C05|3845

Minister for Finance
Minister for Infrastructure
Minister for the Hunter

The Chair
Public Accounts Committee
Legislative Assembly
Parliament House
Macquarie Street
SYDNEY NSW 2000

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Our Reference: I44227

24 OCT 2005

Dear Chair

Government Response to Public Accounts Committee's Report 11/53
Review of Operations of Audit Committees

The Public Accounts Committee's Report 11/53 details findings and recommendations of the Public Accounts Committee (PAC) Inquiry concerning issues raised by the Auditor-General in Volume 3 of his 2002 Report to Parliament. In that report, the Auditor-General recommended that: "all large NSW Government agencies should have audit committees" but did not recommend that audit committees be made mandatory. Two separate surveys have found that approximately 90% of large agencies already operate audit committees. Guidance on audit committees is already available on Treasury's website.

PAC Report 11/53 recommends that audit committees be made mandatory. This recommendation goes further than the Auditor-General's 2002 Report to Parliament and further than private sector practice.

The Government agrees with the Auditor-General's recommendation and does not consider that mandating audit committees is necessary at this time. Treasury will issue a circular reminding agencies of the guidance concerning audit committees available on Treasury's website. The Government's response to the PAC's three recommendations is at appendix 1 attached.

Audit committees are one risk management strategy. The PAC has also commenced an inquiry into the related topic of Risk Management. Agencies should have risk management strategies in place that provide reasonable assurance that agencies are meeting their objectives and managing their operational, legal and regulatory risks. This view is emphasised in various Treasury publications - refer appendix 2 attached.

Yours sincerely

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APPENDIX 1

Response to Public Accounts Committee's recommendations

Recommendation 1: That all NSW government agencies should have an operating audit committee, unless exempted by the specific NSW Treasury provisions relating to the agency's size, risk profile and capacity to maintain proper internal control and that the views of the Auditor-General be taken into account in this regard.

Response:
A general mandate requiring NSW public sector agencies to establish audit committees is not considered necessary for the following reasons:

- the Auditor-General has only recommended the establishment of audit committees for **large** agencies (Vol 3 Auditor-General's Report for 2002),
- the Auditor-General has not recommended that audit committees should be mandatory,
- published documents already state Treasury's view that audit committees are best practice,
- audit committees are best practice (not mandatory) in the Queensland Public Sector,
- in the private sector, only the top 500 listed companies are required to operate an audit committee,
- a high proportion of large NSW public agencies already have audit committees. Two surveys – one by the Audit Office in 2002 and one by Treasury in 2003 both indicated around 90% of large agencies already had audit committees,
- there are many small entities subject to the *Public Finance and Audit Act 1983* including marketing and registration boards for whom the cost of an audit committee is likely to outweigh benefits, and
- many exemptions from a general mandate to operate audit committees would be needed, particularly for small entities.

If Treasury considers that the circumstances of particular agencies warrant the establishment of an audit committee, this could be:

- mandated by Treasurer's Direction for particular statutory bodies and departments, or
- negotiated with State Owned Corporations (SOCs) as part of their annual statement of corporate intent (SCI) negotiation process.

Recommendation 2: That NSW Treasury drafts a Direction to assist agencies to improve the operations of their audit committees, incorporating the following elements:

- That every audit committee should have a Charter or Terms of Reference addressing its operations, including the role of the audit committee in, at a minimum, undertaking a formal assessment of the performance of the internal audit function, overseeing the preparation of the agency's annual financial report and assisting the CEO during the external audit process
- That every audit committee of a Government department should have external members, and that the independence of members on audit committees of statutory authorities or State-Owned Corporations is specified in their respective Charters
- That neither the Chair of the board nor the Chief Executive Officer of the department should be the chair of the audit committee

- That the audit committee should refer to good practice guidelines for its operations
- That the audit committee should communicate internally and externally about its operations at a minimum annually, and that external communications (chiefly in the Annual Report of the agency) should include reference to the frequency of and attendance at meetings; membership and criteria for membership; details of performance reviews; and, how performance has been benchmarked.

Response:
As noted in response to recommendation 1, a general mandate directing that agencies operate audit committees is not considered necessary. However Treasury will issue a circular reminding agencies of the guidance concerning audit committees available on Treasury's website including:

- Statement of Best Practice – Internal Control and Internal Audit [June 1995],
- Internal Control Assessment [July 1995], and
- Risk Management and Internal Controls Toolkit [September 1997].

The above guidance does not explicitly state that the chairman of the board and/or CEO should not be chairman of the Audit Committee. This will be addressed in the Treasury Circular.

Recommendation 3: When appointing members of audit committees, agencies should ensure that members are properly inducted and suitably qualified.

Response:
Agreed. This will be addressed in the Treasury Circular.

APPENDIX 2

Risk Management

The Government considers that each NSW Public Sector entity should operate a risk management function "to be reasonably assured of meeting its objectives and managing its operational, legal and regulatory risks." Treasury emphasised this in its *Risk Management and Internal Control Toolkit (1997)*[1]. This view is echoed by CPA Australia, quoted in the Public Accounts Committee's report on *Audit Committees*:[2]

"We believe that an entity should have in place a risk management function and if anything, it is this that should be mandated. The establishment of an audit committee function is a tool by which an entity can mitigate risk."

Consistent with annual reporting legislation, each NSW Public Sector agency's annual report must detail its aims and objectives, operations, performance measures and risk management.

Risk Management is also incorporated into Treasury's Financial Management and Commercial Management Frameworks, in the following ways:

- All Budget Dependent General Government Sector Agencies are required to prepare a Results and Services Plan. This Plan includes planned results, services, strategies and Risk Management strategies[3].
- The Commercial Policy Framework has 2 policies[4] for the development of either a Statement of Corporate Intent (SCI) or a Statement of Business Intent (SBI). The policies require the SCI and SBI to include an analysis of Risks, which includes risk management strategies.

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[1] *Risk Management and Internal Control Toolkit* (1997) Volume 1 page 8.

[2] PAC report *Review of Operations of Audit Committees* #154 April 2005 Chapter 2, page 3

[3] See Example Results and Services Plan page 12 for risk management strategies.

[4] *Guidelines for the Development of the 2005-06 Statement of Corporate Intent* and *Guidelines for the Development of the 2005-06 Statement of Business Intent*