



The Role of
Audit
Committees
in a Changing
Public Sector?

Sean Quigley

Deficit in the Public Finances

“The gap between what we as a Government spend and what we raise in taxes is huge. Overall Government spending in 2011 will be roughly €18 billion more than this year’s overall Government income. The Government will get €42 billion from tax and PRSI this year. My Department alone is expected to spend over €20 billion of this.” (Burton, 25 Nov 2011)

Budget 2012?

- A&E Closures
- Hospital/Nursing Home Closures
- Cuts in Child Allowance?
- Cuts in Social Welfare?
- Medical Card Charge?
- Reduced funding for the education system (at all levels) – bigger class sizes, lower standards, etc
- Reduced funding for the justice system (Garda, Prisons, Courts, etc)
- Further Cuts in Staff Numbers, plus no recruitment
- Further Cuts in Funding for Public Services
- Service Level Reductions
- Increased Charges for Public Services (e.g. motor tax, student fees?)

“At the moment I don’t see any floor for the Irish health service, we still have the moratorium in place, we still have beds closed on an increasing basis, we still have community services being cut back and now we are told X hundreds of millions more has to come out for the fourth year in a row.” (Doran, Nov 2011)

Could some of this have been avoided with better governance?

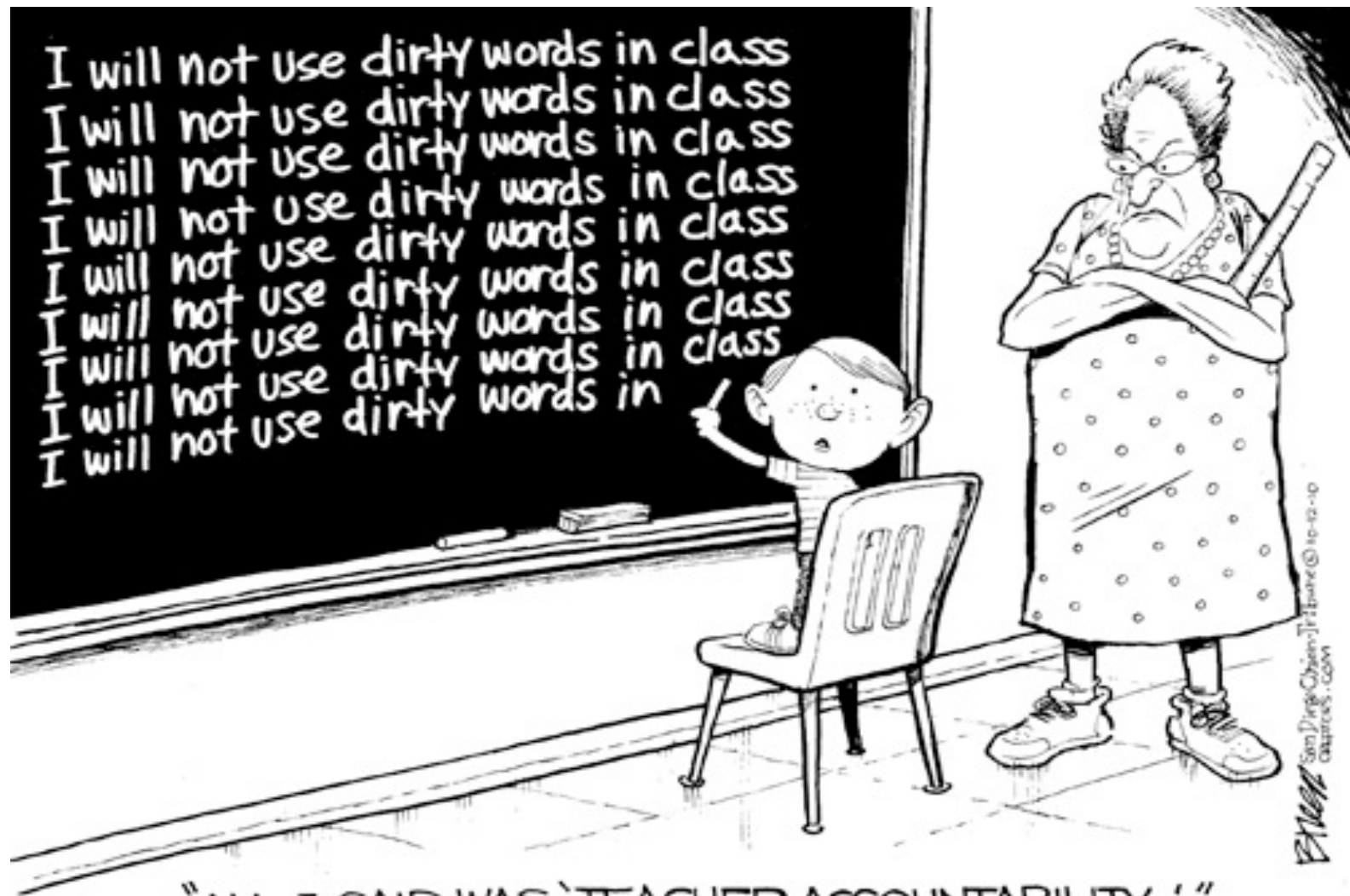
Can Good Come From a Crisis?

If good can come from the current crisis, it will be the instituting of a more rigorous and thoughtful approach to the use of taxpayer's money to replace the if-I-have-it-I'll-spend-it idiocy of the boom-era administration

(Dan O'Brien, Irish Times July 2011).



**KEEP
CALM
AND
CARRY
ON**



I will not use dirty words in class
I will not use dirty words in class
I will not use dirty words in class
I will not use dirty words in class
I will not use dirty words in class
I will not use dirty words in class
I will not use dirty words in class
I will not use dirty words in class
I will not use dirty words in class
I will not use dirty words in class

"ALL I SAID WAS 'TEACHER ACCOUNTABILITY...!'"

Sam Dyer's Cartoon Tribune © 10-12-10
Cartoonists.com

How Do We Avoid This?



Corporate Governance – What Is It?

- **Fundamental to any effective organisation, the hallmark of any well managed corporate entity.**
- **There is an ever increasing demand in both the public & private sectors, for accountability & transparency.**
- **Governance focuses on an organisation's stakeholders, the associated objectives, and the responsibility of the organisation's management to achieve those objectives.**
- **In most countries the public sector plays a major role in society, and effective governance in the public sector can encourage the efficient use of resources.**
- **Governance in the public sector is complicated by factors not found in the private sector. (e.g. the role of the minister, government policy & public service obligations).**

Annual Report/Financial Statement Indicators

FINANCIAL INDICATORS

- Sales Revenue
- Cost of Sales
- Profitability
- Earnings Per Share
- Liquidity
- Working Capital (Stock, Debtors, Creditors)
- Asset Usage
- Return on Assets
- Return on Equity
- Free Cash Flow
- R&D Investment
- Interest cover
- Pension funding

- NON FINANCIAL INDICATORS (Ryanair examples)
- On-time flights
- Customer complaints
- Baggage complaints
- Complaints answered within 7 days
- No of passengers
- Average fares
- Traffic growth
- Fleet size
- Environmentally friendly

Corporate Governance: Conformance v Performance

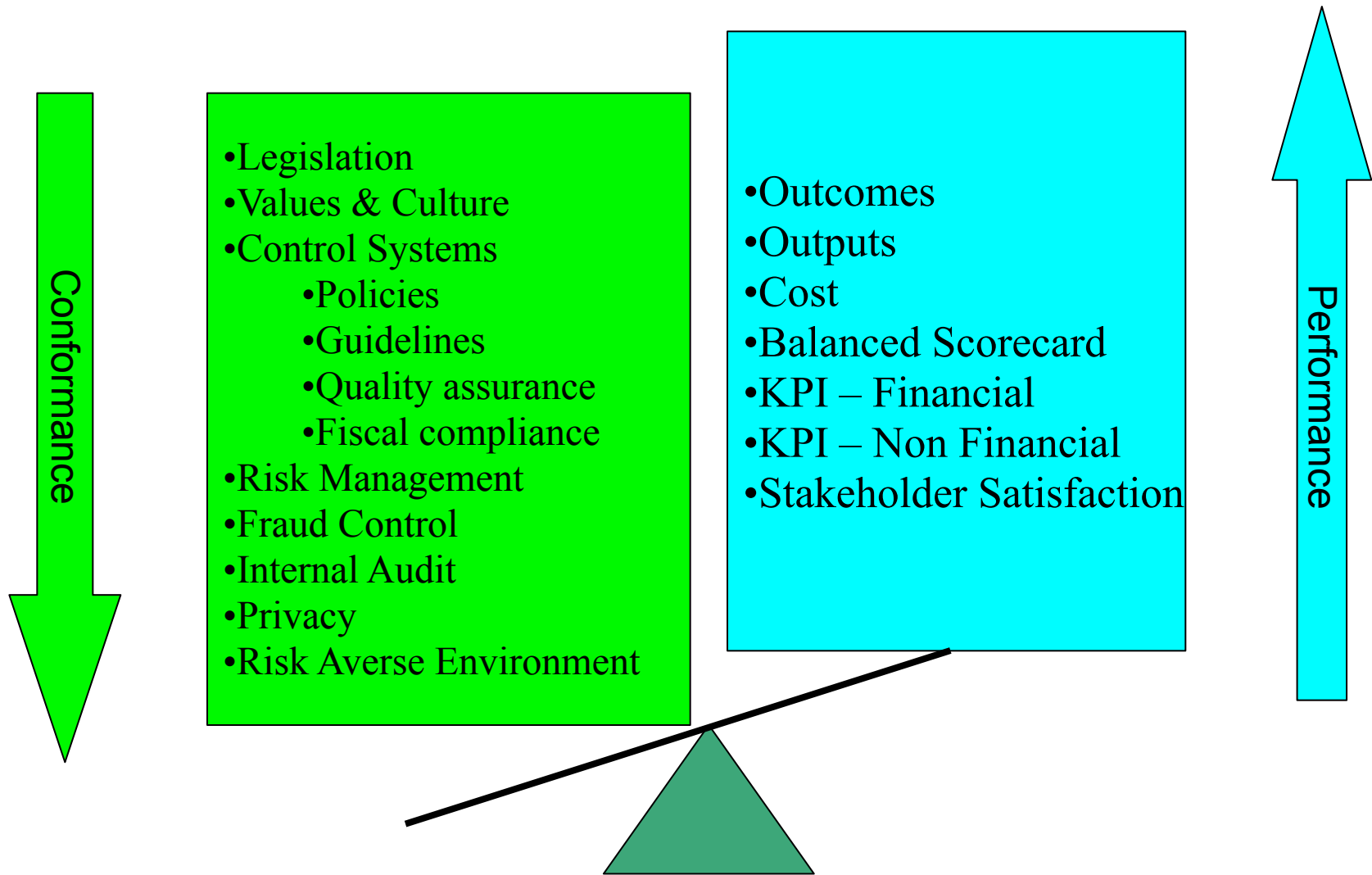
- **Performance**

- How an agency uses governance arrangements to contribute to its overall performance and the delivery of goods, services and programme

- **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

The Performance - Conformance Nexus



The Role of the Audit Committee

- Not a new concept - Cadbury report – 1992
- Citizens demand high-quality services from public sector agencies
- Increasing pressure on public officials to demonstrate higher levels of accountability
- One means of demonstrating greater accountability is through the establishment of an audit committee.
- Governance in public sector deserves the same attention as in the private sector.
- Unethical behaviour in private sector impacts on shareholders
- Unethical behaviour in public sector impacts on tax payers.
- The aim of the audit committee is to improve organisational governance, regardless of whether it is in the public or private sectors.
- The audit committee also provides a link between the Board and external auditor.
- A mistake often made is the belief that putting in place codes of practice & frameworks is enough to bring about improved governance.
- If it were that simple, why then have we seen so many corporate scandals/ failures over the past 20 years. In many cases these organisations would argue that they had best practice structures & processes in place.
- The mere existence of an audit committee is not enough!

Core Responsibilities of the Audit Committee

- **Financial Reporting**
 - Review significant financial reporting issues, judgements, accounting policies, disclosures
 - Review related information presented with financial statements, including the operating and financial review & corporate governance statements.
- **Internal Controls & Risk Management**
 - Review internal controls and risk management systems
 - Review statements included in annual reports re internal control and risk management
- **The Internal Audit Process**
 - Monitor and review effectiveness of Internal Audit
 - Review and approve the Internal Audit function's remit
- **The External Audit Process**
 - Make recommendations re the appointment of external auditors
 - Assess annually the qualification, expertise, resources & independence of the external auditors
- **Whistle-blowing**
 - Review arrangements by which staff can raise concerns about possible improprieties
 - Ensure matters are investigated and followed up

Other Responsibilities of the Audit Committee (particularly for public sector audit committees)

- **Effectiveness of governance arrangements**
- **All external reporting, including non-financial performance**
- **Clarity of links between non-financial performance and strategy**
- **Monitoring Value for Money**
- **Overseeing management of significant projects**

Audit Committee Effectiveness

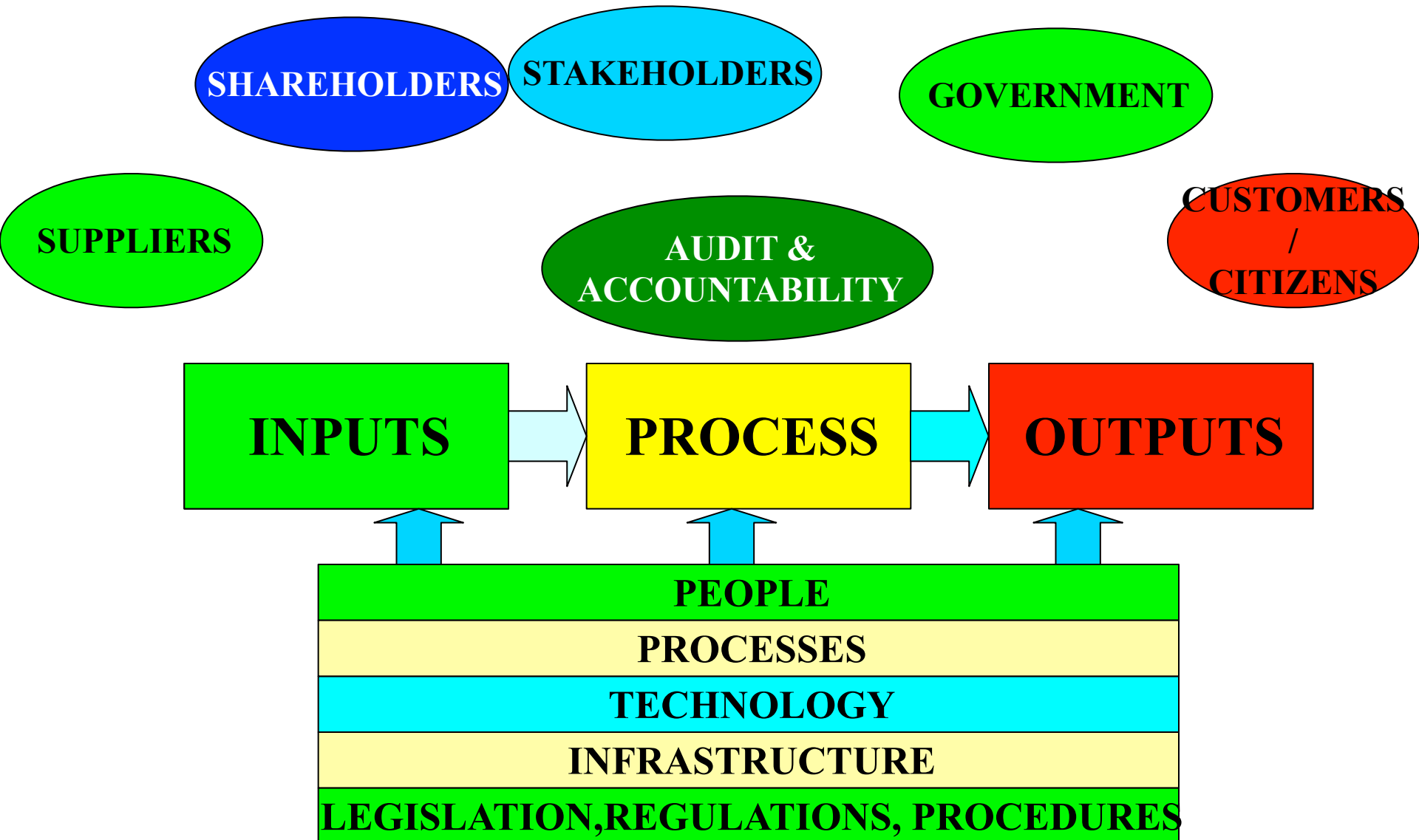
- **Effective audit committees are cornerstones of the public's confidence in corporate governance.**
- **Cadbury identified a number of benefits:**
 - **Improve the quality of financial reporting**
 - **Strengthen position of external auditor**
 - **Increase public confidence**
- **Research shows there is no evidence of automatic relationship between establishing audit committees & improved governance.**
- **One suggestion of audit committee popularity may be found in their ceremonial function (comforting display of concern for corporate governance).**
- **Questions have been asked about the role of audit committees in the banking system failures.**

How Does The Audit Committee Add Value?

- The role of the Audit Committee is fundamental to ensuring that organisations function according to good governance and accounting and auditing standards, and adopt appropriate risk management arrangements.
- As well as providing assurance within the governance and accountability structures of the organisation, it is essential that the Audit Committee is seen to contribute, **deliver results and value** to the organisation.

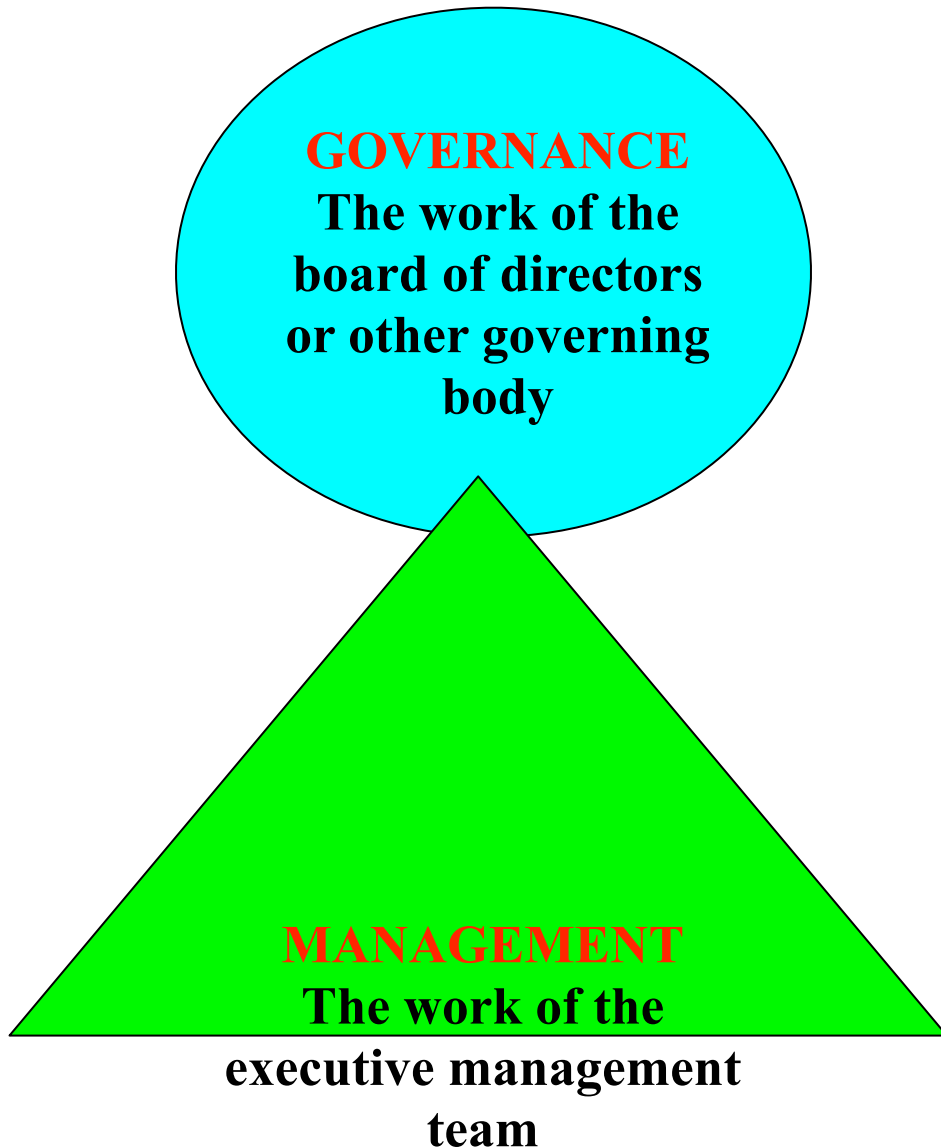
Source: NAO, United Kingdom

Private & Public Sector Organisations Similarities and Differences



Corporate Governance

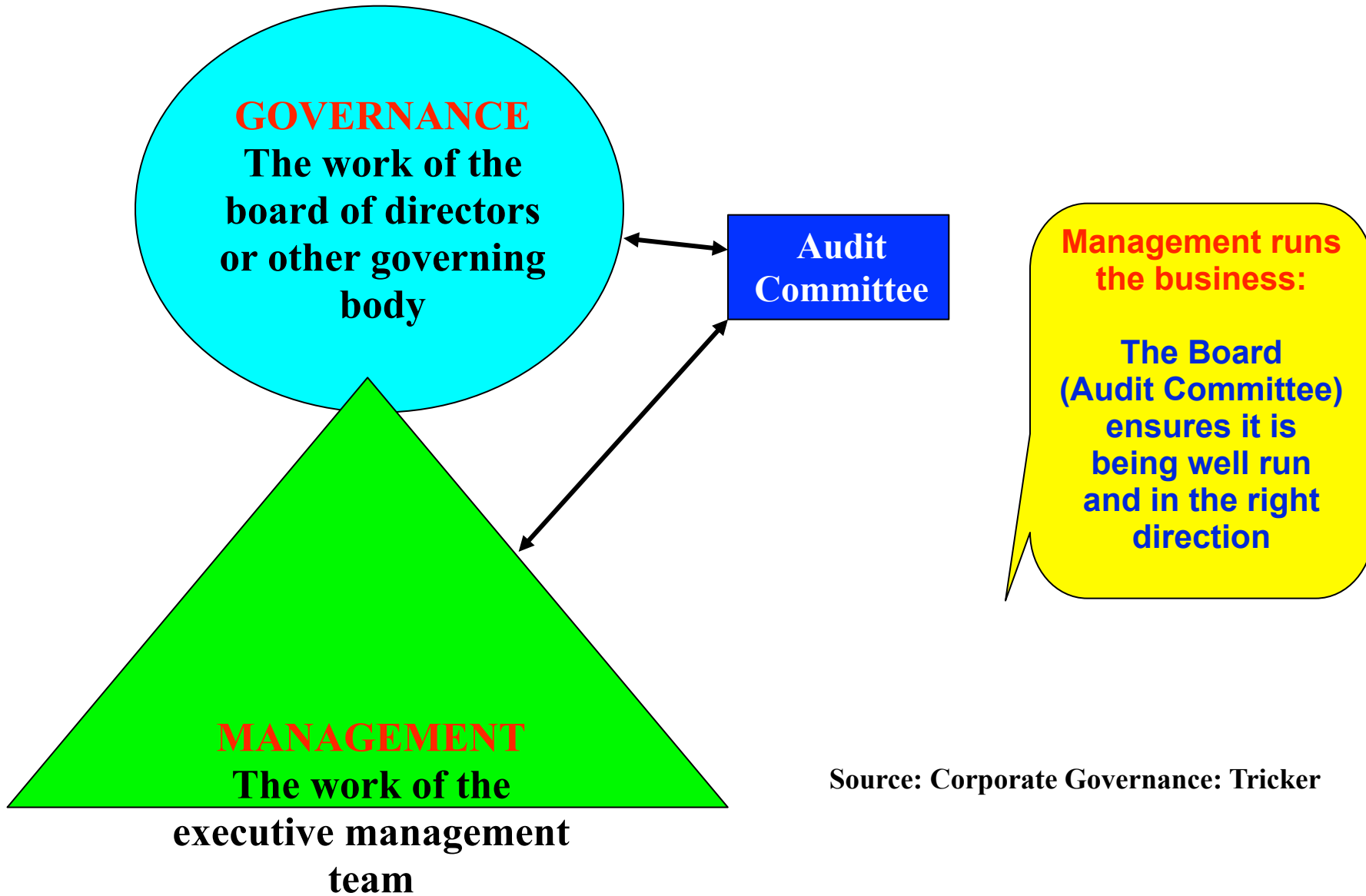
The Role of the Board and Management



Source: Corporate Governance: Tricker

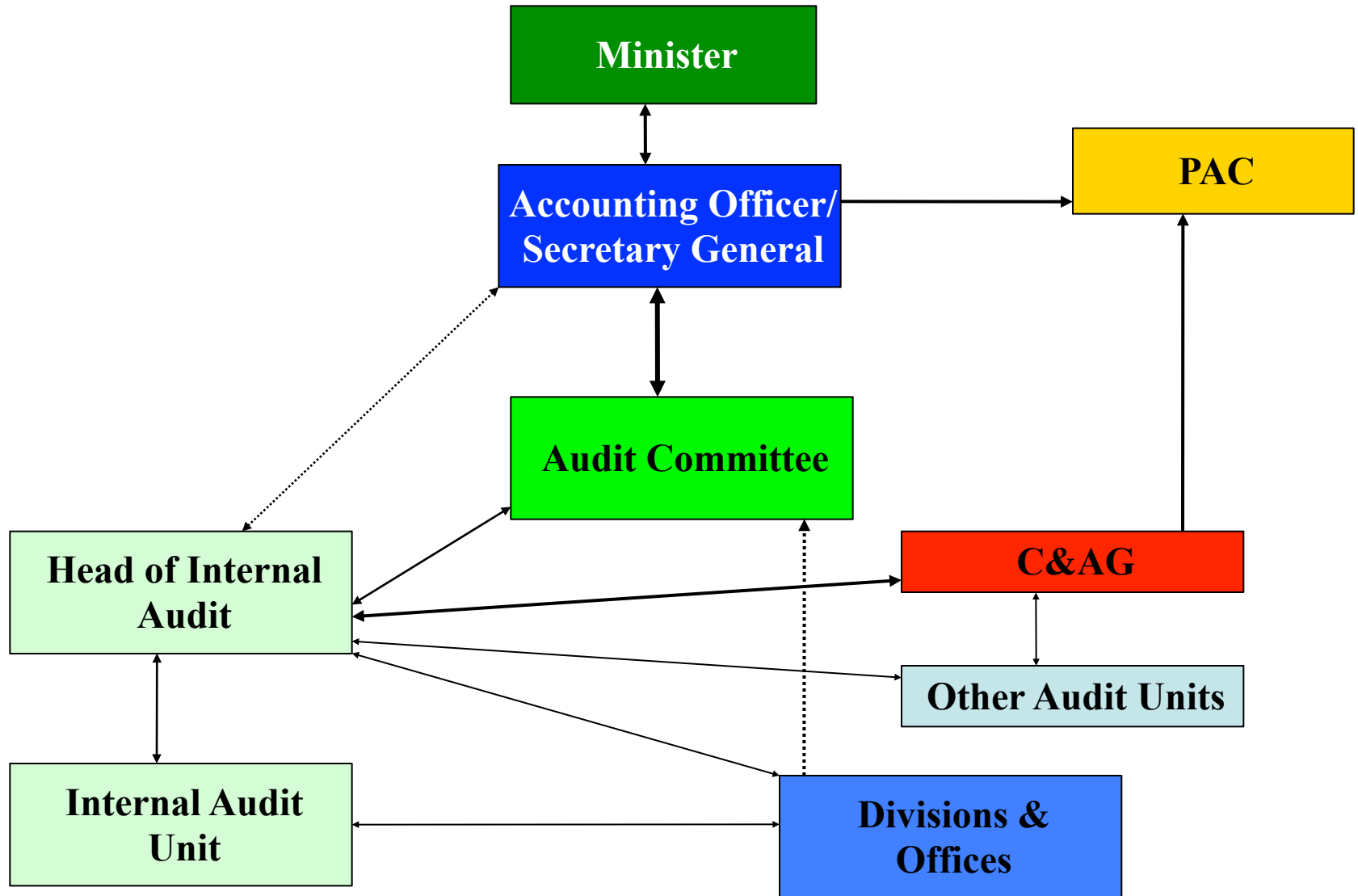
Corporate Governance

The Role of the Board and Management



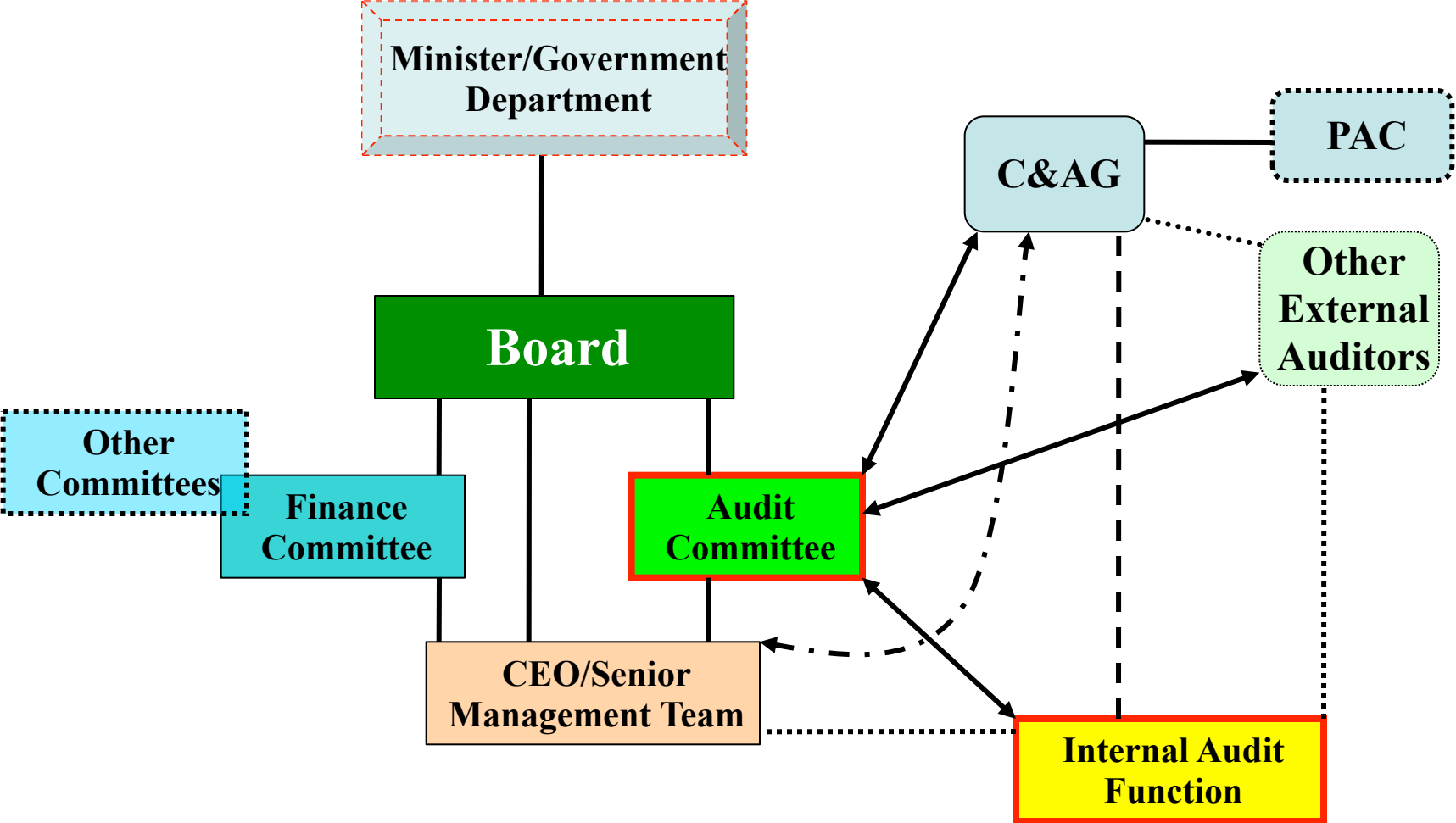
Source: Corporate Governance: Tricker

Audit Committees in Government Departments



Source: Department of Justice

Audit Committee (State Body) Governance Structure



Source: The Courts Service

The Role of the Comptroller & Auditor General

- **Irish system of financial administration is derived from the British system.**
- **The C&AG holds office under Article 33 of the Constitution**
- **The Exchequer & Audit Departments Act 1866, is the basis for the annual Appropriation Account.**
- **The C&AG Act 1993 extended remit of C&AG to include VFM.**
- **C&AG provides reports to and supports the work of the PAC**
- **The role of the C&AG is different to that of other external auditors – C&AG reports to Parliament, not the shareholders.**
- **Comparison with other “external auditors”**

Peer Review of the C&AG (2008)

- **A number of areas for improvement were identified**
 - **Client expectations were narrow and limited**
 - **Annual audit seen as a “necessary evil”, rather than a process that could add value to the client**
 - **Need to improve relationship between C&AG and bodies it audits**
 - **Quality of Output Statements limiting role of C&AG**
 - **Lack of resources**
 - **Restricted mandate re Value for Money audits**
- **My research has found that there is much greater support provided to public sector audit committees by the equivalent of the C&AG in other countries (e.g. The UK NAO)**
- **It is well established (in both the public and private sectors) that good communication between the audit committee and the external audit can enhance corporate governance.**
- **The issues identified in the Peer Review limits the effectiveness of public sector audit committees & by extension the effectiveness of corporate governance.**

The Need to Improve Accountability

- **Effective communication with shareholders & stakeholders is a vital constituent of good governance, including a clear view of an organisation's performance.**
- **In the report; The 21st Century Annual Report, (ICAEW, 1999) it was envisaged that more information on performance including non-financial performance indicators would be required by future users of financial statements.**
- **Public service performance should be approached from the perspective of enhancing services to citizens and improving value for money.**

The Need to Improve Public Sector Accountability

- **OECD – 2008**
 - Agencies not given appropriate accountability frameworks
- **An Bord Snip Nua (McCarthy Report)– 2008**
 - Management focus is more on maximising expenditure
 - Consideration of outputs & actual performance seem secondary
 - Annual output statements had been ineffective in bringing about greater accountability
- **Transforming Public Services – 2008 (section on governance mentions)**
 - Organisational and sectoral performance and delivery
 - The efficiency and effectiveness of agencies and regulators
 - The governance of agencies and regulators
 - The governance of the Civil Service & its relationship with other sectors & levels of Government
- **Programme for Government (2011-2014)**
 - Commitment to address shortcomings in public sector accountability
 - Committed to giving C&AG more powers re VFM
 - Annual reports to include output statements and audited financial statements
- **Performance Budgeting/Revised Appropriation Account (2011)**
 - New form of annual financial statement/appropriation account, with outputs and KPI

Survey of Public Sector Audit Committees - Comments

- 89% of audit committee chairman surveyed agreed that giving responsibility for monitoring VFM to the audit committee would be a positive development.**
- A better focus on value for money issues would improve the effectiveness of the audit committee's work.**
- Greater investment in in-house Internal Audit resources rather than using external contractors**
- There is still a major gap in the apparent appreciation by the C&AG's Office that they are accountable for their work, at least in part to the organisation whose accounts they are auditing.**

Survey of Public Sector Audit Committees - Comments

- The C&AG has still to fully embrace the professional courtesies and conventions of an auditor and client, or the importance of pre and post audit meetings with the audit committee.**
- There is a wide variation in the quality of the professional relationship between the C&AG's Office and organisations being audited by them.**
- The relationship of audit committees with the C&AG is one sided. Openness seems to be ad-hoc.**
- Enhanced guidelines, whether from the centre or emerging from a network of audit committees, would be helpful.**
- Training/development is required with an emphasis on how audit committees can add value in the public sector.**
- A process of regular evaluation of the audit committee should be in place**

Key Conclusions from Survey

- ✓ **Improved engagement and communication between the C&AG and audit committees is needed.**
- ✓ **Better Internal Audit Resources to support Audit Committee**
- ✓ **Public sector governance would be improved by giving audit committees responsibility for monitoring value for money.**

Key Conclusions from Survey

- ✓ **Updated guidelines for public sector audit committees are needed**
- ✓ **Structured training for public sector audit committees is required**
- ✓ **Regular evaluation of public sector audit committees is needed**

How Improve Effectiveness of Public Sector Audit Committees?

No	Issue to be Addressed	Action Required	Owner
1	Role of the C&AG	Give C&AG responsibility for auditing output statements. C&AG to improve communication and engagement with the audit committee in each body it audits	PER* C&AG*
2	Role of Public Sector Audit Committees	Issue a revised code setting out the roles required to be performed. This should address the relationship between it and the C&AG on all aspects of the annual audit. The role should also include monitoring value for money.	PER* & C&AG* Sponsoring organization
3	Value for Money	Put in place a performance framework for each organisation, including meaningful key performance indicators, which can be used to assess the performance and value for money delivered by each department/agency. Annual output statements to be audited by the C&AG and published in the annual report.	PER & Sponsoring Organisation Sponsoring organization
4	Membership of Audit Committees	Members of audit committees needs have necessary skills and experience to deal with the role they are being asked to carry out.	Sponsoring organization
5	Other Matters	All audit committee members to receive induction training and undergo regular training to ensure that are competent to carry out their role. All public sector audit committees to undergo evaluation to ensure effective operation.	Sponsoring organisation Sponsoring organization