

Audit Committee Effectiveness in the South African Provincial Treasuries: Regular Meetings and Commitments

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Abstract: Considering annual reports of the municipalities and their audit committee reporting about the state of municipal governance, this study aims to investigate the effect of factors associated with the audit committee effectiveness in the South African Provincial Treasuries. Data for the nine provincial treasuries are employed in the analysis, collected from 2015 to 2017. A Chi Square P-Values was employed to determine if the P-value test results have some significant relationship or not. The results indicate that the regular meetings and commitments are significantly associated with the audit committee effectiveness, while the financial experience is not leveraging the effectiveness. These results are consisted with the literature and the nature of the expectations of audit committees formally outlined in the charter by National Treasury.

Keywords: Annual Reports, Audit Committee, Commitments, Financial Experience, Provincial Treasuries, Regular Meetings

1. Introduction

Little research has been done in the area of factors associated with the audit committee effectiveness in the South African public sector. Although, some published works on the audit committees in the public sector have paid attention to audit committees and accountability (Van der Nest *et al.*, 2008); audit committee responsibilities and disclosure practices (Marx, 2009), little is known about how the audit committee effectiveness are determined. Audit committees in the South African municipalities are still grappling the challenges of adherence to their mandate as outlined in the charter.

While research on audit committee effectiveness in South African public sector have largely focused on perception and accountability (Van der Nest *et al.*, 2008); a number of factors associated with the effectiveness of audit committees in the municipalities have not yet been dealt with comprehensively in existing literature. Drawing on both Public Financial Management and the Municipal Finance Management Act institutions, this study examines the determinants of audit committee effectiveness in the South African municipalities based on regular meetings, commitments, and skills. In addition, this study reports on the effectiveness of audit committees in the South African provincial treasuries. In more specific sense, an active audit committee is important because it indicates the commitment to the issues of interest because of the reports it release (Bhasin, 2015). In commenting to this sentiment, Christensen

et al. (2015) state that the number of meetings per year undertaken by the board committees is used as a representation for board commitment. Thus, the organisations need to create an environment that will harness commitment and support (Odoyo *et al.*, 2014). Tanyi and Smith (2014) also note that the audit committee roles are vital to the functioning of the audit committee and that their over commitment affects audit committee oversight and the firm's financial reporting quality. Notwithstanding the fact that a time commitment is a concern to audit committee members (Kachelmeier *et al.*, 2016). Thus, while indicators of audit committee members' ineffectiveness can arise from financial reporting failures such as restatements and material control weaknesses and from individual audit committee member characteristics such as over commitment to too many boards or questionable independence from management, the former category is likely to be more visible and more likely to threaten perceived legitimacy from an institutional-theoretic perspective (Kachelmeier *et al.*, 2016). Therefore, there should be sufficient time between the audit committee meeting to discuss any work arising out of reporting and the reviewing minutes, following up actions and developing matters for information, recommendation or decision, within timeframes for financial reporting, other committee meetings and members' schedules (Hidayah *et al.*, 2018; Surbakti *et al.*, 2017; Alzeban & Sawan, 2015).

Audit committee effectiveness is not about compliance on review of financial reporting, internal control and risk management systems, internal and external

audit processes, but to processes and activities surrounding audit committee meetings play a key role in configuring meanings of effectiveness (Gendron & Bédard, 2006). McMullen and Raghunandan (1996) state that audit committee effectiveness can be enhanced by direct communication between auditors and audit committees. At the other side of the spectrum, Qasim (2018) used various factors such as independence of audit committees' members, number of meetings, financial expertise, and size of the committee to examine the audit committee effectiveness and found that the most important character of audit committee effectiveness is the independence of audit committee members. The research literature highlights many areas of ineffectiveness of audit committees. These include lack of commitment, poor meeting attendance (Kachelmeier *et al.*, 2016) and failure to engage at the right level of skill on financial reporting (Chang *et al.*, 2013). The effectiveness of audit committee in the public sector is aiming at enhancing governance transparency and accountability in the public sector. Failing to address these issues has been shown to have significant consequences for effective audit committee. Hence, the characteristics of effective audit committee are appropriated with technical skills (Chen and Komal, 2018), commitment (Ishak, 2016) and attendance of frequent meetings (Hidayah *et al.*, 2018). The remainder of this study is organised as follows; the review of relevant literature, methodology, analysis and results, recommendations and conclusion.

2. Literature Review

2.1 Regular Meetings

Although there is a vast literature on audit committee effectiveness, prior research has not considered how the regular meetings of the audit committee might affect their effectiveness in the municipalities. Instead, prior research focused on audit committee's role in the public sector. Using data from a survey of chief internal auditors from UK-listed companies on the frequency of meetings between the audit committee and interaction with internal audit, Alzeban and Sawan (2015) find that frequent meetings between the AC and the internal auditors are significantly positively and associated with the AC effectiveness. Surbakti *et al.* (2017) examine the impact of audit committee expertise, meeting and meeting attendance on the earnings quality of companies and found that audit committee members' meeting attendance is positively associated with the

earnings quality. On the other hand, Sharma *et al.* (2009) examine the determinants of the frequency of audit committee meetings in a voluntary governance system in New Zealand. They found that the audit committee meeting frequency is positively associated with the size of the audit committee and the level of institutional and managerial ownership. They also document that financial expertise and board independence are positively associated with meeting frequency when the risk of financial misreporting is higher. Greco (2011) also investigate the determinants of board and audit committee meeting frequency based on the empirical evidence provided by a sample of Italian listed companies and found that the board and the audit committee meeting frequency is negatively associated to insider ownership and positively associated to the proportion of independent directors on the board.

Hidayah *et al.* (2018) examine the effect of gender and expertise of the AC on the AC meeting frequency. Using a logistic regression analysis based on the sample of 180 listed companies in Indonesia, the study showed that there is no significant relationship between AC expertise and the AC meeting frequency. Their study also document that there is no correlation between the AC expertise and gender on AC meetings. Chariri and Januarti (2017) note that mixed results on the effect of audit committee effectiveness may have risen because of others studies did not consider the factors such as independence of the audit committee and reports. Hence, their study also finds that the audit committee expertise and frequency of audit committee meetings positively influenced the level of integrated reports. Their study was based on data gathered from integrated reports of manufacturing companies listed on the Johannesburg Stock Exchanges.

2.2 Commitments

Ishak (2016) emphasises that the frequently meeting among the members of audit committee is a commitment in their jobs. Carcello *et al.* (2002) had studied the disclosures in audit committee charters and reports by examining a random sample of 150 proxy statements filed in Spring 2001 and found that what the audit committees say they are doing in their reports differs from what their charters say the committee should be doing. Therefore, these results indicate either more active audit committees in such companies, or a greater commitment to audit committee disclosure in such companies. Unfortunately, the increasing time

commitments required of audit committee members may be discouraging many corporate managers from accepting audit committee appointments (Knapp, 1987). Krishnamoorthy *et al.* (2002) investigated the audit committee effectiveness and financial reporting quality based on the implications for auditor independence. Their study reveals that the audit committee's financial literacy, expertise, independence and strong commitment were identified as important characters which give the audit committee enough power to confront important issues. Notwithstanding the fact that Setiany *et al.* (2017) compared the audit committee characteristics which consisted of the size of audit committees, education background of audit committees members, independency of audit committees members, time commitment of audit committees members, number of audit committees meetings, and tenure of audit committees members. Their findings showed that the education background of audit committees' members, time commitment of audit committee members, number of audit committees meetings are insignificant.

2.3 Skills

Madi *et al.* (2017) state that the audit committee and skill represents the talents to rely on their work in overseeing the financial reporting. Anafiah *et al.* (2017) also purport that the audit committee should have a range of required skills, experience, knowledge and professional qualifications. Although the soft skill criteria such as communication skills and personal characteristics are not emphasised, Lee (2017) emphasises that such skills would intensify their oversight responsibilities over financial reporting, risk management and governance of organisations. On the other hand, Bedard *et al.* (2004) investigated whether the expertise, independence, and activities of a firm's audit committee have an effect on the quality of its publicly released financial information. Their study finds that aggressive earnings management is negatively associated with the financial and governance expertise of audit committee members, with indicators of independence, and with the presence of a clear mandate defining the responsibilities of the committee. Similarly, Ghafran and Yasmin (2018) also found that the experiential and monitoring expertise of audit committee chairs have a significant negative association with the delay in the financial reporting. As a result, the literature has found mixed evidence. For example, Chen and Komal (2018) examined financial experts' monitoring on audit committees of financial reporting quality and their results show that

audit committee financial expertise has a positive relationship with earnings quality and that accounting financial experts have a stronger relationship with earnings quality than non-accounting financial experts. Therefore, one reason for such a positive relationship may be attributed to the fact that the skill is a function of experience performance of service, while knowledge is a function of qualification. Garba and Mohamed (2018) also found that the audit committee financial expertise have a significant positive influence on financial health of the institutions. Consequently, it is important for the audit committee to be suitable qualified and have the necessary skill, and they should collectively as a committee be able to deliver on their duties and function, with performance being measured reliably and specific based on the skill and qualification. To this end, when the organisations appoint the audit committees they should be able to prove that the such audit committee has an acceptable level of qualifications to be able to have knowledge on the nature of the organization and its strategic objectives. Also ensure that the skills of organizational performance on the other hand can be measured and linked to audit committee functions and delivery of duties.

3. Research Methods

Data description includes 36 observations based on Provincial Treasuries annual reports in the South Africa's nine provinces. The years from 2013 to 2016 were selected. Therefore, this study intends to investigate the determinants of factors associated with the audit committee effectiveness in the South African Provincial Treasuries. Data for the nine provincial treasuries are employed in the analysis, collected from 2013/14 to 2016/17. In particular, it investigates the factors such as regular meetings, commitments and skills of the audit committees in the South African public sector. In order to investigate the effectiveness of the audit committees, the following limitations were considered: the data were gathered from the provincial treasuries annual reports and were analysed for the 2013/14 to 2016/17. Having outlined the relevant literature of the paper, the methodology adopted in this research was the quantitative one, which is based on the collection of data from annual reports in all nine provinces of the provincial treasuries. In South Africa, it is a requirement for all public organisations to disclose their financial and non-financial information in the annual reports, which publishes all the financial reports and financial statements.

Table 1: Set of Data Observed

Provincial Treasuries	Freq.	Percent	Cum.
Eastern Cape	4	11.11	11.11
Free State	4	11.11	22.22
Gauteng	4	11.11	33.33
KwaZulu-Natal	4	11.11	44.44
Limpopo	4	11.11	55.56
Mpumalanga	4	11.11	66.67
North West	4	11.11	77.78
Northern Cape	4	11.11	88.89
Western Cape	4	11.11	100.00
Total	36	100.00	

Source: Authors

Table 2: Frequency Table for the Year 2013

Commitments	Meetings		Total
	No	Yes	
No	4	0	4
	100.00	0.00	100.00
Yes	8	24	32
	25.00	75.00	100.00
Total	12	24	36
	33.33	66.67	100.00
Pearson chi2(1) = 9.0000 Pr = 0.003			

Source: Authors

4. Analysis and Results

According to Whitley and Ball (2001) the first step in any analysis is to describe and summarize the data. Table 1 shows how the data was observed over four (4) years period and the frequency level in all nine provincial treasuries. Frequency tables are used as a way of summarising a set of data. The data was pulled out of the annual reports which have been prepared in accordance with the guidelines on the annual report as issued by National Treasury, with all disclosure requirements and submitted full financial information in their financial reports. This data set was accessible through the internet.

Table 2 shows that the two most important relationship between audit committee commitments and regular meetings attendance. In general, Pearson's chi-square test was used to test for association between two categorical variables. The association was declared significant if the p-value was found to be less than 0.05. Included in the dataset are the variables commitments and regular meetings. These associations are summarised in Table 2.

Regular meetings organised and commitments or attendance are significantly associated ($P = 0.003$). That is, the proportion of the no's to the proportion of the yes's is significantly different in the levels of commitment. Therefore, it is concluded that there is statistically significant evidence of associations in audit committee commitments and attendance of regular meetings in the Provincial Treasuries.

After assessing associations using categorical data analysis, the results in Table 3 and 4 on the following page show that from 2013/14 to 2014/15 there is no significant evidence of associations in the audit committee commitments and meeting attendance. Therefore, these results indicate the Chi Square of ($P = 0.236$) in 2013 and ($P = 0.134$) in 2014. However, there is a positive association at the P-value of 0.047 in 2016.

On the flip side, when the variable of skills is used on the Chi-squared test using tabulate skills, row Chi2 commitment and regular meetings, the results show that the audit committees who have no skills are more likely to affect the effectiveness of the

Table 3: Frequency Table for the Year 2014

Commitments	Regular Meetings		Total
	No	Yes	
No	1	0	1
	100.00	0.00	100.00
Yes	3	5	8
	37.50	62.50	100.00
Total	4	5	9
	44.44	55.56	100.00
Pearson chi2(1) = 1.4063 Pr = 0.236			

Source: Authors

Table 4: Frequency Table for the Year 2015

Commitments	Regular Meetings		Total
	No	Yes	
No	1	0	1
	100.00	0.00	100.00
Yes	2	6	8
	25.00	75.00	100.00
Total	3	6	9
	33.33	66.67	100.00
Pearson chi2(1) = 2.2500 Pr = 0.134			

Source: Authors

Table 5: Frequency Table for the Year 2016

Commitments	Regular Meetings		Total
	No	Yes	
No	1	0	1
	100.00	0.00	100.00
Yes	1	7	8
	12.50	87.50	100.00
Total	2	7	9
	22.22	77.78	100.00
Pearson chi2(1) = 3.9375 Pr = 0.047			

Source: Authors

Table 6: Frequency Table - when the skills is NO

Commitments	Regular Meetings		Total
	No	Yes	
No	2	0	1
	100.00	0.00	100.00
Yes	1	6	7
	14.29	87.50	100.00
Total	3	6	9
	33.33	66.67	100.00
Pearson chi2(1) = 5.1429 Pr = 0.023			

Source: Authors

Table 7: Frequency Table - when the skills is YES

Commitments	Regular Meetings		Total
	No	Yes	
No	2	0	2
	100.00	0.00	100.00
Yes	7	18	25
	28.00	72.00	100.00
Total	9	18	27
	33.33	66.67	100.00
Pearson chi2(1) = 4.3200 Pr = 0.038			

Source: Authors

audit committees in the South African Provincial Treasuries than those who have (85.71% compared with 72%). The correlations between the two variables skills and regular meetings attendance can be found using the correlate command.

In Table 7, there is an association between skills and regular meetings attendance of audit committees in the Provincial Treasuries. The p -value indicates that these variables are dependent of each other and that there is a statistically significant relationship between the categorical variables at ($Pr = 0.023$; $Pr = 0.038$).

5. Conclusion and Recommendations

Regular meetings and commitments of audit committee are very important to factors to assessment the contribution of the audit committee and also to consider the audit committee charter and the responsibilities they are expected to fulfil. As this paper has demonstrated through the literature review that there is no single best was to determine the effectiveness of the audit committee. This paper used the effectiveness is the ability to achieve stated goals. Thus, it is a multifaceted concept, which is used to measure the responsibilities of the audit committee in terms the charter and the best practice with which the audit committee are comfortable, providing feedback and reporting, taking timely, corrective action if or when required. The analysis illustrates that there is no panacea or single determinant for measuring the audit committee effectiveness. Rather, this paper has looked at the small aspects such as regular meetings, commitments and skills of the audit committees. Another implication of this paper is that if the audit committees lack of technical competencies they cannot prompt relevant questions from management. And the questions therefore becomes,

where the members of the audit committee take appointment for their personal advancement, while they do not have public interest at heart and also have insufficient time to read audit packs, it may as well render them ineffective, which results in no meaningful contributions. Given the discussion of the results, it can be concluded that the audit committee members are busy with other commitments (for example, a member may be a chief executive officer in other organisations or serving in more than three audit committees elsewhere), and a result would not have enough time to prepare for the audit committee meetings.

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