27. Lacking in courage
28. Indecisive
29. Dominated by Management

9.5 EXPLANATIONS

The successful audit committee is modelled as a system, with stakeholders playing their role. In the public sector their role is sanctioned by legislation, and customised as a charter or terms of reference. Audit committees are run by competent people more in the mode of stewards rather than agents as in highly paid private sector managers, with the appropriate knowledge and experience. The function they serve provides an oversight over activities and processes that produce results and balances. This is achieved in an ethical, professional process called governance, making those responsible accountable for their actions. The model introduced in this thesis also recognises the contribution of important stakeholders who are technically partners in the accountability process - management, internal audit and external audit. Similar to what is expected of an audit committee they are responsible for the role they play, exercising professional practices, performing in accordance with and complying with professional and legislative professional standards that are promulgated by professional bodies and the government. Management provides dedicated and complete set of records that are summarised into financial and operational reports. Internal auditors provide assurance of accounting and operational systems. External auditors perform financial audits in order to express an opinion on the state of the financial reports. They also undertake performance audits which look at themes, programs and systems on issues of economy (waste), efficiency and effectiveness.

9.6 NEW ISSUES ARISING FROM THE SURVEY

The following issues were selected for discussion:

First, this research has indicated that respondents to the survey agree that audit committees in the public sector contribute to the governance process. Audit committees cannot guarantee governance or accountability. Government businesses, like private sector business are subject to human decisions.

Human decisions are subjective and at times the public sector political masters dictate the operational agenda and operational program. However, under the Westminster system of government, a professional public service should be professionally entrusted to ethically conduct its business of supporting the political government of the day.

Second, the reporting line for the audit committee may lack objectivity and independence when departmental secretaries or chief executive officers have a one to one reporting relationship between them and the chair of the audit committee (CAE), especially when the CAE only provides advice. Thus to ensure issues between the audit committee and executive management can be resolved, should there be differences in accounting treatment, the policy making Department of Treasury and Finance or a Parliamentary Committee should issue instructions to enable a process be in place to document and facilitate, in order that decisions can be made to resolve accounting treatment of such issues as politically sensitive projects and programs; or the disclosure requirements of “secret” commercial-in-confidence contracts that could materially affect government funding requirements.

Third, the Charters (Terms of Reference/Contracts) of the major stakeholders (audit committee, internal audit, and external audit) must be up-to-date. In this way each stakeholder organisational unit know exactly what they have to do and deliver. It will be important to meet and share information. Where interrelationships are silent in the Charters, satisfactory bridging of this gap may be achieved informally or by developing a “*memorandum of understanding*” with these bodies.

Fourth, remuneration policy or guidance for independent audit committee members from the central financial policy making department may enable organisations gain a better understanding of fees to pay and transparency achieved if these deals (although immaterial in most instances) are disclosure in annual financial reports.

Fifth, policy and advice on professional indemnity for independent audit committee members if clarified will give the audit committee greater assurance of its status.

Sixth, clarity regarding the reporting and transparency of business practices such as contract probity, contract disclosures affect audit committees and as such should be clarified because audit committees must understand the business. This includes the possible corrupt practices of contract assessor being offered positions with successful contract providers.

Finally an audit committee is a risk and internal control mechanism to oversee governance prepared by competent and ethical management with assurance confirmed through independent and objective audits.

9.7 INDICATORS AND EVIDENCE

Some indicators or consequences (n.b. some of which were not included in the thesis survey e.g. fraud) that enable audit committees to judge whether their performance is successful include:

1. Financial reports signed off as true and fair or presented fairly.
2. Financial reports are not qualified by the external auditor.
3. No major budget blow outs.
4. No major frauds reported.
5. No major corrupt schemes unearthed.

9.8 SIGNIFICANCE OF PRESENT RESULTS

This thesis forms a platform for future research in the public government funded sector. To recognise the importance of compliance as well as performance, the International Federation of Accountants coined the term *Enterprise Governance Framework* (IFAC 2004). Enterprise governance includes business and corporate governance; compliance, performance, accountability, assurance, value creation and effective use of resources.

The value of this approach is that it recognises that the top level of organisation (Board, Departmental Secretary, Ministers and Parliament) is responsible for governance as a whole and any possible non-disclosure may be more readily detectable. In a growing complex operating environment audit committees must recognise that good governance is about the effectiveness of the governing body – not simply about compliance with codes and not be confined to verifying recorded financial data and information.

9.9 BETTER PRACTICE GUIDANCE FOR AUDIT COMMITTEES

The *Corporate Secretaries International Association* released a research report recommending twenty practical steps for Boards (Audit Committee) to improve their governance responsibility (Risk, April 2010 Issue 73:18-19). The report, written by Professor Bob Tricker listed the following twenty practical steps.

Adapting the principles generally to this research:

Table 9.4

Best Practice indicators compared to observations made in this research.

	Twenty practical steps for Boards (Audit Committee) to improve their governance responsibility (Risk, April 2010 Issue 73: 18-19)	Observations and application to the Victorian government organisations.
1	Recognise that good governance is about the effectiveness of the governing body – not about compliance with codes.	The model recommended in this research incorporates internal checking, internal controls, assurance audits and financial report audits, procedures that can assist in confirming compliance
2	Confirm the leadership role of the Board or Departmental Head.	The Victorian government's Directions of the Minister for Finance mention the specific role of the Board and Department Head.
3	Check that independent (non-executive) directors have the necessary skills, experience and courage.	Responses indicated that financial knowledge was sought.
4	Consider the calibre of the independent (non-executive) directors and the objectivity of the Departmental Head.	This cannot be assessed in this research as evidence of this will require detail assessment of Board Minutes of meeting.
5	Review the role and contribution of independent (non-executive directors).	This also cannot be assessed in this research as evidence of this will require detail assessment of Board Minutes of meeting.

6	Ensure that all directors and Departmental heads have a sound understanding of the organisation.	The research recognised a valued trait but not assessed in this research.
7	Confirm that the Board or Departmental head's relationship with executive management is sound.	Responses to the Questionnaire indicated that this was not a concern in the present public sector environment.
8	Check that directors can access all the information they need.	Responses indicated that this is valued highly by respondents.
9	Consider whether the Board or Departmental head is responsible for formulating strategy.	This cannot be assessed in this research as further evidence of this will required.
10	Recognise that the governance of risk is a Board and Departmental head responsibility.	Risk management is recognised and advice is provided. See Appendix 10.1.
11	Monitor Board and Departmental Head performance and pursue opportunities for improvement.	This cannot be assessed in this research as evidence of this will required.
12	Review relations with stakeholders (parliament, taxpayers, and shareholders).	This was broadly covered in this research.
13	Emphasis that the organisation does not belong to the directors (to ensure independence).	Responses indicated that independence is a valued principle.
14	Ensure that directors' remuneration packages are justifiable and justified.	External members in Victorian government audit committees are paid.
15	Review relations between Auditor General (external auditors) and the organisation.	Responses indicate that this is satisfactory.

16	Consider relations with the regulators (Department of Treasury and Finance, Department of Premier and Cabinet).	The quality of instructions is good and well documented.
17	Develop written Board-level policies covering relations between the organisation and the stakeholders and clients it affects.	Management is expected to provide information to the Board (Audit Committee). Internal Auditors have their Charter. External Auditors have legislated authority.
18	Review the organisation's attitudes to ethical behaviour.	Responses indicated that ethics is valued highly
19	Ensure that organisations provide value.	Although valued this could not be confirmed in this research.
20	Consider how organisations deliver goods and services.	This research adopted an enterprise business approach instead of one that has purely a financial perspective.

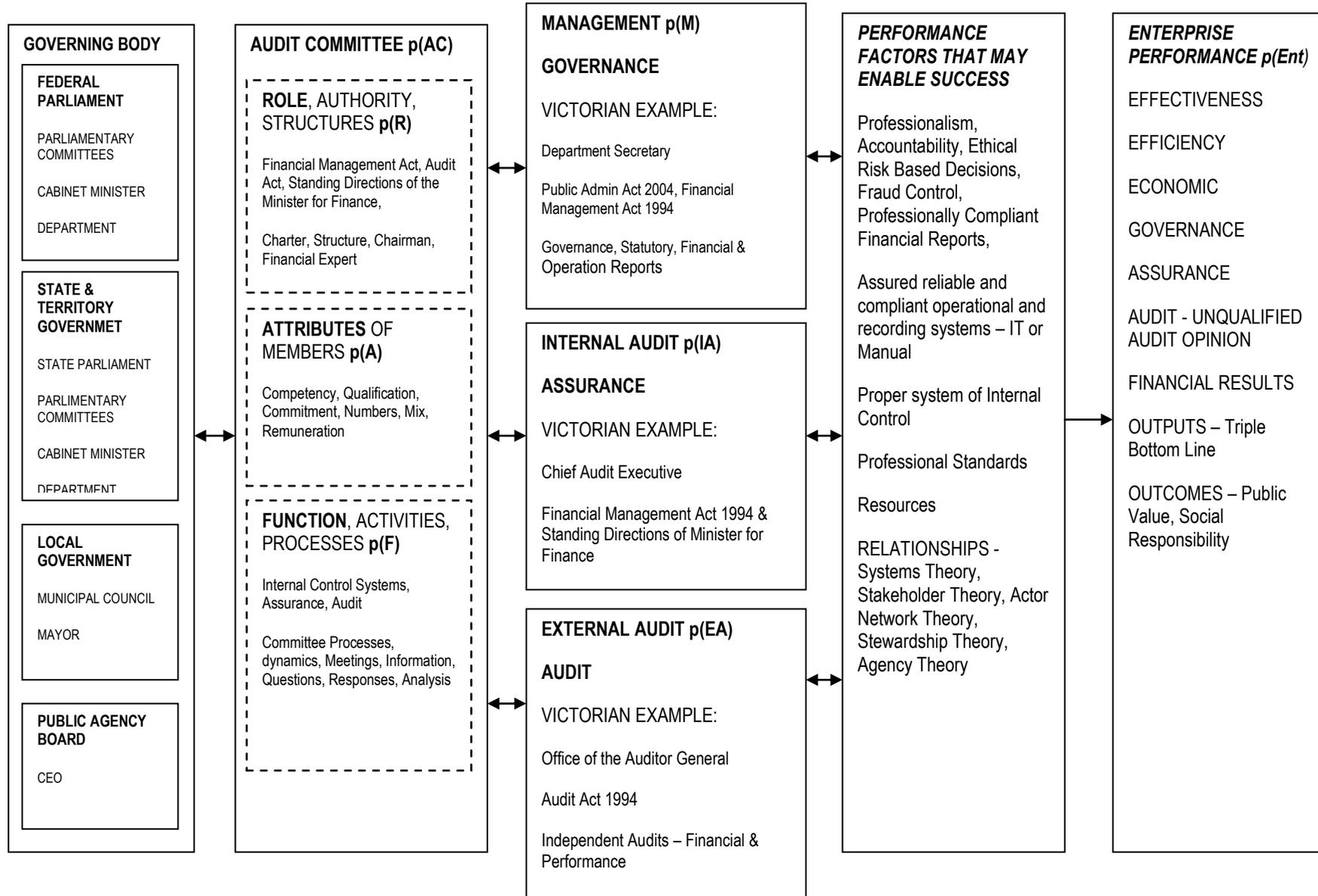
9.10 SUMMARY OF DISCUSSION

This thesis discussed findings from the survey conducted, identifying the important strengths and assessing the risks associated with using audit committees in government public sector. In this chapter we revisited the conceptual model which basically identified three factors (role, members, functions) that makes up the audit committee and extended the model to identify the key supporting organisational units (stakeholder partners) - management, internal audit, and external audit that audit committees relies on to perform its oversight function. It related the survey findings to the research questions, discussed issues of risks and treatment of those risks. It looked at the significance of the findings; of new things that emerged; and of how things could be improved.

Thus applied to the Victorian government environment, a hypothesised initially network is now recommended as a functional conceptual framework and model in figure 9.2 (Page 187).

The recommended framework illustrates the organisational units and links of how such a framework operates in a public sector environment. Figure 9.2 (Page 187) incorporates the factors and issues discussed in this chapter. For the model to be effective there must be good communications and professional interaction between the stakeholder partners.

Figure 9.2: RECOMMENDED FRAMEWORK TO ACHIEVE SUCCESSFUL PERFORMANCE IN GOVERNANCE, ASSURANCE AND AUDIT



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10. CONCLUSION

10.1 INTRODUCTION

The objective of this thesis was to find out more about audit committees in the government public sector. Audit committees are sub-committees of boards. Their generally perceived role is:

- to provide assurance that internal control systems address via a risk management process over operating systems within an organisation, and
- to ensure that business is exercised ethically through governance to provide assurance through audits that the financial reports present fairly the results and conditions of the reporting entity.

Specifically the thesis was about how audit committees are used in the public sector:

Research Question 1: What is the actual role of an audit committee; the attributes of its members; and the functions (activities, procedures, process) when such a committee operates in government public sector organisations?

Research Question 2: What relationship and contribution do management (ethical practices, risk management, accountability, records and reports); internal auditors (internal control, risk assessment, evaluating assurance); and external auditors (verifying financial reports, providing assurance to other stakeholders), to assist audit committees to oversee governance (enterprise, corporate and business performance)?

3a. What is success for an audit committee?

3b. What are the characteristics of an audit committee that contribute to its successful performance?

4. What is an appropriate governance framework that enables audit committees to be successful?

5. What is the perceived role of audit committees as perceived by audit committee members?

10.2 SUMMARY OF FINDINGS AND CONTRIBUTION

This thesis offers a comprehensive and practically sound conceptual model that attempts to identify factors that affect performance of audit committees to provide assurance that governance is observed in government funded organisations that make up the public sector.

1. Audit committee competency and success is directly dependent on the ability of the audit committee to clearly exercise its role through role clarity (Charter, Professional, legislative and regulatory authority); attributes of members competency (Independence, skills, knowledge, leadership); and the functions, activities and process (enterprise risk, internal control, fraud, communications, chairmanship and meetings, accountability, reporting).

2. Successful audit committee performance is related to the organisation's consistent and ethical cooperation with the practices and performance of management, internal audit and external audit (Auditor-General, Independent of Management and the Board). Cooperation is essential - With the Board and audit committee together as joint stakeholders represent the reporting entity, it is important that internal and external auditors work together optimally from the perspective of efficiency and effectiveness. The scope and content of the work activities of both parties should be coordinated with this in mind in order to support the organisation's governance to the extent possible.

3. Characteristics that contribute to successful audit committee that contribute to successful performance are directly related to attitude, commitment, ethics, governance, assurance, outputs, outcomes, public value, and social responsibility.
4. Performance enablers can be identified and explained through management theories. These theories include Stakeholder, Stewardship, and Agency Theories. A framework developed in this research linked the audit committee to its critical partners suggest that this provides greater assurance of oversight responsibilities of the audit committee (Refer to Table 9.3).
5. Respondents to this research perceived Victorian government public sector audit committees indicated that their audit committees were operating similarly to private sector audit committees based on Sabia and Goodfellow (2005) documented characteristics.

10.3 LIMITATIONS TO THIS RESEARCH

This thesis researched the role of audit committees, attributes of audit committee members, and functions performed by audit committees. This thesis also identified the relationships between audit committees and their main sources of information. Information has to be supplied to audit committees because audit committees do not have the staff to acquire the information. In this research, the Victorian Government was the targeted sector. Reliable policy is acquired from the central policy making body and the statutory external auditor and confirmed from documentation from their official websites.

Literature review portrays a situation where it is perceived by some as biased by a preconceived conceptual framework. Literature scans noted the scarcity of research done in the government public sector most of the key words. For example the role, attributes, functions performed of audit committees, key stakeholders in the oversight role came from the private sector literature and the search for material went deep into what could be perceived as dated information. The findings were mind-mapped and common elements

judgementally selected and deemed relevant in a public sector environment were pooled together.

Empirical data for this research comes from the use of a Questionnaire. The researcher was introduced to a commercial survey package called Survey Monkey. This has been used by past PhD candidates and accepted as a package that can be relied on.

The design of the questionnaire posed some challenges. The scope of the audit was broad. The researcher had to acquire reliable basic information of the respondent's environment as well as their attitude and opinion to situational scenarios.

Some might assume that the statistical analysis is ordinal. Literature suggests that treating Likert scales as ordinal in character prevents one from using more sophisticated and powerful modes of analyses and, as a result, from benefiting from the richer, more powerful and more nuanced understanding they produce (Carifio & Perla, 2008:1151). Analyses in Chapter 7 Psychometrics and chapter 8 Analysis of the results for statistical analysis is adapted to an intervalist position Carifio & Perla 2008:1151).

Selection bias by the choice of only one Commonwealth Department was a judgemental decision by the researcher. The Federal government is outside the scope of this research, however, following initial discussions with the Victorian policy making body which prepared most of the policies accessed through their intranet site and the policy body's decision of declining the offer to respond to the questionnaire, a judgemental decision was made to determine the validity of the questionnaire. Sadly the Office of the Auditor General Victoria did not respond to the request. The researcher is aware that audits they conduct comply with Australian Auditing Standards. The researcher regrets missing the opportunity of sending the questionnaire to the Australian National Audit Office

Common methods bias occurs when the instruments the researcher employs enter into or affect the scores or measures that are being gathered. This may occur when respondents are asked a question and answers the second question influenced by the first answer.

A limitation noted was that, although requested to respond to the survey questionnaire, there were a number who failed to respond. These were mainly from the local government sector. This may led to a bias on the results. Some local government councils were experiencing difficult rebuilding after the bush fires and may not have been interested in answering questionnaires. The selection of the sample was judgemental and takes into consideration materiality of the large departments and geographical dispersion of local government around the State of Victoria. Responses were not received from the Victorian Department which developed the financial policy and issued its procedures and not receiving a response from the Victorian Auditor General is recognised as a limitation. Both organisations were approached in the early information gathering stage of this thesis.

The final limitation is that the research was a snap shot in time. Legislation came into effect in 1994 and the survey for this research was conducted in 2009. Things may have changed over the earlier years of implementation and the survey is taken after reasonable bedding down of the legislative requirement to create audit committees in Victorian State Government organisations.

10.4 RECOMMENDED ISSUES FOR FUTURE RESEARCH

The primary role of an audit committee is to ensure that any organisation, be it in the private shareholder funded or public government funded sector, acknowledges that governance plays a critical role in business operations and performance. Business activities are documented and recorded in manual and information technology systems in place to comply with applicable legislation. Money as a resource is required to run organisations. The management of money covers three major activities: (1) funding, meaning the acquisition of funds; (2) management and cost accounting, meaning the application and control over the use of funds; and (3) financial accounting, meaning the recording and reporting of the financial results and status of the business. The system of accountability lies with management.

Management has the role of running the business of the organisation within the boundaries of how and why it was established. This role is usually undertaken by a chief executive officer, managing director or in Government departments in Australia, the departmental secretaries. Guiding management in business decision making are boards of directors, In the Government sector this role is undertaken by the government elected by the public through periodic elections. Government usually Minister with the specialised portfolio roles. For example, the Minister for Finance is responsible for the accountability of public funds and similarly a Minister for Education is responsible for the government's delivering the government's program for education.

This thesis looked at the role of audit committees in the public government funded sector. In the private shareholder funded environment evidence of major corporate failures suggests that the role of audit committees have not been comprehensively effective. For the purpose of acquiring information in the public government funded sector, the research obtained data and information from the Victorian government departments, local government municipalities; a small sample of public bodies (Universities and Water Bodies). A response for the questionnaire was requested and received from a member of a financial management department in the Federal department. Two major stakeholders did not respond to the questionnaire. The Victorian government department that promulgates financial policy and procedures was consulted and a meeting with the administrator of their audit committee confirmed the regulatory statutory, policy and procedures that exist. These are well documented and published in their Department website. The research questionnaire was designed based on what was documented in these regulatory documents. The second stakeholder that did not provide a response to the research questionnaire was the Victorian Auditor General. His position is known because he audits his clients in accordance with Australian Accounting Standards. His practice is evidenced in the annual financial audit certificates he signs. In this research his views were sought through the attendance of lectures and presentations that he conducted as part of his role as the Victorian Auditor General.

His philosophy and practice are well documented in his website, including his presentations and his Specialised and Annual Reports.

This research made an original contribution to knowledge in two ways. First, this research appears to be the first of its kind in Australia to research public sector audit committees. The second was by the development of the survey instrument. The high reliability results suggest that this could be adopted in other contexts and prove a valuable tool for benchmarking audit committee performance.

Future research could extend the study. It would be valuable to focus on audit committees in the Australian Federal government and to other Australian States, local government and public agencies. Other research could look at comparison between similar sized private and public organisations to identify if there are differences between the two sectors. Benchmarking using the instrument developed in this study with public sectors of governments in other countries is perceived as a great contribution to accountability, prevention of fraud and corruption, and ultimately to enterprise governance.

10.5 SUMMARY – CONCLUSION

This research successfully examined factors, namely the role, attributes and functions that contribute to the performance of audit committees as an organisation unit in taxpayer-funded public sector. It has further asserted and assessed that performance of audit committees rely on the ethical and professional information supplied by management, internal auditors and external auditors.

The elements that constitute its role and authority as an organisational unit, the attributes of its members, and the functions and activities that it performs were tested in a public sector environment, an environment that has adopted the application of audit committees after their application in the private sector.

Although there are structural differences, which include the authority of their creation and chain of command, audit committee policy and procedural practices of public sector organisations are similar to those in the private sector. It is the conclusion of this thesis that the principles of performance, accountability, audit and assurance are similar in both public and private sectors. The basis of the research initiated from business theories applicable to both public and private sectors. This research adds incrementally to knowledge of audit committees and provided an opportunity to examine public government funded sector against best practice governance and performance references and research that have been conducted in the private shareholder funded sector.



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GLOSSARY

Accountability

The responsibilities of individuals and entities for a task or activity (State Services Victoria 2010).

Actor-Network Theory

Spira (1999) uses the Actor-Network Theory (ANT) to illuminate the role and activities of the audit committee. The term actor-network in ANT's name conveys the idea that the actor does not act "on his own" but only under the influence of a complex network of material and semiotic influences. The primary tenet of actor-network theory is the concept of the heterogeneous network i.e. a network containing many dissimilar elements (partners and stakeholders). Spira recognising the pioneers of ANT B. Latour and M. Callon noted that coextensive networks comprise of both social and technical parts. Moreover, the social and technical are treated by Actor-Network Theory as inseparable in achieving a common goal (governance and performance).

Agency Theory

Agency theory is a theory of corporate behaviour in which it is recognized that the manager, as agent, may have differing motives from the owner, as principal. Agency theory is also an economic theory of incentives and behaviour based on the relationship between a principal who offers an incentive plan and an agent who accepts the plan to work on behalf of the principal. The principal-agent problem or agency dilemma treats the difficulties that arise under conditions of

incomplete and asymmetric information when a principal hires an agent; a problem emerges when the two may not have the same interests.

Audit

Audit is the application of procedures for the purpose of expressing an opinion on the reliability of management's representation in the financial reports.

The process requires an auditor to:

- Examine the existence of assets, systems and records to verify reported results and balances disclosed in financial reports.
- Assesses an organisation's effectiveness over its governance, internal control systems, legislative compliance, and fraud control.
- Provide an opinion on the figures disclosed in financial reports from recorded transactions.

Audit is a service where the auditor's objective is to provide a high level of assurance through the issue of a positive expression of opinion that enhances the credibility of an assertion about an accountability matter.

Auditing

The objective of auditing is to provide a high level of assurance:

- The issue of a positive expression of an opinion that enhances the credibility of assertion(s) about an accountability matter (attest audit);
- The provision of relevant and reliable information and a positive expression of opinion about an accountability matter where the party responsible for the matter does not make a written assertion(s) (Australian Accounting Standard 2002).

Auditing is also defined by the American Accounting Association in *A Statement of basic auditing concepts* as a systematic process of obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established

criteria and communicating the results to interested users (American Accounting Association (AAA) 1973).

Audit Committee

The *Victorian Standing Directions of the Minister for Finance (2008)* states that an audit committee is appointed to oversee and advise the department or agency on matters of accountability and internal control. The audit committee is a subset of the Responsible Body (or Board) which has been formulated to deal with issues of a specific nature. The audit committee is a board subcommittee whose role is determined by the board. It oversees and monitors the company's audit processes, including the company's internal control activities. This oversight includes:

1. internal and external reporting disclosures;
2. risk management policies and activities;
3. internal audit internal control assurance;
4. external audit opinion and assurance;
5. internal control framework including policies and procedures;
6. financial reporting and disclosure processes;
7. compliance with applicable laws and regulations (financial accounting policies and principles and, in limited areas non-financial);
8. oversight of activities to control and report on ethics, whistle-blowers and fraud.

(Auditing & Assurance Standards Board (AASB), 2008)

Authority

In the context of the *Financial Management Act 1994 (FMA)* An Authority is a Department or body prescribed as an authority for the purposes of the FMA, per s 3.

Assurance

A process that provides confidence that planned objectives will be achieved within an acceptable degree of residual risk. (Standards Australia HB 158–2006:6)

Assurance involves the professional independent service of testing, evaluating and providing a positive or negative opinion on the performance of systems, assets, reports and reported results in organisations.

Board

A Board in a public entity is the governing body. (Public Administration Act 2004:s. 4(1))

External Audit

The examination by an independent third party of the financial statements of an organisation, resulting in the publication of an independent opinion as to whether or not, in all material respects, the financial report is presented fairly in accordance with Accounting Standards and, when appropriate, relevant statutory and other requirements (AARF 2002 AUS 702 cited by Standards Australia HB 158-2006:8).

Internal Audit

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance process (IIA Professional Practices Framework, Definition of Internal Auditing , cited by Standards Australia HB158-2006:9).

Ethics

Ethics refers to a system of moral principles. Ethics is the concept of what is right and wrong, moral and immoral. Ethical behaviour is generally considered behaviour that is in line with the accepted moral code, and that is proper.

Code of Conduct

Victoria's Public Administration Act s. 63 provides, as regards codes of conduct, that the Public Sector Standards Commissioner may prepare and issue codes of conduct based on the public sector values. A code of conduct is binding on

any public official or class of public official to whom it applies. A contravention of a code of conduct by a public official who is bound by the code is capable of constituting misconduct.

Governance

The Australian Standard on Good Governance Principles (AS 8000 2003) recognises that definition of corporate governance is many and varied.

For the purpose of this thesis corporate governance addresses the issues arising from the interrelationships between boards of directors, such as interaction with senior management, and relationships with the owners and others interested in the affairs of the entity, including regulators, auditors, creditors, debt financiers and analysts. This is corroborated by OECD's definition of corporate governance which allows for a range of stakeholders (OECD 2004). ANAO's Better Practice Guide on Public Sector Governance 2003:6):

Good governance is about both:

- Performance —how an agency uses governance arrangements to contribute to its overall performance and the delivery of goods, services or programs, and
- Conformance —how an agency uses governance arrangements to ensure it meets the requirements of the law, regulations, published standards and community expectations of probity, accountability and openness.

Corporate governance refers to the processes by which organisations are directed, controlled and held to account. It encompasses authority, accountability, stewardship, leadership, direction and control exercised in the organisation. (ANAO 2003)

Enterprise governance

Enterprise governance is an emerging term to describe both the corporate governance and business management aspects of an organisation. Enterprise

governance addresses both business performance and corporate governance and achieves a panacea of good governance that links compliance with performance metrics. This will enable organisations to focus all their energies on the key drivers that move their business forward. Enterprise governance considers the whole picture to ensure that strategic goals are aligned and good management is achieved (IFAC and CIMA 2003).

Business performance

Business performance includes the management performance aspects that organisations strategically aim to achieve (IFAC and CIMA 2003).

Fraud

The *Australian Standard AS 8001-2003* defines Fraud as dishonest activity causing actual or potential financial loss to any person or entity and whether or not deception is used at the time, immediately before or immediately following the activity.

Corrupt conduct

In the Victorian *Whistleblowers Protection Act 2001* corrupt conduct is the conduct of a person (whether or not a public officer) that adversely affects, or could adversely affect, either directly or indirectly, the honest performance of a public officer's or public body's functions; or conduct of a public officer that amounts to the performance of any of their functions as a public officer dishonestly or with inappropriate partiality; or conduct of a public officer, a former public officer or a public body that amounts to a breach of public trust; or conduct of a public officer, a former public officer or a public body that amounts to the misuse of information or material acquired in the course of the performance of their functions as such (whether for the benefit of that person or body or otherwise); or a conspiracy or attempt to engage in the conduct referred to above.

Improper conduct

In the Victorian *Whistleblowers Protection Act 2001* (s.3(1)) improper conduct is corrupt conduct; or a substantial mismanagement of public resources; or conduct involving substantial risk to public health or safety; or conduct involving substantial risk to the environment. The conduct must be of a kind that would, if proved, constitute a criminal offence; or reasonable grounds for dismissing or dispensing with, or otherwise terminating, the services of a public officer who was, or is, engaged in that conduct.

Department

A Department in Victoria exists by virtue of an Order made under s.10 of the Victorian Public Administration Act (PAA ss. 4(1)).

Department Head

A Department Head in Victoria is a person employed as a Department Head under the *Victorian Public Administration Act* (PAAs 12).

Director

Director's Duties are:

1. duty to act with honesty and integrity
 2. duty to act in good faith in the best interests of the public entity
 3. duty to act fairly and impartially
 4. duty to use information appropriately
 5. duty to use your position appropriately
 6. duty to act in a financially responsible manner
 7. duty to exercise due care, diligence and skill
 8. duty to comply with establishing legislation
 9. duty to demonstrate leadership and stewardship
- (Victorian Government, Code of Conduct & Guidance Notes 2006).

Department of Premier and Cabinet Guidelines

Department of Premier and Cabinet Guidelines are guidelines for the appointment and remuneration of part-time non-executive directors of State Government Boards and Members of Statutory Bodies and Advisory Committees.

Management Theory

A collection of management principles, rules, methods, and procedures tried and checked by general experience (Foyal as cited in Wren 1994:182).

Management

Management is defined as getting work done through others. Performance is achieved operationally, financially and value for money.

Mary Parker Follett (1868–1933), wrote on the topic of management in the early twentieth century, defined management as "*the art of getting things done through people*". Henri Fayol (1841-1925) considers management to consist of five functions: "*planning, organizing, leading, co-ordinating, and controlling*" (Wren 1994:188-192)

Public Sector

The sector that comprises the public service, public entities, and special bodies (Public Administration Act 2004 Victoria s. 4(1)).

Public Sector Agency

For the purposes of the Standing Directions of the Minister for Finance, Government Departments and public bodies are collectively termed "Public Sector Agencies" (Victorian Standing Directions of the Minister for Finance Clause 1.1).

Public Sector Body Head

A public service body in relation to a public entity is the Head of, the public entity Head; in relation to a special body.

Risk Management

Risk is the chance of something happening that will have an impact on objectives (Standards Australia ANZ Risk Management Standard AS/NZS 4360:2004). Risk management is the culture, processes and structures that prevent the chance of something happening that will have an adverse impact on a public entity's objectives.

Stakeholder Theory

Stakeholder Theory suggests that a firm serves a duty to others (employee, society, suppliers), its shareholders, and incorporates the interests of stakeholders in a business. It widens the view that a firm is responsible only to its owners (A Dictionary of Finance and Banking 1997).

State Services Authority (SSA)

SSA was established by Division 1 of Part 4 of the *Public Administration Act 2004* (PAA). Its functions are defined in Division 2 of Part 4 of the *Public Administration Act 2004*.



APPENDIX 0.1

PROJECT APPROVAL

Wong, Geoffrey

From: Tina Jeggo [Tina.Jeggo@vu.edu.au]
Sent: Tuesday, 8 April 2008 5:35 PM
To: Wong, Geoffrey; geoffrey.wong
Cc: Anona Armstrong; Peter Demediuk
Subject: Faculty Postgraduate Committee Meeting - April 3

The Faculty of Business and Law Postgraduate Committee met on 3 April 2008. Below is an extract of the unconfirmed minutes of the meeting for your information and/or action.

4.2 Application for Candidature (Resubmission)

4.2.1 Mr Geoffrey WONG (3115042) (DBA)

*The Committee considered the resubmitted Candidature application entitled **An Analysis of the Role and Performance of Audit Committees in the Victorian Government Public Sector In Providing Assurance and Governance** and noted that the candidate had addressed the issues raised by the Committee.*

The Committee approved the application for candidature with no further comment.

If you have questions regarding the above, please do not hesitate to contact me.

Regards,

Tina Jeggo
Student Advice Officer (Research and Graduate Studies)
Faculty of Business and Law
Victoria University
Phone 61 3 9919 1549
Fax 61 3 9919 1551
Email tina.jeggo@vu.edu.au
Web www.vu.edu.au



28/04/2008



APPENDIX 0.2

ETHICS APPROVAL

ETHICS APPROVAL FOR QUESTIONNAIRE USE

Mon, 13 December 2010 2:27:10 PM

From: Geoff Wong <gwyp99@yahoo.com> [View Contact](#)
To: Anthony Benka <vu.edu.au>
Cc: Anona Armstrong <vu.edu.au>

Dear Anthony

Ethics approval was granted for me to conduct a questionnaire survey for the thesis I was conducted. The email of this approval was sent to my previous work email at Victoria Police. However I have now retired from Victoria Police and cannot access a copy of that approval. The approval was conditional that in order to go to proceed to the second phase which was the conduct of interviews I had to seek further approval from the ethics committee. However responses from the questionnaire were good and I was able to use statistics to prove its reliability. Thus, it was decided not to proceed with the interview phase. Instead a comparative analysis of Australian and International sources was deemed to be of more academic value for the research.

Would you kindly send me an email or letter I can include in my thesis indicating approval was granted for the questionnaire.

Appreciate your cooperation.

Sincerely

Geoffrey Wong
DBA Candidate

----- Forwarded Message -----

From: Anona Armstrong <Anona.Armstrong@vu.edu.au>
To: Geoff Wong <gwyp99@yahoo.com>
Sent: Wed, 15 October, 2008 11:32:08 AM
Subject: RE: ETHICS APPROVAL - New Form + Responses

Dear Geoff,

Here are the details of the legal person in the Office for Research.

If you wish, give him a ring and get an opinion. Compliance is the name of the game!

Attached is your response to the committee. I made a couple of minor changes. Please make sure that you agree with them.

Kind regards,

Anona

Anthony Benka, 919 4148
Fax:
Mobile Phone:
eMail:

anthony_benka@vu.edu.au

From: Geoff Wong [mailto:gwyp99@yahoo.com]
Sent: Monday, 13 October 2008 9:10 PM
To: Anona Armstrong
Subject: ETHICS APPROVAL - New Form + Responses



Anona

Missed the Ethics Agenda dateline today. Will be ready for the 17Nov08 dateline. I worked at home today. Had to type out the info as I did not have an electronic copy to cut and paste. Working on the Questionnaire.

Regards

Geoff Wong



APPENDIX 2.1

Financial Management Compliance
Framework

An overview of the Financial Management Compliance Framework (FMCF)

What is the FMCF?	What are the objectives?	Who needs to comply?	How and when do agencies certify?
<p>The FMCF is a framework to assist Victorian Public Sector (VPS) agencies establish and maintain effective financial management to support the achievement of agencies' key objectives and goals.</p> <p>It also helps the Victorian government monitor the standard of financial management in line with the Standing Directions of the Minister for Finance (the 'Directions').</p> <p>The FMCF was launched by the Department of Treasury and Finance (DTF) in July 2003 and was subsequently updated in July 2005.</p>	<p>The FMCF was developed to:</p> <ul style="list-style-type: none"> • promote effective financial management • meet the government's requirements for accountability • provide Ministers (including the Minister for Finance) with reasonable assurance that VPS agencies have implemented appropriate systems to comply with the Directions and to use public resources efficiently and responsibly • assist agencies in identifying and documenting their financial compliance status 	<p>The FMCF applies to all VPS agencies who:</p> <ul style="list-style-type: none"> • are a "public body" (defined in section 3 of the FMA) and • are included in the whole of government consolidated "Annual Financial Report for the State of Victoria." 	<p>Agencies certify compliance with the Directions Requirements (that are derived from the Directions) of the FMCF via the Compliance Monitoring System (CMS) website.</p> <p>Certification takes place annually from July to September each year.</p> <p>Refer overleaf for an overview of the annual certification process.</p>

Details of the Directions

How did the Directions come about?	What are the key components of the Directions?	How are the Directions presented?
<p>The Directions are designed to supplement the <i>Financial Management Act 1994</i> (FMA). They are pursuant to section 8 of the FMA.</p>	<p>The Directions are based on the following three components of sound financial management:</p> <ul style="list-style-type: none"> • Financial Management, Governance and Oversight • Financial Management, Structure, Systems, Policies and Procedures • Financial Management Reporting 	<div style="display: flex; justify-content: space-between;"> <div style="width: 20%;"> <p>Background</p> <p>Explanatory section providing users with an understanding of the compliance obligation.</p> </div> <div style="width: 20%;"> <p>Direction</p> <p>A statement which sets out the compliance obligation (mandatory).</p> </div> <div style="width: 20%;"> <p>Procedure</p> <p>Sets out the method of achieving the compliance obligation (mandatory).</p> </div> <div style="width: 20%;"> <p>Guidelines</p> <p>Serve to explain and clarify the principles and objectives of the direction (reference only).</p> </div> <div style="width: 20%;"> <p>Supplementary material</p> <p>Information designed to assist in achieving compliance with the Directions.</p> </div> </div>

Further information and assistance

<p>Financial Management Knowledge Centre: www.fmc.dtf.vic.gov.au</p>	<p>DTF Initiatives:</p> <ul style="list-style-type: none"> • Extensive information sessions across Victoria for VPS agencies • Formal presentations and seminars
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Financial Management Compliance Framework (FMCF)

Introductory Message

The Financial Management Compliance Framework (FMCF, the Framework) has been developed to assist Victorian Public Service (VPS) agencies attain the most effective financial management to achieve organisational goals, whilst simultaneously meeting Government requirements for the purposes of accountability. It will also provide a mechanism through which the Government can effectively monitor and review compliance with the Standing Directions of the Minister for Finance (Directions), as part of the Financial Management Package.

The Framework was implemented from **1 July 2003** with subsequent amendments been made in July 2005 to integrate financial management, taxation, purchasing card and thefts and losses.

The Framework provides assurance that VPS agencies have implemented the appropriate systems to ensure compliance with the Directions to provide for effective, efficient and responsible financial management of public resources.

The Framework also assists in discharging the Minister for Finance's accountability to the Parliament, by ensuring that public resources are being managed in a financially responsible manner.

Under this Framework, Ministers, Portfolio Departments and agencies work together to manage risks and obligations. The primary accountability for compliance rests with individual agencies. Departments have a portfolio assurance and coordinating role, and the Department of Treasury and Finance has a whole-of-government assurance and support.

Please become familiar with the Financial Management Compliance Framework and the requirements of the Directions. It is important that the Department of Treasury and Finance (DTF), portfolio departments and VPS agencies work together to ensure that the Victorian Government meets its financial management obligations.

The Financial Management Compliance Framework - Background

Through this Framework, Government can assist agencies to meet their obligations and effectively monitor and review their overall performance in financial management compliance. Incorporated into this Framework are the financial management, taxation, purchasing card and thefts and losses compliance and reporting requirements. These were previously subject to separate compliance reporting frameworks.

The Framework responds to the Government's initiative of promoting responsible financial management. Inherent in this is a process for the DTF to monitor and report on financial compliance across the VPS. It incorporates a monitoring and reporting process to ensure all VPS agencies are adhering to the requirements of the Framework. Departments and agencies have traditionally relied on the Auditor-General's Office to identify compliance issues, however this is not the Auditor-General's role rather it is the role of the agency's management. The monitoring and reporting processes are centred on a process for annual certification against the Directions, which forms part of the Financial Management Package.

The objectives of the Framework include:

- To attain the most effective financial management to achieve the goals of the agency whilst meeting Government's accountability requirements;
- Provide Ministers with assurance that VPS agencies have implemented the appropriate systems to ensure compliance with the Standing Directions and the effective, efficient and responsible financial management of public resources;
- Discharge the accountability of the Minister for Finance to the Parliament by ensuring that public resources are being managed in a financially responsible manner; and
- Sharpen reporting responsibilities of portfolio departments and agencies.

Key Messages

- This Framework assists VPS agencies in attaining the most effective financial management compliance to achieve the goals of the agency whilst meeting the requirements of Government for the purposes of accountability.
- Accountability for compliance and reporting exists at the agency level. Departments are not to be held accountable for individual agencies. Departments are however responsible for consolidated reporting obligations on a portfolio basis to their Ministers and the Minister for Finance.
- Financial compliance needs to be embedded in work practices.
- Compliance awareness is promoted through this Framework.
- Effective compliance is the primary responsibility of the Responsible Body (Board or Accountable Officer). It requires active and ongoing participation of leadership teams, line managers, supervisors and executives.
- This Framework should be integrated with other existing agency risk management and compliance programs.
- This Framework utilises the best available technology to ensure effective delivery and implementation.

The key principles of the Framework are:

- Agencies and Departments are responsible for meeting their compliance reporting obligations relating to financial management, taxation, purchasing card and thefts and losses.
- DTF will have a Whole of Government key role in supporting agencies in achieving compliance through the update of the Directions, update of websites, development of supplementary material and the provision of information and communication sessions as required.
- Departments have key portfolio roles on behalf of their Ministers to report, provide guidance on systemic issues and assist with corrective actions across their portfolios.
- Where necessary, strengthen internal controls and mechanisms already in place within agencies and thus lead to a reduction in the potential for unexpected “surprises”.
- Assist in ensuring that the Government (in particular, the Minister for Finance), is provided with relevant, up-to-date and accurate information on key financial management issues.

Standing Directions of the Minister for Finance

The Directions form the basis of sound financial management for the State. The Directions are designed to supplement the *Financial Management Act 1994* by prescribing mandatory elements (procedures) that must be complied with by all VPS agencies. The Directions ensure that the VPS continues to practice leading edge financial management.

The three high-level components of the Directions include:

- Financial Management Governance and Oversight.
- Financial Management Structure, Systems, Policies and Procedures.
- Financial Management Reporting.

Scope

The Framework applies to all VPS agencies which meet the “public body” definition contained within section 3 of the FMA and which “feed” into the whole of Government consolidated “Annual Financial Report for the State of Victoria”. Consequently, the Framework applies to 300+ agencies across the State. These agencies are identified in the notes to the Annual Financial Report of the State of Victoria.

Of the agencies to which the Framework applies, the purchasing card requirements are only applicable to those agencies which operate a purchasing card, while the taxation requirements are only applicable to those agencies that have an Australian Business Number (ABN) and which have Commonwealth taxation obligations (including Goods and Services Tax (GST), Fringe Benefits Tax (FBT) and Pay As

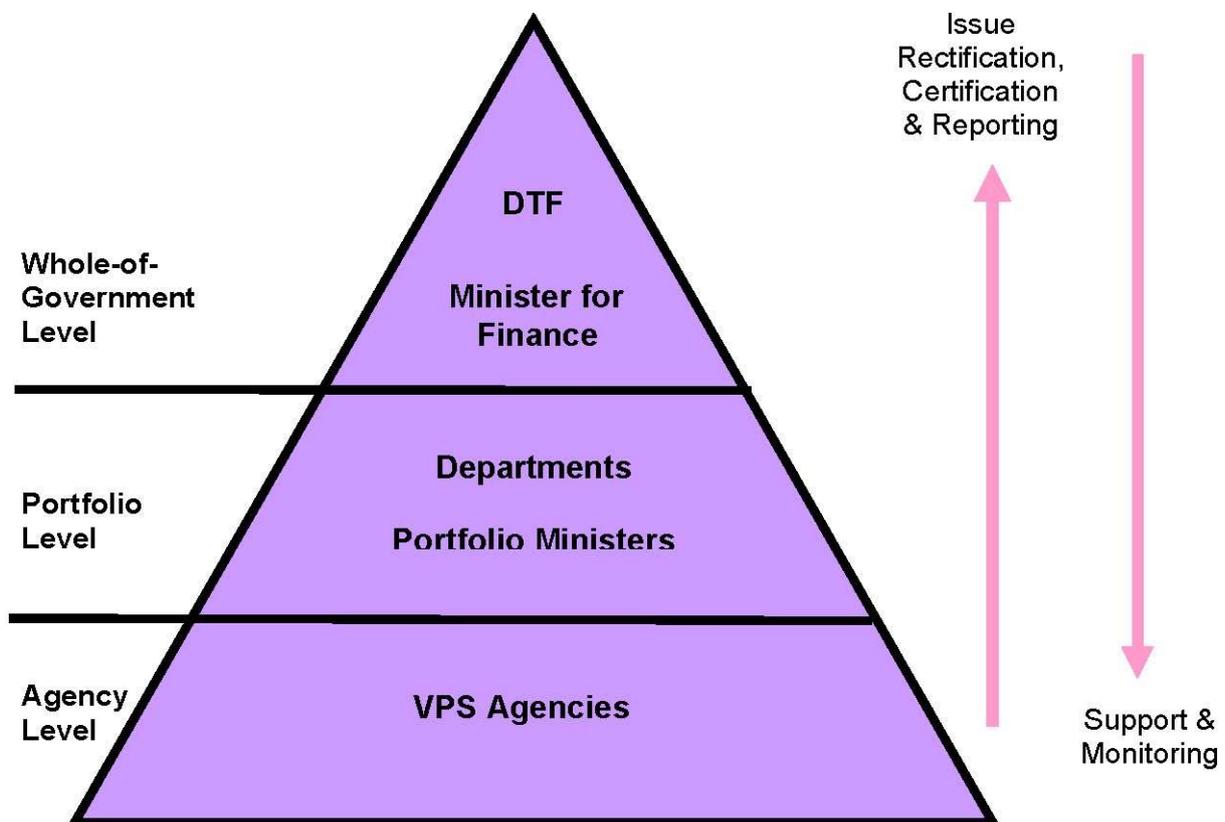
You Go (PAYG)). The thefts and losses requirements are applicable to all public bodies.

Agencies that are incorporated under the *State Owned Enterprises (SoE) Act 1992* and to which Part 7 of the FMA “Accountability and Reporting” applies, or Government owned Corporations Law companies which are declared for Parliamentary tabling purposes under section 53A of the FMA, are expected to apply the Directions as best practice principles and comply with the requirements of the Framework to ensure that their respective Portfolio Minister is provided with relevant information on their financial management compliance status.

All other agencies which meet the ‘public body’ definition contained within section 3 of the FMA but are not consolidated into the “Annual Financial Report for the State of Victoria” are not required to certify against the Framework on an annual basis. However, these agencies are still required to comply with the Directions (including the financial management, taxation, purchasing card and thefts and losses requirements). Portfolio departments may choose to make alternative arrangements to monitor the compliance status of these agencies.

Reporting Structure

A key feature of this Framework is that the primary responsibility for financial management compliance is vested in individual VPS agencies, with Departments performing a portfolio level assurance role and DTF performing a whole-of-government monitoring and support role.



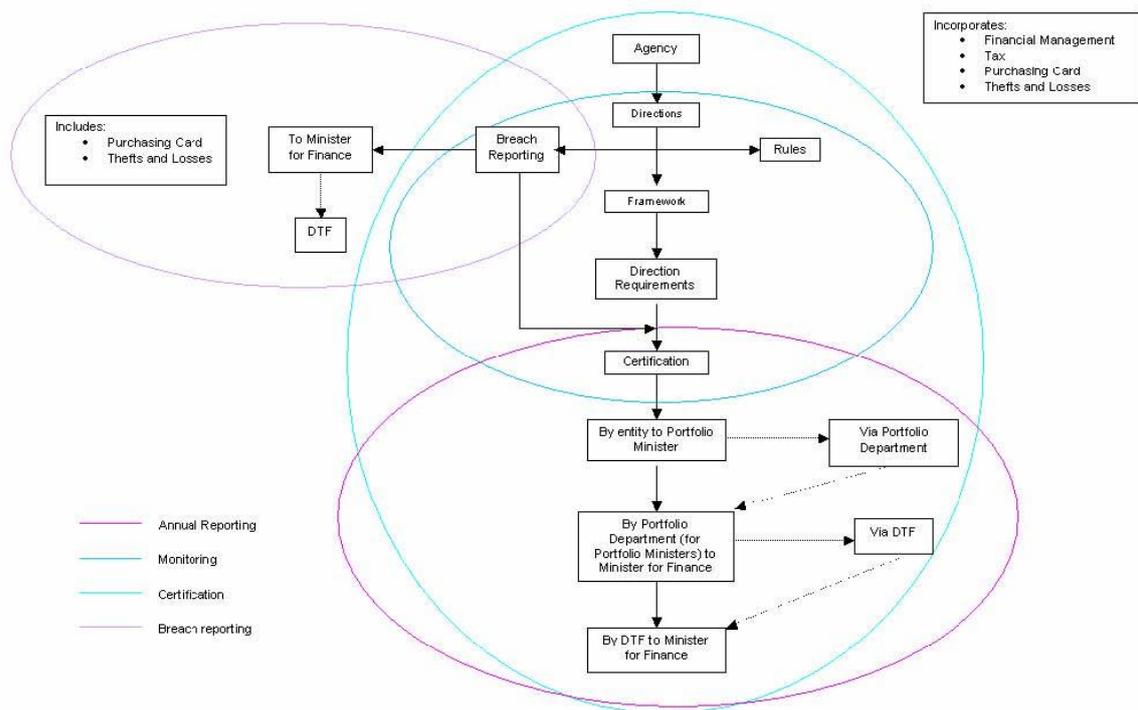
The various taxation, purchasing card and thefts and losses reporting requirements have now been incorporated into the Framework. The Directions have been amended to incorporate these specific requirements.

The Framework also explicitly incorporates the reporting of breaches/unauthorised use of purchasing cards and instances thefts and losses to the Minister for Finance as required by the Directions (with a copy to their Portfolio Minister). However, agencies are still required to report to their respective Portfolio Minister as to whether they have observed the taxation, purchasing card and thefts and losses requirements contained within the Directions through the Framework's certification process. As a result, the previous requirements for a separate annual assurance letter to the Minister for Finance on Purchasing Card Rules for Use and Administration and the annual Taxation Compliance Framework certification have been removed.

The agency certification letters and departmental portfolio summary reports now incorporate financial management, taxation, purchasing card and thefts and losses reporting.

To support the integrated Framework, supporting rules for taxation, purchasing card and thefts and losses still exist together with additional guidance to ensure that agencies understand and observe the revised requirements for breach and incident reporting. Generally, the purpose of the support rules is to assist agencies in meeting the requirements of the Directions. Further information on rules and breach reporting can be found in the Taxation Compliance Rules, Purchasing Card Rules for Use and Administration and Thefts and Losses Rules.

The diagram that follows illustrates the operation of the integrated Framework.



Role of Internal Audit

Agencies will benefit from active involvement of their Internal Auditors, or other appropriate resources, in establishing an up front understanding of the level of compliance with the Directions and the actions to be taken to achieve compliance in accordance with the required timeframes.

Role of the Audit Committee

The Audit Committee (or Responsible Body in its absence) should assume a leading role in the financial governance and oversight matters of the agency. The Audit Committee should become actively involved in the monitoring of financial management compliance issues and in particular the monitoring of rectification action plans in order to achieve compliance in the future. The Audit Committee should work closely with Internal Audit to achieve this.

How the Framework Operates

Outlined below are key aspects of the Framework. For further information please refer to the Framework, Directions, Taxation Compliance Rules, Purchasing Card Rules for Use and Administration and Thefts and Losses Rules.

Certification, Reporting, Monitoring and Reviews

The Framework requirements for VPS agencies will emerge through the annual certification process in which agencies certify as to their level of compliance with Direction Requirements (developed from key elements of the Directions). The certification process is designed as a review of controls and risk management mechanisms, to ensure financial management compliance and the management of risks. VPS agencies must certify that they have complied with the mandatory requirements (procedures) of the Directions facilitated through the Compliance Monitoring System website. VPS agencies are required to sign an exceptions certification letter and forward it to their Portfolio Ministers (via their Portfolio Departments). Portfolio summary reports are then be provided to the Minister for Finance (via DTF).

It is up to individual Departments to determine the exact form of monitoring and assistance for their portfolios. DTF will be actively involved in working with agencies to resolve whole-of-government systemic issues. At a minimum, a portfolio summary report should be completed. This report summarises the certification letters received from the portfolio's agencies and includes comments from the certification process and compliance issues.

In theory, the portfolio summary reports should be addressed to the Minister for Finance and signed by individual Portfolio Ministers. However, as most Departments report to more than one Minister and would need to prepare numerous portfolio summary reports, a practical solution has been developed which will involve the portfolio summary report being signed by the Departmental Secretary (which is the Accountable Officer under the *Financial Management Act*

1994). Departments may wish to seek formal delegation for the Secretary to issue portfolio summary reports on behalf of the relevant Portfolio Ministers.

Issues Management

Agencies are responsible for the resolution of issues specific to them. To promote efficiency in financial management, Departments have responsibility for resolving issues which are common to a number of portfolio agencies. Departments also need to communicate the issue and how it was resolved to all affected agencies.

Issues with whole-of-government implications (i.e. issues that are systemic and affect agencies across more than one portfolio) should be referred to DTF. DTF is responsible for resolving whole-of-government issues and for communicating those issues to agencies that could potentially be affected.

Knowledge Management

Agencies are to ensure that training should be incorporated into induction program for new staff which includes training on the Framework, financial management policies and processes and legislative requirements. Portfolios should provide assistance for industry-specific knowledge management by the adoption of appropriate practices for industry specific knowledge management. This could include training programs focussed on industry specific issues and/or briefings, guides or other prepared material on relevant industry specific issues. DTF will be actively involved in whole-of government education and information sessions, guides, maintaining the Financial Management Knowledge Centre and sharing information across the VPS.

Culture and Commitment

Culture and commitment is a crucial element of this Framework. Commitment is essential at all three tiers of Government (agency, Departmental and whole-of-government) for this Framework to operate effectively. The Responsible Body of all agencies should ensure that an appropriate compliance culture is established at all levels by regularly communicating their commitment to financial management compliance and providing adequate resources and training to meet compliance objectives. DTF encourages an appropriate financial management compliance culture be established across all Departmental portfolios, particularly by encouraging that corrective action is taken on systemic issues.

Achievement of financial management compliance

Financial management compliance will take some time to achieve. It should be incorporated in day to day practices and should be embedded within each agency. To ensure compliance, financial management should be subject to ongoing review to ensure that compliance issues are promptly identified and rectified. Another important element is the reporting and monitoring of compliance issues both within the agency and to the Portfolio Minister through the annual certification process.

Financial Management Knowledge Centre – www.fmkc.dtf.vic.gov.au

The Financial Management Knowledge Centre website is a valuable online information resource for Accountable Officers, CFOs and VPS staff involved in financial management and is a convenient way to exchange information with your colleagues from other Departments and Agencies.

The Financial Management Knowledge Centre contains a number of elements to assist you in meeting your compliance obligations including:

- Library - containing the Financial Management Package
- What's New
- Key Dates and Events
- Issues Management System
- Compliance - containing the Framework, certification checklist and supplementary material
- Financial Reporting - containing the Financial Reporting Directions and Model Financial Report.
- International Financial Reporting Standards – contains information of the Australian equivalents to the International Financial Reporting Standards.

Tax Knowledge Centre – www.tkc.dtf.vic.gov.au

The Tax Knowledge Centre website is a valuable online information resource for Accountable Officers, CFOs and VPS staff involved in taxation compliance and is a convenient way to exchange information with your colleagues from other Departments and Agencies.

The Tax Knowledge Centre contains a number of elements to assist you in meeting your compliance obligations including:

- What's New
- Key Dates and Events
- Taxation Compliance Rules
- Tax Training
- Tax Library
- Issues Management System
- Rulings and Determinations
- Division 81
- ATO Cooperative Compliance

Compliance Monitoring System – <https://www.cms.dtf.vic.gov.au>

The Compliance Monitoring System website is used by Departments and Agencies to facilitate the Framework's annual certification process. This website is normally only available from July to end September annually. For further information on this website, please contact your portfolio coordinator.



APPENDIX 3.1

Victorian Guidelines

Standing Directions of the Minister for Finance

(Directions) extracted from the Victorian Government Department of

Treasury and Finance internet website

(<http://www.dtf.vic.gov.au/CA25713E0002EF43/pages/budget-and-financial-management-financial-management-compliance-framework-standing-directions-and-associated-rules>. viewed Feb 2011)

Purpose of the Victorian Standing Directions of the Minister for Finance.

The Directions are designed to supplement the FMA by prescribing mandatory elements (procedures) that must be complied with by Public Sector Agencies (all VPS agencies that apply the FMP) to:

Implement and maintain appropriate financial management practices; and

Achieve a consistent standard of accountability and financial reporting.

The Directions prescribe best practice, high-level requirements for financial management. This allows Public Sector Agencies to develop agency specific systems, procedures and practices, which must be tailored to their own business, approved and monitored within their own agency requirements.

Guideline 1

- (i.) External financial reports reviewed by the Responsible Body will typically include:
- Annual budgets, forward estimates and forecasts; and
 - Other related reports, in particular significant financial reporting to external parties including other Public Sector Agencies.
- (ii.) It is recommended that the Responsible Body's oversight of a Public Sector Agency's financial performance be based on periodic financial information and associated performance indicators. In discharging its responsibilities it is anticipated that the Responsible Body will:
- Monitor performance against targets incorporated into budget papers, business plans, targets, forecasts and similar;
 - Make appropriate enquiries to understand the reasons and implications for divergences between actual and expected performance;
 - Ensure it has sufficient information to assess management initiatives, to correct or mitigate unfavourable results and to reinforce or enhance favourable results;
 - Approve and monitor management's actions to correct or mitigate unfavourable results; and
 - Review and authorise the release of financial information to ensure it:
 - Is factual;
 - Does not omit material information; and
 - Is expressed in a clear, balanced and objective manner that allows stakeholders to assess the impact of the information on their decision-making.

- (iii.)** It is recommended that where the Responsible Body has a Charter or equivalent document, it should clearly articulate the role of the Responsible Body and the responsibility and accountability relationships between the Minister, the Responsible Body, the Accountable Officer and the Chief Financial Accounting Officer (CFAO) in financial management.
- (iv.)** There is nothing in these Directions that prevents the operational aspects of the Responsible Body's oversight and governance role being delegated to management in accordance with Direction 2.4.

Guideline 2

- (i.)** An Audit Committee may be a committee of the Responsible Body or be appointed by the Responsible Body to undertake, among other functions, the oversight of:
- Financial performance;
 - The financial reporting process;
 - The scope of work, performance and independence of the internal auditor;
 - Ratification of the engagement and dismissal by management of any chief internal audit executive;
 - The scope of work and performance of the external auditor;
 - The operation and implementation of the risk management framework;
 - Matters of accountability and internal control affecting the operations of the Public Sector Agency;
 - The effectiveness of management information systems and other systems of internal control;
 - The acceptability, disclosure of and correct accounting treatment for significant transactions which are not part of the Public Sector Agency's normal course of business;
 - The sign-off of accounting policies; and

- The specific matters to which it is required to direct its attention as set out in 2.3 Financial Risk Management, 2.5 Internal Audit and 2.6 External Audit.
- (ii.) The role may, at the Public Sector Agency's discretion, be extended to cover other matters appropriate for the consideration of such a committee.

Guideline 3

- (i.) With respect to Committees, an independent person is one who is independent of the management of the Public Sector Agency, and:
- Within the last three years has not been employed in an executive capacity by the Public Sector Agency or a related organisation or been a director after ceasing to hold such employment;
 - Within the last three years, has not been a principal of a material professional advisor or a material consultant to the Public Sector Agency or a related organisation, or an employee materially associated with the service provider;
 - Is not a material supplier or customer of, the Public Sector Agency, or a related organisation or an officer or otherwise directly or indirectly associated with a material supplier or customer;
 - Has no material contractual relationship with the Public Sector Agency or a related organisation other than as Committee member of the Public Sector Agency;
 - Has not served on the Responsible Body (if it is a board) or the Committee for a period which could, or could reasonably be perceived to materially interfere with the person's ability to act in the best interests of the Public Sector Agency; and
 - Is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the Committee member's ability to act in the best interests of the Public Sector Agency.

- (ii.) Family ties and cross-directorships may be relevant in considering interests and relationships which may compromise independence.
- (iii.) In the context of these guidelines “materiality” should be considered from the perspectives of both the Public Sector Agency and the individual Committee member/candidates.

Guideline 4

- (i.) The role and responsibilities of each Committee is to be set out in its Charter and should be:
 - Sufficiently detailed to ensure there is:
 - No ambiguity;
 - Clear guidance on key aspects of the committee’s operations; and
 - No overlap in the activities of individual committees.
 - Regularly reviewed for relevance and consistency with the needs of the Responsible Body.
- (ii.) In addition:
 - An annual programme is to be prepared detailing the number, date, time and key matters for attention at each meeting;
 - Agendas and papers should be prepared and circulated in advance of each Committee meeting and in sufficient time for members of the committee to read and absorb their contents; and
 - Committee members should undertake an annual evaluation of the performance of the Committee and report their conclusions to the Responsible Body.

Guideline 5

Where an exemption to create an Audit Committee has been granted, the Responsible Body itself should actively seek to evidence the discharge of all the

Public Sector Agency's financial oversight and governance obligations. Meeting the requirements of this Direction may include the Responsible Body meeting specifically in a separate meeting to address financial management issues.

Guideline 6

With respect to the qualifications of members of the Audit Committee:

Basic financial literacy is defined as the ability to read and understand financial statements, including financial statements, including the income statement, balance sheet, statement of recognised income and expense and cash flow statement. This may also include an understanding of the following, where a Public Sector Agency is subject to their impact:

- Generally Accepted Accounting Principles (GAAP);
- Financial Reporting Directions;
- Budget Memoranda; and
- Budget and Financial Management Guide (BFMG) published by the Department of Treasury and Finance.

(i.) All Audit Committee members should have access to updated copies of the above material and undertake periodic financial reporting and other relevant updates/training to ensure they stay current as to relevant developments in accounting and finance within the Public Sector Agency.

Guideline 7

Appropriate expertise may have been developed from one or a combination of:

- Relevant past employment experience in an accounting profession;
- Requisite professional qualification in accounting; or
- Comparable experience with financial oversight responsibilities.

Guideline 8

The Department of Treasury and Finance will provide detailed in Taxation Compliance Rules to assist Public Sector Agencies to meet their compliance obligations in relation to:

- Australian Business Number (ABN);
- Goods and Services Tax (GST);
- Pay As You Go (PAYG);
- Fringe Benefits Tax (FBT);
- Deductible Gift Recipient (DGR);
- Income Tax Exempt Charity (ITEC); and
- Fuel Credits Scheme.

Each Public Sector Agency is accountable for meeting its Commonwealth tax obligations in its own right.

More information on the Taxation Compliance Rules can be found on the Tax Knowledge Centre at www.tkc.dtf.vic.gov.au.



APPENDIX 3.2

VICTORIAN AUDIT COMMITTEE SUPPLEMENTARY MATERIAL

The *Standing Directions of the Minister for Finance (the Directions)* detail a number of requirements in relation to Audit Committees. The following guidance is designed to assist Audit Committee and Responsible Body members in understanding their role under the *Directions*. Sourced from the Victorian Government's intranet site the following material provides a detail set of instructions that Departments and Public agencies have to abide by (*Directions* (available on the *Financial Management Knowledge Centre* website www.fmkc.dtf.vic.gov.au).

The following are quoted directly from the *Directions*:

1. What is an Audit Committee?
2. The purpose of an Audit Committee.
3. Audit Committee requirements under the *Direction*.
4. Audit Committee activities.
5. Where to get more information.

1. What is an Audit Committee?

An Audit Committee is a subcommittee of the Responsible Body (or the Board) assigned the task of assisting the Responsible Body fulfil its governance and oversight responsibilities in financial reporting, internal controls, risk management and internal and external audit. This is achieved by providing an independent and objective review of the financial reporting processes, internal

controls and the audit function. The precise role of an Audit Committee will reflect the size and nature of the entity.

Audit Committees require the support of management, together with pertinent information and resources to be effective. Indeed, it is essential that management, internal and external auditors and Audit Committee themselves work with a common purpose in improving financial reporting and greater effectiveness of internal controls. An informed, diligent and probing Audit Committee can enhance confidence in the integrity of business processes while making a valuable contribution to the process by which entities are directed and controlled.

The establishment of an Audit Committee does not release the Responsible Body from its responsibilities.

2.The purpose of an Audit Committee

The Audit Committee has a lead oversight role in financial governance and financial reporting matters. It is actively involved in monitoring financial management compliance issues, particularly in the identification of risk areas and the monitoring of associated rectification plans. It also reviews the integrity of the financial reporting and internal control structures and oversees the financial performance of the entity.

The Audit Committee gathers and assesses information and provides a focus for the Responsible Body in managing financial risks and opportunities confronting the entity. Its establishment supports the Responsible Body's own performance in the discharge of its financial governance and oversight responsibilities.

3.Audit Committee Requirements under the Directions

There are a number of Directions and Procedures relating to Audit Committees. Amongst other things, these include:

- *Direction 2.2: Financial Governance*
 - *The requirement to appoint an Audit Committee (or equivalent)*
 - *Two Audit Committee must be independent*

- *The Audit Committee must consist of at least three members, a majority of which must be independent*
- *The Audit Committee must have an Audit Committee charter*
- *The Accountable Officer and Chief Finance and Accounting Officer are not to be Audit Committee members*
- *The Audit Committee chairperson to be one of the independent members of that Committee*
- *The Audit Committee members to have and maintain a range of skills and knowledge*
- *Audit Committee members are to be financially literate*
- *At least one Audit Committee member must have financial expertise*
- *All Audit Committee members must have an understanding of the entity*
- *Newly appointment Audit Committee members must be provided with necessary and relevant information*
- *The Audit Committee membership must be reviewed at least every three years*
- *The Audit Committee is to have access to internal and external auditors*
- *The Audit Committee is to have access to management*
- *The Audit Committee is able to seek independent, expert advice when required*
- *Direction 2.5: Internal Audit*
 - *The Audit Committee is to approve the internal audit charter*
 - *The Audit Committee is to approve the internal audit plan*
 - *The Audit Committee to conduct an annual review of internal audit's performance*
- *Direction 2.6: External Audit*
 - *Audit Committee members are to have a clear understanding of the role of the external auditor (the Auditor-General)*
 - *The results of external audit to be considered by the Audit Committee*

- *The Audit Committee is to meet privately with external audit at least once annually*
- *The conducting of discussions, at least annually, by the Audit Committee with external without management present*
- *The Audit Committee is to monitor the rectification of issues identified by the Auditor-General*

4. Audit Committee Activities

In fulfilling the requirements under the *Directions and Financial Management Compliance Framework*, the Audit Committee may wish to undertake the following activities:

- *review the results of the annual Financial Management Compliance Framework certification process prior to its finalisation based on:*
 - *an understanding of the business;*
 - *prior management reporting of the implementation of financial management compliance action/rectification plans*
 - *internal audit findings on work performed*
 - *findings of any external audit reviews*
- *make enquiries of management in relation to any identified or emerging issues and their associated rectification plans*
- *include financial management compliance as a standing Audit Committee agenda item*
- *ensure that internal audit continue to be proactive in the monitoring of financial management compliance and risk areas*
- *encourage management to implement a culture of compliance throughout the entity*

5. Where to obtain more information

The Financial Management Knowledge Centre website contains a range of templates and guidance which may be of use to Audit Committees in meeting their requirements under Direction 2.2. This information can be found at <http://www.fmkc.dtf.vic.gov.au/CA256C8C000B6952/0/FCACEF1F2FDB6083CA256D4F001F7B0B?OpenDocument>

The various accounting firms have available a range of resources available to the general public. The following are some of the more useful resources.

- Deloitte's Audit Committee Better Practice Guide:
http://www.deloitte.com/dtt/cda/doc/content/AC_better_practice%281%29.pdf
- PricewaterhouseCoopers' Audit Committee Matters publication:
<http://www.pwc.com/Extweb/pwcpublications.nsf/docid/D42D3F6F31BFE83FCA256BB4002E50B2>
- PricewaterhouseCoopers' Audit Committee Effectiveness – What Works Best 3rd Edition (due for release mid 2005): www.pwc.com
- KPMG's Audit Committee Institute:
<http://www.kpmg.com.au/aci/home.htm>
- Various Ernst & Young publications:
[http://www.ey.com/global/content.nsf/Australia/AABS -
Corporate Governance - Toolkits Surveys and Resources](http://www.ey.com/global/content.nsf/Australia/AABS_-_Corporate_Governance_-_Toolkits_Surveys_and_Resources)

Other various accounting firms may have other resources available for reference.

Another potentially useful guide is the Australian National Audit Office Better Practice Guide on Public Sector Audit Committees which can be found at:
<http://www.anao.gov.au/WebSite.nsf/1c8fb55046f2cc5cca256bed00179e7f/db82bd972f2a30aaca256faf00159722!OpenDocument>.

In addition, a range of courses are available to assist Audit Committee members in understanding their role and various requirements. In the first instance, Audit Committee members are encouraged to contact their local university, TAFE college, CPA Australia or the Institute of Chartered Accountants. Details on various short courses run throughout Victoria can also be found at www.shortcourses.vic.gov.au.

The follow is a list of some of the courses available:

Location	Course Name	Provider	Telephone
Bendigo	Accounting – basic reports	Bendigo Regional Institute of TAFE	5434 1555

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Bendigo	Accounting – introduction to accounting	Bendigo Regional Institute of TAFE	5434 1555
Box Hill	Accounting for business – a non-accountant’s guide	Box Hill Institute of TAFE	1300 363 430
Camberwell	Accounting – general accounting practices	Bowen Street Family Centre	9889 0791
Castlemaine	Accounting – introduction to accounting	Bendigo Regional Institute of TAFE	5470 6440
Croydon	Quality Internal Auditor Training	Swinburne University of Technology	9726 1500
Diamond Creek	Accounting	Diamond Creek Living and Learning Centre	9438 5350
Diamond Creek	Accounting – Introduction	Diamond Creek Living and Learning Centre	9438 5350
Echuca	Accounting – Basic Reports	Bendigo Regional Institute of TAFE	5483 1333
Geelong	Accounting for Non-Accountants	Gordon Institute of TAFE	5225 0680
Hawthorn East	Beyond the Audit	Mayfield Education Centre	9882 7644
Melbourne	Accounting Decisions and Accountability	Open Learning Australia	9903 8955
Melbourne	Accounting for Non-Accountants	Centre for Adult Education	9652 0611
Melbourne	Accounting Fundamentals	Spherion	9243 2210
Melbourne	Financial Accounting Foundations	Open Learning Australia	9903 8955
Melbourne	Public Sector Accounting	Open Learning Australia	9903 8955
Melbourne	Audit of Small to Medium Sized Enterprises	CPA Australia	9606 9861
Melbourne	Audit Theory and Practice	Open Learning Australia	9903 8955
Warrnambool	Making Accounting Friendly	South West Institute of TAFE	5564 8967



APPENDIX 3.3

VICTORIAN AUDIT COMMITTEE CHARTER (SAMPLE)

Below is an example of an Audit Committee Charter that could be used as basis for developing a formal Charter by a Public Sector Agency. The example is only a guideline and may not comprehensively address the individual requirements of each Public Sector Agency. It also contains some areas that may not be directly applicable to all Public Sector Agencies.

The Charter of an Audit Committee represents the framework for the Committee's role, responsibilities, composition, structure and membership requirements.

A Public Sector Agency's Audit Committee Charter should be consistent with the Standing Directions of the Minister for Finance under the Financial Management Act 1994. The Audit Committee Charter should be reviewed on a regular basis to ensure that it is consistent with changes in the financial, risk management and governance arrangements of the Public Sector Agency and reflects the latest thinking on Audit Committees.

Public Sector Agencies should also refer to relevant best practice guidelines from both public and private sector bodies in developing an Audit Committee Charter. For example reference may be made to, recommendation 4.4 of Principle 4 "The Audit Committee should have a formal Charter" of ASX Corporate Governance Council, Principles of good corporate governance and best practice recommendations, March 2003. However, best practice guidelines (and this template, if used) should be tailored to suit the individual needs of the Public Sector Agency.

The date that the Charter is approved by the Responsible Body should be noted on the Charter.

Purpose and Objectives

The [Insert name of Public Sector Agency] Audit Committee ("the Committee") will assist the [Insert name of Public Sector Agency] Responsible Body (Accountable Office/Board/Other) in fulfilling its oversight responsibilities. The Committee will undertake the oversight of:

- Financial performance and the financial reporting process, including the annual financial statements
- The scope of work, performance and independence of internal audit
- Ratifying the engagement and dismissal by management of any chief internal audit executive
- The scope of work, independence and performance of the external auditor
- The operation and implementation of the risk management framework
- Matters of accountability and internal control affecting the operations of the Public Sector Agency
- The effectiveness of management information systems and other systems of internal control
- The acceptability of and correct accounting treatment for and disclosure of significant transactions which are not part of the Public Sector Agency's normal course of business
- The sign off of accounting policies
- The Public Sector Agency's process for monitoring compliance with laws and regulations and its own Code of Conduct and Code of Financial Practice.

<The Public Sector Agency should include in its Charter only those areas that are the responsibility of the Audit Committee. Those areas that are the responsibility of other Committees of the Responsible Body should be included in their respective Charters. There may be additional responsibilities that need to be included.>

In performing its duties, the Committee will maintain effective working relationships with the Responsible Body, management, and the internal and external auditors. To perform his or her role effectively, each Committee member will obtain an understanding of the detailed responsibilities of Committee membership as well as the Public Sector Agency's business, operations and risks.

Authority

The Responsible Body authorises the Committee, within the scope of its responsibilities, to:

- Perform activities within its terms of reference
- Seek any information it requires from:
 - any employee (and all employees are directed to co-operate with any request made by the Committee)
 - internal and external audit
 - external parties
- Obtain outside legal or other professional advice to assist in undertaking its oversight responsibilities
- Ensure the attendance of Public Sector Agency officers at meetings as appropriate

Organisation

Membership

The Committee will comprise [insert number].

Each member should be capable of making a valuable contribution to the Committee and will have the qualifications outlined in the Standing Directions of the Minister for Finance under the Financial Management Act 1994.

At least two members of the Committee will be independent of the Public Sector Agency in accordance with the independence requirements of the Standing Directions of the Minister for Finance under the Financial Management Act 1994

<Where the Responsible Body is a Board, insert “The Audit Committee is to be comprised of <insert relevant number (at least 3)> members all of whom are non executive directors and a majority of whom are independent based on the requirements of the Standing Directions of the Minister for Finance under the Financial Management Act 1994.>

The Accountable Officer and the CFAO are not to be members of the Audit Committee.

The Chairperson of the Committee will be one of the independent members of the Committee and will be nominated by the Responsible Body from time to time. The Chairperson is not to be the Chairperson of the Responsible Body.

Members will be appointed for a [insert number – it is recommended this should be no more than 3 years] year term of office. [If possible, membership renewal dates should be staggered so significant knowledge is not lost to the Committee].

A quorum for any meeting will be [insert number] members.

The secretary of the Committee will be nominated by the Responsible Body from time to time.

Each new member is required to complete the Committee induction requirements, consistent with the requirements of the Standing Directions of the Minister for Finance under the Financial Management Act 1994.

Attendance at Meetings

The Committee may invite such other persons (eg. The Accountable Officer, CFAO, Head of Internal Audit) to its meetings, as it deems necessary.

The internal and external auditors should be invited to make presentations to the Committee as appropriate.

Meetings shall be held not less than [insert number – at least 4] times a year. Special meetings may be convened as required. Internal audit or the external auditors may convene a meeting if they consider that it is necessary.

The agenda and supporting documentation should be delivered to the Audit Committee members at least **[insert timeframe but suggest “three working days and one weekend”]** in advance of each meeting.

The proceedings of all meetings will be minuted to reflect the work done by the Committee and are to be provided to the Responsible Body, at **<insert appropriate timeframe based on Direction 2.2, Procedure i>**.

Roles and Responsibilities

The Committee will monitor and oversight the following:

Financial performance and the financial reporting process, including the annual financial statements

- 4.1 <insert text in accordance with the requirement in Direction 4.2, Procedure (e) to review and recommend the financial statements prior to finalisation and submission, where appropriate. Examples of roles and responsibilities which can be selected include:
- 4.1.1 Review the current areas of greatest financial risk and how these are being managed in the Public Sector Agency
- 4.1.2 Review significant accounting and reporting issues, including recent professional and regulatory pronouncements, and understand their impact on the financial statements
- 4.1.3 Oversee the financial reporting process implemented by management and review any interim financial statements, annual financial statements and preliminary announcements prior to their release to determine whether they are complete, reflect appropriate accounting principles, contain appropriate disclosures, and are consistent with the information known to Committee members. In discharge to this responsibility the Audit Committee is to:
- Ensure accounting policies are consistently applied and any new accounting standards requirements, related to the Public Sector Agency, are appropriately reflected
 - Pay particular attention to complex and/or unusual transactions such as Machinery of Government changes, measurement and reporting of financial instruments, where applicable
 - Focus on judgmental areas of the financial statements, for example those involving revenue recognition; valuation of assets and liabilities, environmental liabilities, and other commitments and contingencies
 - Meet with management and the external auditors to review the financial statements and the results of the audit
 - Ensure that any significant adjustments, unadjusted differences, disagreements with management and critical accounting policies and practices have been discussed with the external auditor
 - Obtain the relevant representations from management as to the preparation of the financial statements
- 4.1.4 Discuss with management significant movements in the financial statements between periods and from budget and ensure that

explanations are consistent with the Audit Committee's understanding of the business

- 4.1.5 *Review the other sections of the annual report before its release and consider whether the information is understandable and consistent with members' knowledge about the Public Sector Agency and its operations>*

The scope of work, performance and independence of internal audit

- 4.2 *<insert text as applicable from the following:*
- 4.2.1 *Review and approve the internal audit plan, its scope and progress, and any significant changes to it, including any difficulties or restrictions on scope of activities, or significant disagreements with management*
 - 4.2.2 *Confer with the external auditor regarding the standard or work of internal audit staff and assess the health of relationship between external and internal audit teams and whether this leads to inefficiencies in the Public Sector Agency's assurance activities*
 - 4.2.3 *Review the effectiveness of the internal audit function and ensure that it has appropriate standing within the Public Sector Agency*
 - 4.2.4 *Meet separately with the head of internal audit [**internal audit service provider**] to discuss any matters that the Committee or the internal auditor believe should be discussed privately*
 - 4.2.5 *Ensure significant findings and recommendations made by the internal auditors are received, discussed with a course of action agreed and that this is implemented on a timely basis*
 - 4.2.6 *Review the proposed internal audit plan for the coming year, ensure that it covers key risks and that there is appropriate co-ordination with the external auditor*
 - 4.2.7 *Ensure that the annual work plan of internal audit includes an analysis of the effectiveness of the Public Sector Agency's risk management, internal compliance and control system*
 - 4.2.8 *Monitor and oversee any mechanisms in place whereby internal audit assesses and reports on its own performance>*

The engagement and dismissal by management of any chief internal audit executive

- 4.3 *<insert text, possibly:*
- 4.3.1 *Confirm the appointment, promotion or dismissal of the head of internal audit [**or internal audit outsourced service providers if applicable**] >*

The scope of work, independence and performance of the external auditor

- 4.4 *<insert text which may include a selection from:*
- 4.4.1 *Review the external auditors' proposed audit scope and audit approach, including materiality, for the current year in the light of the Public Sector Agency's circumstances and changes in regulatory and other requirements*
 - 4.4.2 *Regularly review with the external auditor any audit problems or difficulties the auditor encountered in the normal course of audit work including any restriction on audit scope or access to information*

- 4.4.3 *Ensure significant findings and recommendations made by the external auditors are received and discussed on a timely basis*
- 4.4.4 *Ensure management responds promptly to recommendations made by the external auditors*
- 4.4.5 *Discuss with the external auditor the quality of accounting policies applied in the company's financial reporting*
- 4.4.6 *Meet separately with the external auditors to discuss any matters that the committee or auditors believe should be discussed privately*
- 4.4.7 *Review all representation letters signed by management and ensure that the information provided is complete and appropriate >*

The operation and implementation of the risk management framework

- 4.5 *<insert text as appropriate which may include a selection from:*
 - 4.5.1 *Review the Public Sector Agency's policy for the oversight and management of business risks*
 - 4.5.2 *Oversee management's overall risk management strategy/framework and ensure the required actions are appropriately resourced*
 - 4.5.3 *Oversee the establishment and implementation of the Public Sector Agency's risk management system*
 - 4.5.4 *Ensure that the Public Sector Agency has identified, reviews and regularly updates the profile of the principal strategic, operational and financial risks to which it is exposed and assessed the appropriateness of the steps management has taken to manage these risks*
 - 4.5.5 *Review trends on the Public Sector Agency's risk profile, reports on specific risks and the status of the risk management process*
 - 4.5.6 *Monitor performance of management in implementing risk management responses and internal control rectification activities and ensure that there are appropriate systems for identifying and monitoring risks in place and that these are operating as intended>*

Matters of accountability and internal control affecting the operations of the Public Sector Agency

- 4.6 *<insert text which may include a selection from the following as appropriate:*
 - 4.6.1 *Ensure any internal control recommendations made by the internal and external auditors, and approved by the Committee, have been implemented by management ie track all agreed action points from audit*
 - 4.6.2 *Evaluate the process the entity has in place for assessing the effectiveness and efficiency of, and continuously improving internal controls, particularly those related to areas of significant risk eg: fraud, code of ethics etc*
 - 4.6.3 *Assess whether management has appropriate controls in place for unusual types of transactions and/or any particular transactions that may carry more than an acceptable degree of risk>*

The effectiveness of management information systems and other systems of internal control

- 4.7 *<insert text, similar to above and which may include more specific references to understanding the Public Sector Agency's IT strategy, IT risks and IT controls>*

The acceptability of and correct accounting treatment for and disclosure of significant transactions which are not part of the Public Sector Agency's normal course of business

4.8 <insert text – refer section 4.1 above for examples>

The sign off of accounting policies

4.9 <insert text – refer section 4.1 above for examples>

The Public Sector Agency's process for monitoring compliance with laws and regulations and its own code of conduct and code of financial practice

- 4.10 <insert text, which may include a selection from the following:
- 4.10.1 *Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of management's investigation and follow-up (including disciplinary action) of any fraudulent acts or non-compliance*
 - 4.10.2 *Obtain regular updates from management and the Public Sector Agency's legal counsel regarding compliance matters that may have a material impact on the Public Sector Agency's reputation or financial statements*
 - 4.10.3 *Make appropriate enquiries to satisfy itself that all regulatory compliance matters, related to the business of the Public Sector Agency, have been considered in the preparation of the financial statements*
 - 4.10.4 *Review the findings and recommendations of any examinations by regulatory agencies>*

Performance

The Committee will review its performance on an <annual> basis and provide recommendations to the Responsible Body.



APPENDIX 3.4

VICTORIAN AUDIT COMMITTEE SELF-ASSESSMENT QUESTIONNAIRE

This survey is based on the “Purpose and Objectives” as described in the example Audit Committee Charter provide as part of the guidance material to accompany the Ministerial Directions to the Financial Management Act 1994.

Introduction

The purpose of the review is to enable the Audit Committee members to critically assess the Committee’s operations and performance and either:

- *Confirm the appropriateness of existing procedures, or*
- *Provide suggestions for improvements to procedures.*

The survey asks you to consider how well the Committee has performed in relation to the major functional areas defined in the Charter. The results of the survey, and its discussion at the meeting, will form the basis of a report to the Responsible Body.

Process

Action	Timing
<i>Committee members complete survey.</i>	
<i>Survey results to be consolidated by [insert appropriate officer].</i>	
<i>Committee discusses survey results and potential improvements.</i>	
<i>Committee agrees a self-assessment rating and actions it will undertake to improve performance.</i>	
<i>Committee reports agreed survey results and suggested improvements to the Responsible Body for endorsement</i>	

*Please complete and return the attached questionnaire to **[insert appropriate officer]** by **[insert date]** in order for the results to be collated and a report prepared for **[insert date of appropriate Audit Committee]**.*

The Audit Committee’s Charter and annual work-plan¹ should be referred to when answering the questionnaire.

Respondents are not limited to the space provided. If additional space for comments is required, please either use the reverse side of the page, or attach an additional sheet at the end of the questionnaire.

*If you have any queries about the questionnaire itself or the process and timing of its completion, please contact **[insert appropriate officer]**.*

Survey

¹ Where an annual plan exists

Rating Scale

Questions ask you to assess the performance of the Committee in relation to its activities as described in the charter.

Using the rating scale below as a guideline circle the number that best reflects your assessment.

Rating	Description
0	<i>No evidence that the Committee has met any of its responsibilities in this area. Extensive improvements required, approaching worst in field.</i>
2 – 3	<i>The Committee has partially met some of its responsibilities in this area. Considerable improvements required.</i>
5	<i>The Committee has fully undertaken some of its responsibilities in this area. Major improvements required, approaching middle of field.</i>
7 – 8	<i>The Committee has fully undertaken most of its responsibilities in this area. Minor improvement required, but approaching best in field.</i>
10	<i>The Committee has fully undertaken all its responsibilities in this area. It would be expected that independent assessment would find that [insert name of Public Sector Agency] is a leader in this field.</i>

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Name:

1) How well is the Audit Committee achieving its purpose and objective to oversee:

- *Financial performance and the financial reporting process, including the annual financial statements*

0	1	2	3	4	5	6	7	8	9	10
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- *The scope of work, performance and independence of internal audit*

0	1	2	3	4	5	6	7	8	9	10
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- *Ratifying the engagement and dismissal by management of any chief internal audit executive*

0	1	2	3	4	5	6	7	8	9	10
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- *The scope of work, independence and performance of the external auditor*

0	1	2	3	4	5	6	7	8	9	10
---	---	---	---	---	---	---	---	---	---	----

- *The operation and implementation of the risk management framework*

0	1	2	3	4	5	6	7	8	9	10
---	---	---	---	---	---	---	---	---	---	----

- *Matters of accountability and internal control affecting the operations of the Public Sector Agency*

0	1	2	3	4	5	6	7	8	9	10
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- *The effectiveness of management information systems and other systems of internal control*

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0	1	2	3	4	5	6	7	8	9	10
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- *The acceptability of and correct accounting treatment for and disclosure of significant transactions which are not part of the Public Sector Agency's normal course of business*

0	1	2	3	4	5	6	7	8	9	10
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- *The sign off of accounting policies*

0	1	2	3	4	5	6	7	8	9	10
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- *The public sector agency's process for monitoring compliance with laws and regulations and its own code of conduct and code of financial practice*

0	1	2	3	4	5	6	7	8	9	10
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Reasons for your assessment.

What are your suggested improvements?

2) *How well has the Audit Committee interact with the internal audit function of the [insert name of Public Sector Agency]?*

0	1	2	3	4	5	6	7	8	9	10
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Reasons for your assessment.

What are your suggested improvements?

- 3) *How well has the Audit Committee undertaken its responsibility to provide an independent and objective review of the financial statements presented by the [insert name of Public Sector Agency] to the Parliament?*

0	1	2	3	4	5	6	7	8	9	10
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Reasons for your assessment.

What are your suggested improvements?

- 4) *How well has the Audit Committee undertaken its responsibility to report periodically to the Responsible Body and senior management on the activities of the Committee?*

0	1	2	3	4	5	6	7	8	9	10
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Reasons for your assessment.

What are your suggested improvements?

5) *How well has the Audit Committee undertaken its responsibility to satisfy itself that appropriate action is taken on matters raised in respect of the **[insert name of Public Sector Agency]** by the Auditor General and Internal Audit?*

0	1	2	3	4	5	6	7	8	9	10
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Reasons for your assessment.

What are your suggested improvements?

Appendix

<attach Audit Committee Charter, Annual Audit Plan

and any other relevant information>

Suggested activities that the Responsible Body should undertake where an exemption has been granted from the requirements for an Audit Committee and/or Internal Audit²

Audit Committee Exemption

Where the Responsible Body has been exempted from creating an Audit Committee the Responsible Body must actively assume all the usual roles and responsibilities of an Audit Committee in addition to the responsibilities of the Responsible Body and should actively seek to evidence the discharge of these obligations.

For example the following requirements will apply to the Responsible Body in the absence of an Audit Committee:

- *Direction 2.2: Financial Governance*
 - *The Responsible Body must consist of at least three members, all of whom are non-executive directors and the majority of whom are independent, unless it is a Government Department where the Accountable Officer is the Responsible Body*
 - *Responsible Body members are to have and maintain a range of skills and knowledge that fulfil the requirements in the Directions for Audit Committee members (i.e. the requirements contained in Direction 2.2(n) and at least one member should have appropriate expertise in financial accounting or auditing)*
 - *Responsible Body members are to have reasonable knowledge of the Public Sector Agency and its risks and controls*
 - *Newly appointed members must be provided with necessary and relevant information*
- *Direction 2.5: Internal Audit*

² This will not apply to Government Departments, where Responsible Body is an Accountable Officer as Government Departments are not able to seek exemption from having an Audit Committee and Internal Audit.

- *The Responsible Body should approve the internal audit charter*
- *The Responsible Body should approve the internal audit plan*
- The Responsible Body should have direct access to the internal auditor, Accountable Officer, CFAO and Public Sector Agency management, where required, or to other independent experts if required
- The Responsible Body should conduct an annual review of internal audit's performance
- Direction 2.6: External Audit
 - Responsible Body members are to have a clear understanding of the role of the external auditor (the Auditor-General)
 - The results of external audit to be considered by the Responsible Body
 - The Responsible Body is to meet with external audit at least once annually
 - The Responsible Body is to monitor the rectification of issues identified by the Auditor-General

For further information see also the Audit Committee supplementary material.

Internal Audit Exemption

Where the Public Sector Agency is exempt from establishing an internal audit function the Responsible Body must take alternative steps to secure an appropriate level of assurance from alternative sources such as in-house assurance activities and/or compliance functions or work performed independently of management. The level of detail will depend on the nature and complexity of the Public Sector Agency. Activities the Responsible Body may carry out include a combination of:

- Requests for independent reviews to be performed
- Interview of management and/or service providers before, during or after projects or work undertaken
- Review of financial transactions and reports to highlight potential problem areas
- Review of reports on controls, process or financial activities prepared by management or other parties
- Review of policies and procedures

Where to obtain more information

The Financial Management Knowledge Centre website contains a range of templates and supplementary material which may be of use to Responsible Bodies in meeting their requirements under Direction 2.2. This information can be found at

<http://www.fmkc.dtf.vic.gov.au/CA256C8C000B6952/0/FCACEF1F2FDB6083CA256D4F001F7B0B?OpenDocument>

There are various resources on the internet available to the general public relating to governance and board (Responsible Body) arrangements. The following are some of the more useful resources.

- PricewaterhouseCoopers' Board Agenda:
<http://www.pwc.com/extweb/pwcpublications.nsf/docid/7019BBC44A9BE9BC80256A2B004B8C9F>
- Various PricewaterhouseCoopers' publications:
<http://www.pwc.com/corporategovernance/>
- ASX Corporate Governance Council:
<http://www.asx.com.au/supervision/governance/index.htm>
- CPA Australia Corporate Governance:
http://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FEDF-A76C5C39/cpa/hs.xsl/875_ENA_HTML.htm
- Institute of Public Administration Australia:
Spotlight on Spring Street, Guiding Principles of Good Governance in the Public Sector, Wayne Cameron, Victorian Auditor-General, September 2003.
<http://www.vic.ipaa.org.au>

In addition, a range of courses are available to assist Responsible Body members in understanding their role and various requirements. In the first instance, Responsible Body members are encouraged to contact their local university, TAFE college, CPA Australia or the Institute of Chartered Accountants. Details on various short courses run throughout Victoria can also be found at **www.shortcourses.vic.gov.au**.

The follow is a list of some of the courses available:

Location	Course Name	Provider	Telephone
St Kilda	Corporate Governance	Australian Institute of Management (AIM)	9534 8181
East Melbourne	Corporate Governance (Not-for-Profit and Local Government Agencies)	Victorian Employers Chamber of Commerce and Industry (VECCI)	8662 5127



APPENDIX 3.5

ROLE OF THE VICTORIAN AUDITOR-GENERAL

REFERENCE: http://www.audit.vic.gov.au/about_us/audit_legislation.aspx viewed 15 June 2010

Under the Audit Act 1994, the Auditor-General is responsible, on behalf of Parliament, for the external audit of the financial operations and resource management of the Victorian Public Sector (VPS). Accordingly, the primary role of the Auditor-General is to provide information/audit assurance to the Parliament – independently of Public Sector Agencies and the Government.

The establishment of an effective environment and Framework which establishes compliance with legislation, regulations, guidelines, policies and other requirements is the responsibility of the Responsible Body and Accountable Officer working with management. Within the public sector, ultimate responsibility for compliance rests with the individual agency.

The Auditor-General may review and report on the adequacy of the Framework as a risk management approach and, where deemed appropriate, may review/monitor compliance of individual VPS agencies.

AUDIT LEGISLATION

REFERENCE: http://www.audit.vic.gov.au/about_us/audit_legislation.aspx viewed 15 Jun 2010

The position of Auditor-General is designated as an independent officer of Parliament within Division 3 of Part V of Victoria's Constitution Act 1975.

Provisions relating to the appointment, operational independence and tenure of the Auditor-General are also set out in the Constitution Act.

In March 2003, the Victorian Parliament passed amendments to the Constitution Act that, among other things, preclude any future change to the provisions relating to the Auditor-General other than by way of a referendum. With this action, Parliament has reinforced the importance it places on ensuring that the independence of the Auditor-General in Victoria is always adequately protected.

The Audit Act 1994 establishes the legislative framework governing the ongoing role and functions of the Auditor-General. This Act identifies the statutory powers and responsibilities of the Auditor-General. It provides the authority for the Auditor-General to:

1. conduct annual financial statement audits of public sector agencies
2. undertake performance audits within the public sector which encompass assessments of the economy, efficiency and effectiveness of the management of public resources by the Government or individual government agencies
3. examine the use of public grants received by both private and public sector organisations
4. utilise the Victorian Auditor-General's Office as the organisational and resourcing avenue available to the Auditor-General to assist in the discharge of the position's legislative functions.

During June 2003, Parliament approved a range of amendments to the Audit Act. These amendments significantly strengthen the legislation and include:

1. a capacity for the Auditor-General to present reports to Parliament, and for the reports to be regarded as public documents, when Parliament is in recess
2. widening of the Auditor-General's mandate to encompass all entities controlled by the State
3. assignment of an explicit power to the Auditor-General to examine instances of waste, probity or lack of financial prudence in the use of public resources
4. provision for the Auditor-General to audit the financial statements of a non-public body if invited, and the Auditor-General considers it is in the public interest to do so.

The Audit Act also addresses the special relationship of the Auditor-General with Parliament and with Parliament's Public Accounts and Estimates Committee. The Act assigns several statutory responsibilities to the committee in relation to the work of the Auditor-General. These responsibilities include:

1. review of the Auditor-General's draft annual work plan and annual budgetary needs
2. a consultative role in the formulation of objectives and scope for all performance audits undertaken by the Auditor-General
3. provision of recommendations to Parliament on the appointment of a financial statement auditor (annually) and a performance auditor (every 3 years) to independently examine and report on the quality of financial reporting and resource management within the Victorian Auditor-General's Office.

These legislative responsibilities of the Public Accounts and Estimates Committee represent the means by which Parliament protects and supports the independence of the Auditor-General and ensures that there is adequate accountability back to it on the ongoing use of that independence.

AUDIT ACT 1994 APPLIED TO PUBLIC ENTITIES

REFERENCE:

<http://www.ssa.vic.gov.au/CA2571C900701857/0/33E38B7FF17B3EA9CA2571CA0026C17F?>

OpenDocument viewed 15 June 2010

The Board must have an active audit committee as required by the *Financial Management Act 1994* (FMA).

The Board manages the relationship between the public entity and the Auditor-General's office so that there is a professional and constructive relationship between the entities both generally and during an audit process.

The Board ensures rapid consideration and feedback on any audit opinion or report affecting the public entity published by the Auditor-General.

What is the purpose of the Audit Act 1994?

The Audit Act 1994 is concerned with efficient and effective financial and performance audits in the Victorian public sector (s.1).

The objectives of the Audit Act 1994 include:

- 1. determining whether financial statements prepared in the Victorian public sector present fairly the financial position and financial results of operations of authorities and the State*
- 2. determining whether authorities are achieving their objectives effectively, economically, efficiently and in compliance with legislation*
- 3. monitoring wastage of public resources or any lack of probity or financial prudence in the management or application of public resources.*

Does the Audit Act 1994 apply to this public entity?

The Audit Act 1994 applies to a number of bodies including a public body.

The relevant parts of the definition of a public body are that it is:

- 1. a public statutory authority, or*
- 2. a State owned enterprise under the State Owned Enterprises Act 1992 (SOEA), or*
- 3. a corporation all of whose shares are owned directly or indirectly by or on behalf of the State*

Almost all Public Administration Act 2004 public entities come within this definition.

How does the Audit Act 1994 affect a public entity?

- 1. The Auditor-General must audit the financial statements of each public entity at least once a year. The Auditor-General must express a written audit opinion on the financial statements to the entity and give a copy of each audit opinion on the financial statements of an entity to the portfolio Minister and the Minister for Finance*
- 2. the public entity must pay audit fees to the Consolidated Fund as determined by the Auditor-General*
- 3. the Auditor-General can compel the presence of a person from the public entity to answer questions, possibly on oath, and provide documents that help the Auditor-General carry out functions under legislation*
- 4. the Auditor-General can conduct any audit necessary to determine whether a public entity is achieving its objects effectively, economically and in compliance with legislation*
- 5. the Auditor-General can report to Parliament on any one or more of the audits carried out*

What are the steps a public entity should take to ensure compliance with the Audit Act?

The Board must ensure that:

- 1. it has an active audit and risk management committee as required under the Financial Management Act 1994.*
- 2. the Board's audit and risk management committee and the public entity's internal auditors develop and maintain a constructive and professional relationship with the Auditor-General's office*
- 3. the public entity administers a well targeted program of internal financial and compliance audits so that there are no surprises when the Auditor-General conducts an audit of the public entity*
- 4. staff at all levels are aware of the function, procedures and powers of the Auditor-General when the Auditor-General is conducting an audit of the public entity*
- 5. there is a protocol that is widely understood by staff relating to co-operation and liaison with Auditor-General's staff who are engaged in an audit of the public entity. Subject to the Auditor-General's power to question any person who may be of assistance in conducting the audit, these protocols would identify public entity staff who are authorised to speak with the auditors and any processes to prepare for that assistance*
- 6. immediate attention is given by the Board's audit and risk management committee to any audit opinion relating to a public entity audit received from the Auditor-General, and that the audit and risk management committee reports to the Chair on any implications for the public entity, at the earliest opportunity*
- 7. immediate attention is given by the Board's audit and risk management committee to any report by the Auditor-General which mentions the public entity and that the audit and risk management committee reports to the Chair on the report and its implications for the public entity at the earliest opportunity.*



APPENDIX 3.6

ROLE OF INTERNAL AUDIT

REFERENCE: Standing Directions of the Minister for Finance, updated June 2011.

Role of Internal Audit

Agencies benefit from active involvement of their Internal Auditors, or other appropriate resources, in establishing an upfront understanding of the level of compliance with the Directions and the monitoring of actions to be taken to achieve compliance over time.

Background

Internal audit is commonly defined as an independent appraisal activity within a Public Sector Agency, for the review of operations as a service to the Responsible Body and management. It is a control which functions by measuring and evaluating the effectiveness of other controls.

Internal audit is a key assurance mechanism available to the Responsible Body to support the discharge of its governance and oversight responsibilities.

Public Sector Agencies are required to establish, maintain and resource an internal audit function. The work is to be carried out by suitably qualified staff, independent of management and free of operational duties.

Where an exemption is granted the Responsible Body must take alternative steps to secure an appropriate level of assurance from alternative in-house assurance activities and/or compliance functions that are sufficiently robust and rigorous.

For simplicity the term internal audit is used in these Directions to encompass both in-house internal audit and the outsourcing of the internal audit function to an appropriately qualified third party.

Direction

Each Public Sector Agency must, unless an exemption has been obtained, establish and maintain an adequately resourced independent internal audit function appropriate to the needs of the Public Sector Agency. Government Departments are not eligible for an exemption.

Procedure

(a.) An internal audit charter is to be approved by the Audit Committee and is to:

- Provide for the internal audit function to report to senior management;
- Provide for the internal auditor to have direct access to the Chairman of the Audit Committee;
- Provide for internal audit function to have full, free and effective access at all reasonable times to all records, documents and employees of the Public Sector Agency and the right to seek information and explanations; and
- Set out the independent status of the internal audit function and its personnel.

- (b.)** An annual internal audit plan is to be developed by the internal auditor to address relevant elements of the Public Sector Agency's risk profile.
- (c.)** The internal audit plan is to be approved by the Audit Committee.
- (d.)** On an annual basis the Audit Committee is to:
- Review the adequacy and focus of the internal audit work plan and its fit with the Public Sector Agency's risk profile and the work of the external auditors;
 - Review the internal audit function's performance, its authority, the adequacy of its resources and the proposed allocation of those resources;
 - Take steps to confirm that the internal auditor has not been unduly influenced by management or experienced any problems with management; and
 - Meet separately and privately with management and the internal auditors if necessary to ensure free, frank and open communications.
- (e.)** In addition the Audit Committee should make appropriate enquiries to:
- Approve and review management's proposals as to how the Public Sector Agency plans to respond to advice received from the internal auditor and direct management accordingly;
 - Monitor actions taken by management to resolve issues raised by internal audit; and
 - Advise management to adopt and address the accepted recommendations from internal audit on a timely basis.

Guideline

Specific matters to which consideration will be given in determining whether an exemption is to be granted include:

- The Public Sector Agency's size and scale;

- The Public Sector Agency's complexity/diversity;
- The nature of the Public Sector Agency's business in terms of the risk exposure of the business;
- Its overall risk profile;
- Its financial risk management profile;
- Relevant external issues;
- Public Sector Agency changes;
- The history of past issues and incidents;
- The existence of viable alternative mechanisms to provide adequate assurance on matters of compliance and the operation of internal controls; and
- The alternative assurance and compliance mechanisms on which the Responsible Body proposes to rely.



APPENDIX 3.7

GOVERNANCE

REFERENCE: http://www.ssa.vic.gov.au/domino/Web_Notes/SSA/ssagpg.nsf
viewed 15 June 2010

The concept of governance is the domain of the State Services Department.

COMPLYING WITH LEGISLATION

Boards must comply with their statutory obligations under all the legislation which affects them. Public entities are most directly affected by their establishing Acts and by other Acts including the Financial Management Act and the Audit Act. These Acts concentrate on improving standards of public administration, regulating stewardship of assets and providing for accountability by public entities.

What legislation affects a public sector entity?

There is a large body of Acts of Parliament that apply to a public entity. The entity's establishing legislation and the Public Administration Act 2004 (PAA), are obvious examples. Other legislation may be grouped in the following way:

- *Legislation aiming to improve administration such as:*
 - *the Public Records Act 1973*
 - *the Information Privacy Act 2000*
- Legislation emphasising stewardship including:*
 - *the Financial Management Act 1994*

- *the Audit Act 1994*

Legislation with public entity accountability and transparency as a focus such as:

- *the Freedom of Information Act 1982*
- *the Whistleblowers Protection Act 2001*
- *the Ombudsman Act 1973*

Other Acts include the:

- *Equal Opportunity Act 1995*
- *Environment Protection Act 1979*
- *Fair Trading Act 1985*
- *State Superannuation Act 1988*
- *Taxation legislation both State and Commonwealth*
- *WorkCover and Occupational Health legislation*
- *Victorian Managed Insurance Authority Act 1996*
- *Corporations Act 2001 (Commonwealth)*
- *Trade Practices Act 1974 (Commonwealth)*

What is compliance?

Compliance is about ensuring that the requirements of laws, regulations, industry codes and organisational standards are met.

A compliance program is an important element in the governance of an organisation and should:

1. *prevent, identify and respond to breaches of laws, regulations, codes or organisational standards occurring in the organisation*
2. *promote a culture of compliance within the organisation*
3. *assist the organisation in being a good corporate citizen*

There are two important steps to begin the compliance process - identify the obligations to be complied with and develop a compliance policy. The policy should cover:

- 1. the primary objective e.g. so the Board can be satisfied that all possible measures are being taken by the public entity and its employees to comply actively with all relevant legislation, standards and codes*
- 2. the nature of the proposed compliance program that will ensure the public entity can operate and be compliant to manage risks, identify compliance responsibilities for all positions and incorporate an appropriate, consistent approach (See linked module on Directors' Code of Conduct and guidance notes.)*

How do Boards ensure compliance with legislative obligations?

A Board should develop a compliance program that suits the compliance needs of the public entity. In order to ensure compliance with statutory obligations, the Board should aim to have compliance procedures embedded in everyday operational processes, guidelines, manuals and training programs. Sample: compliance program approach (PDF  20.3KB)

What happens if the Board or public entity is not compliant?

Criminal prosecution This has been known to occur where a public entity breaches occupational health and safety legislation or environment protection legislation – it can result in fines or imprisonment. Some of the accountability and stewardship legislation requires a Board to permit officers from the Office of the Ombudsman or the Auditor-General to enter public entity premises and imposes criminal penalties for obstruction. (See linked modules on Audit Act 1994 and Ombudsman Act 1973).

Civil action for damages for breach of statutory duty. For example, Occupational Health and Safety legislation. In most cases this legislation provides for a fine or other penalty when someone fails to perform a

statutory duty but the courts allow a person injured by a breach of a statutory duty to seek compensation for their injury

Adverse assessment by statutory bodies. *The Ombudsman and the Auditor-General are permitted by legislation to make reports to the Parliament (the Auditor-General) and, the portfolio Minister and Governor in Council (the Ombudsman)*

Additional reporting *to the Minister and closer monitoring by the Department*

Appointment of an administrator *where legislation permits*

Resignation or removal *of Board members*

Non-compliance also reflects poorly on Departments and Ministers.

Self- assessment questions about compliance

1. *Has the Board established a system of monitoring agency compliance with:
 - *government policy and Board directives*
 - *legislation?**
2. *Are processes in place to ensure external reporting requirements are met?*
3. *Does the agency have an effective internal and external audit program?*
4. *Does the Board have an audit/risk/compliance committee with an external member?*
5. *Is there full accountability for resources and processes?*

Good practice tips for compliance with legislation:

1. *Ensure that a compliance program suited to your public entity is in place and understood.*
2. *Integrate the public entity's compliance action plan with its business, operational and financial plans.*

3. *Ensure staffs understand their obligations and the meaning and importance of compliance in their day to day work.*
4. *Seek briefings on obligations and compliance from public entity employees on all Acts that affect the public entity.*

COMPLYING WITH GOVERNMENT POLICY

Boards must comply with relevant Government policies.

- *Policy example not based on legislation*
- *Legislative example*

A Government policy can be developed based on a head of power within legislation or can be a policy of the Government without reference to a head of power but still it must be lawful.

Government policy is issued in different ways and, in general, includes:

1. *legislation with a whole of Government perspective (e.g. the Public Administration Act 2004 (PAA) and the Financial Management Act 1994 (FMA))*
2. *Government policy statements related directly to statutory authorities*
3. *Government policy statements related to the whole of the public sector (e.g. contracting)*
4. *Ministerial directions*
5. *specific information contained in the relevant statutory authority legislation*
6. *Government guidelines on particular issues (e.g. General Government Purchasing Card)*
7. *policy decisions arising from intergovernmental agreements/forums (e.g. National Competition Policy)*
8. *industry or sector specific legislation such as the Water Act 1989*

Policy example not based on legislation

It is Government policy to increase the representation of women on public entity Boards. The Government sets targets for the appointment of women and, in situations where nominations are sought by the Minister from a Board, encourages it to put forward female nominees for Board appointments.

Boards should consult the Office of Women's Policy at an early stage when considering nominations or making recommendations to a Minister on appointments

Legislative example

The Public Administration Act 2004

Public entities may be required to comply with a specified government policy if recommended by the Premier or Governor in Council (s.92 (1) of the PAA).

This power to require compliance with policy is visible yet limited in what it can do:

- 1. it is visible because it is the Governor in Council who exercises the power and the Order is published in the Government Gazette*
- 2. appropriate consultation with affected public entities must precede the recommendation for the Order*
- 3. the subject-matter is limited to policy for improving operating standards or service delivery, or otherwise supporting a whole of government approach*
- 4. the terms of the Order are not to impede the public entity in the independent exercise of its functions. A particular application of this principle is that the Order is not to dictate a particular outcome in a matter within the public entity's jurisdiction.*

Orders or directions to comply with Government policy are to be general in their effect and not specific to individual cases.

Complying with Ministerial Directions

Ministers may issue directions affecting their portfolio public entities because of their responsibility for the good governance and proper operations of those public entities. Ministers may issue some directions in accordance with various Acts of Parliament. The Board must ensure that arrangements are in place to consider and monitor implementation of Ministerial directions.

- *What are Ministerial directions?*
- *What should a public entity do about Ministerial directions?*
- *Ministerial directions not issued under an Act of Parliament*
- *Ministerial directions under Acts of Parliament*

What are Ministerial directions?

A Ministerial direction is a direction addressed to a Board of a public entity, requiring it to act in a particular way in relation to certain aspects of its work. The Board and officers of the public entity should follow such a direction unless it is unlawful for some reason.

Some Ministerial directions are authorised by Acts of Parliament. These directions are normally written. Sometimes the Act under which a direction is made requires that directions must be noted in the annual report of the public entity or the annual report of the Department.

A Ministerial direction can be issued without the backing of an Act of Parliament. These non-statutory directions are not required to be written.

Some directions can emanate from a Minister other than the portfolio Minister responsible for a particular public entity, e.g. the Minister for Finance.

What should a public entity do about Ministerial directions?

The Board should:

1. *ensure that the nature and terms of Ministerial directions are complied with by the Board and officers of the public entity*
2. *assume that a Ministerial direction must be complied with unless the Board has reliable advice that the direction is unlawful or cannot be complied with for some other reason*
3. *ensure that, where a Ministerial direction cannot be complied with for any reason, the Minister is advised as soon as possible*

Ministerial directions not issued under an Act of Parliament

It is part of a Minister's responsibility to Parliament to take necessary action to ensure the efficient and proper discharge of the duties of the Department and other portfolio public entities. This action includes providing directions to public entities.

Ministerial directions most often relate to matters of general policy and procedures, rather than to resolution of particular public entity disputes or matters about an individual person.

Directions under Acts of Parliament

The establishing legislation of many public entities will articulate the Minister's powers of direction. These may be broad and general and designed to give the Minister extensive power of direction, or they may be quite limited or restricted to certain types of matters.

A number of Victorian Acts of Parliament dealing with aspects of governance specifically refer to Ministerial directions. These include the:

The Minister for Finance may give a written direction to an authority, public body, Accountable officer or Chief Finance and Accounting Officer (CFAO). The direction may relate to anything covered under the FMA. These may include, for example, management of public money, management of assets and procedures for purchase and supply of goods and services for or on behalf of the State (s.59).

(See linked module on Financial Management Act 1994 (FMA))

- *Standing Directions of the Minister for Finance under the Financial Management Act 1994.*
- *State Owned Enterprises Act 1992 (SOEA) applies to all State owned enterprises including:*
 - *State bodies. Directions from the Treasurer, for example, regarding repayment of capital of a State body following consultation with the portfolio Minister and the Board*

State business corporations. Written directions, for example,

Ministerial Directions under Acts of Parliament

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(See linked module on Financial Management Act 1994 (FMA))

- *Standing Directions of the Minister for Finance under the Financial Management Act 1994.*
- *State Owned Enterprises Act 1992 (SOEA) applies to all State owned enterprises including:*

- *State bodies. Directions from the Treasurer, for example, regarding repayment of capital of a State body following consultation with the portfolio Minister and the Board*
- *State business corporations. Written directions, for example, regarding community service obligations and payment of capital.*
- *Public Administration Act 2004 (PDF  568KB):*
 - *The Premier may direct the State Services Authority (SSA) to conduct a special inquiry into any matter relating to a public service body, a public entity or a special body (s. 52).*
 -  *The Premier may direct the SSA to conduct a special review into any matter relating to a public service body or a public entity (s. 56)*
 - *The relevant Minister may direct a public entity regarding a public entity's proposal to form a subsidiary (s. 84).*
 - *On the recommendation of the Premier the Governor in Council may require all public entities or a specified public entity or class of public entity to comply with a specified whole of government policy of any kind, provided there has been adequate consultation, the order does not impede the exercise by the public entity of any quasi-judicial functions, does not impede the exercise of any statutorily independent functions that the public entity has, and is not intended to bring about a particular result in a particular matter (s. 92).*

Good practice tips to respond to Ministerial directions

- *The Board should create and maintain a database of Ministerial directions affecting the public entity so that anyone connected with the public entity can check compliance with these directions as they plan and go about their work.*

Reference:

<http://www.ssa.vic.gov.au/CA2571C900701857/0/F7BCA0F78636ED7BCA2571CA0026DB87?OpenDocument>

FINANCIAL MANAGEMENT ACT 1994

If the Financial Management Act 1994 (FMA) applies to a public entity, the Board must fulfil a list of requirements including keeping proper financial accounts, risk management, audit requirements, financial reporting, annual reporting to Parliament and responding to Ministerial requests for information. The Board must have a financial code of practice relating to the probity of financial management.

The Board must note and implement the requirements set out in the Directions of the Minister for Finance.

- *What is the purpose of the FMA?*
- *Does the FMA apply to this public entity?*
- *Where to find out what a public entity needs to do to comply?*
- *How does the FMA affect a public entity?*
- *Steps a public entity should take*

What is the purpose of the FMA?

The purposes of the FMA are (s. 1):

1. *to improve financial administration of the public sector*
2. *to make better provision for the accountability of the public sector*
3. *to provide for annual reporting to Parliament on the operations and financial statements of public sector bodies*

Does the FMA apply to this public entity?

The FMA applies to a number of bodies including a public body. A public body is:

1. *a public statutory authority; or*

2. *a State business corporation or State body within the meaning of the State Owned Enterprise Act 1992 (SOEA); or*
3. *a body, office or trust body established by or under an Act or enactment or by the Governor in Council or by a Minister and that is declared by the Minister for Finance in the Government Gazette to be a body to which ss. 41-54 of the FMA apply*

Most public bodies under the FMA would be public entities under the Public Administration Act 2004 (PAA) except for bodies not created by statute and not declared by the Minister for Finance as bodies to which the FMA applies.

Where to find out what a public entity needs to do to comply with the FMA?

The Department of Treasury and Finance website Financial Management Knowledge Centre contains all documents relating to the Financial Management Package (public entities can gain access to this password protected site by contacting their Departmental finance contact officer who will arrange access). The FMA, the Regulations, the Minister for Finance (Standing Directions) and other financial management documents are all located there.

How does the FMA affect a public entity?

Administrative arrangements

1. *The Chief Executive Officer (CEO) of a public entity is the accountable officer under the FMA. The CEO must appoint a Chief Finance and Accounting Officer (CFAO) whose duty is to receive money and make payments (ss. 42, 43)*
2. *The public entity must maintain an assets register and develop, implement and review a risk management strategy (s. 44B)*
3. *The Minister for Finance can decide to grant indemnities, with or without payment, to a public entity that is a State company or statutory authority or to its Board members (ss 40C, 40D)*

Accountability requirements

1. *the CEO must keep proper accounts and records of transactions and records which explain the finances of the public entity (s. 44)*
2. *the CEO must provide the portfolio Minister or the Minister for Finance with any financial information they ask for (s. 44A)*
3. *as soon as practicable after the end of each financial year the public entity must prepare a report of its operations for the year and the CEO must prepare financial statements for the public entity (s. 45)*
4. *the CEO must deliver the financial statements to the Auditor-General within 8 weeks after the end of the financial year (or calendar year where reporting is on a calendar year basis) unless the public entity is exempt from having accounts audited by the Auditor-General. The public entity must submit the report of operations to the Auditor-General as soon as practicable after it is prepared (s. 45)*
5. *the portfolio Minister tables the financial statements and the report of operations in each House of Parliament within a set time frame (s. 46)*
6. *the Minister for Finance can ask for additional information to that included by the CEO to be included in the financial statements (s. 48). The portfolio Minister can ask for additional information in both the financial statements and the report of operations (s. 51)*
7. *the Minister for Finance can, if it is in the public interest, direct the public entity to prepare and submit within 4 weeks, financial statements and other information for any part of a financial year (s. 52)*
8. *a State Owned Corporations Act 1992 (Commonwealth) corporation may be subject to similar requirement regarding its annual financial statements and annual report (s. 53A) – the public entities subject to these requirements are listed on the Department of Treasury and Finance website*
9. *the Minister for Finance may issue written directions about any of the matters about which regulations can be made under the Act (s. 8)*

Directions of the Minister for Finance

In addition to matters in the FMA that affect the public entity, the Minister for Finance has issued a large number of Standing Directions applicable across the Victorian public sector. These are under regulation 12 of the Financial Management Regulations 1994 or regulation 16 of the Financial Management Regulations 2004. These regulations apply to public entities and can be found on the Department of Treasury and Finance website. (See linked module on Complying with Ministerial directions.)

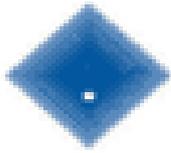
Many of the Standing Directions cover matters of financial reporting detail. Some relate to governance including:

- 1. a general delegation to a Deputy Secretary in the Department of Treasury and Finance of the power to issue directions under ss. 8, 50 and 51 of the FMA*
- 2. the public entity must implement and maintain a financial code of practice relating to the probity of financial management (Standing Direction 2.1)*
- 3. detailed directions on the requirement for an audit and risk management committee formed under specific guidelines and required to operate according to a number of specified procedures (Standing Direction 2.2).*
- 4. detailed directions regarding the operations of the internal audit function and the relationship between the public entity's audit and risk management committee and the external auditor (Standing Directions 2.5 and 2.6)*
- 5. detailed directions for the public entity's financial risk management (Standing Direction 2.3)*
- 6. detailed directions for finance delegations within the public entity (Standing Direction 2.4). (See linked module on Delegations)*

What are the steps a public entity should take to ensure compliance with the FMA?

In order to ensure it complies with the obligations outlined above a Board covered by the FMA must ensure that:

- 1. the CEO has designated a public entity employee as the CFAO*
- 2. the CEO and CFAO have systems in place to keep proper accounts and financial records generally, a system for promptly preparing and auditing the annual financial statements, an assets register, and a system for the timely preparation of the public entity's annual report*
- 3. the CEO and CFAO have effective systems in place to receive, record, implement and monitor directions issued to the public entity, or to the public sector generally, by the Minister for Finance*
- 4. it obtains, at least annually, the assurances of the CEO and CFAO that the mandatory requirements in the Standing Directions of the Minister for Finance are being observed by the public entity and a report detailing how this is being achieved*
- 5. a financial code of practice relating to the probity of financial management is implemented and maintained*
- 6. unless the public entity is exempt, an audit committee is in place and that it meets the requirements of the Standing Directions of the Minister for Finance regarding its constitution and mode of operation*
- 7. the audit committee has approved an internal audit charter as required by the Standing Directions of the Minister for Finance*
- 8. the Board's risk management program includes a financial risk management program that satisfies the requirements of the Standing Directions of the Minister for Finance*
- 9. the Board has in place a system of finance delegations that meets the requirements of the Standing Directions of the Minister for Finance*
- 10. the CEO and CFAO have systems in place to receive and respond promptly to requests for financial and other information from the portfolio Minister or the Minister for Finance*
- 11. it considers whether the public entity needs to make submissions to the Minister for Finance to seek indemnities for the public entity or the members and, if so, arrange for the necessary submissions to be prepared and despatched.*

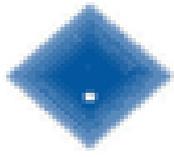


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APPENDIX 5.1

Survey Questionnaire



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APPENDIX 10.1

Victorian Government Risk Management Framework