

**UNIVERSITY OF KWAZULU-NATAL**

**The Corporate Governance Practices of Audit  
Committees in the KwaZulu-Natal Local  
Government Municipalities**

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**2020**



# **The Corporate Governance Practices of Audit Committees in the KwaZulu-Natal Local Government Municipalities**

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**A thesis submitted in fulfillment of the requirements for the degree of Doctor of Philosophy  
(Ph.D.) of the University of KwaZulu-Natal**

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**2020**

## DECLARATION

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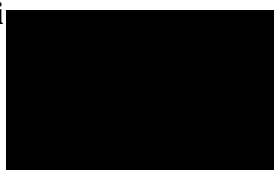
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## DEDICATION

I dedicate this Ph.D. Thesis to both my late parents. My father, **John Mqadi**, whose words of encouragement, push for tenacity and inspiration to strive for better education ring in my ears. A special feeling of gratitude to my loving Mother, **Rose Mqadi**, who motivated me to unleash my most significant potential and always saw the best in whatever I aspired to become. I love and miss both of you.



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## ABSTRACT

For several decades, the Audit Committee has been a subject of substantial research interest in developed countries, including the United States of America, the United Kingdom and Australia. However, in emerging economies, Audit Committee remains a relatively new topic with their current practices not ideal for municipalities to fully benefit from them, as their contribution remains an illusion to communities. The problem derived from the comprehensive academic literature is that Audit Committees in the public sector are not deemed to be an effective instrument (governance structure) of the governing body because the practices culminating in good corporate governance are not understood and supported by the governing bodies, or that the Audit Committees themselves are not cognisant of their practices, are not effectively constituted, or take on responsibilities outside of their remit. The study investigates the corporate governance practices of Audit Committees in KwaZulu-Natal local government municipalities, a public sector sphere. The primary data was collected through questionnaire surveys and supplemented with semi-structured interview surveys from four distinct (although significant) sample groups (i.e., Audit Committee Chairpersons, Municipal Managers, Chief Financial Officers, and Internal Auditors). The study employed a sequential explanatory mixed-methods approach. Data were analysed using -Statistical Package for Social Sciences (SPSS) for quantitative data Semi-structured interviews were transcribed and analysed qualitatively.

The study emphasises the effectiveness of Audit Committee, which can execute its oversight role and responsibilities in relation to the quality of audit in the public sector. More specifically, the observations made in the study include: The lack of guidelines on minimum expertise (qualifications and “appropriate experience”) of Audit Committee members in the legislation creates room for wrong persons to be Audit Committee members; communities in KwaZulu-Natal local government have little to no knowledge of Audit Committees and their oversight roles; the municipal administration does not provide proper support for Audit Committees to discharge their duties; and although the Audit Committees are playing an essential role in some areas including financial reporting, external auditing, and internal auditing, there is a still considerate scope where the Audit Committees can play a more proactive and robust role. The study concludes by accentuating the need for Audit Committee effectiveness in KwaZulu-Natal local government, which includes: The adoption of a corporate governance framework (based on standardised sound governance principles) that will address the uniqueness of the local government sphere through a

code of corporate governance and a corporate governance framework; strengthen municipal leadership to ensure that leaders possess official skills to enable them to realise the vision of the institution; promulgation of codes of ethics for local government to deal with problems of ethics, transparency, and accountability, and offer measures on non-compliance to this code of ethics; making financial sustainability center-stage of each municipality; and implementation of the municipal intervention (including local participatory governance) in a way it was initially conceived and written.

**Keywords:** Audit Committee; Audit Committee Effectiveness; Corporate Governance; Municipal Governance; Local Government; Mixed Method Approach

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## LIST OF ABBREVIATIONS

ACF	–	Accounting and Finance
AG	–	Auditor General
AGM	–	Annual General Meeting
AGSA	–	Auditor-General South Africa
APC	–	Assessment of Professional Competency
BCCI	–	Bank of Credit and Commerce international
BoD	–	Board of Directors
BRC	–	Blue Ribbon Commission
CAE	–	Chief Audit Executive
CEO	–	Chief Executive Officer
CFO	–	Chief Financial Officer
CoGTA	–	Cooperative Governance and Traditional Affairs
COVID-19	–	Coronavirus disease of 2019
DCoG	–	Department of Cooperative Governance
EGM	–	Exceptional General Meeting
EU	–	Europe Union
FRC	–	Financial Reporting Council
GAAP	–	Generally Accepted Accounting Practice
IIA SA	–	Institute of Internal Auditors South African
IoDSA	–	Institute of Directors Southern Africa
IRBA	–	Independent Regulatory Board for Auditors
ITC	–	The Initial Test of Competence

JSE	–	Johannesburg Stock Exchange
KZN	–	KwaZulu-Natal
MD	–	Managing Director
MFMA	–	Municipal Financial Management Act
MPAC	–	Municipal Public Accounts Committee
OECD	–	Organisation for Economic Co-operation and Development
PEC	–	Provincial Executive Committee
SAICA	–	South African Institute of Chartered Accountants
SAIPA	–	South African Institute of Professional Accountants
SALGA	–	South African Local Government Association
SD	–	Standard Deviation
SEC	–	Securities Exchange Commission
SOX	–	Sarbanes–Oxley Act
SPSS	–	Statistical Package for the Social Sciences
UK	–	United Kingdom
USA	–	United States of America
WHO	–	World Health Organization

# CHAPTER ONE

## OVERVIEW OF THE STUDY

### 1.1 Introduction

KwaZulu-Natal (hereafter KZN) is the biggest province, out of the nine, in South Africa that is located in the south-east of South Africa, bordering the Indian Ocean. Created in 1994 when the Zulu bantustan of KwaZulu ("Place of the Zulu" in Zulu) and Natal Province were merged, it covers an area of 94 361km<sup>2</sup>, the third-smallest in South Africa. It has a population of 10 267 300, making it the second-most populous province in the country. The capital city is Pietermaritzburg, with the largest city being Durban. The province's manufacturing sector is the largest in terms of contribution to Gross Domestic Product, and the entire province is the second-largest contributor to the National Gross Domestic Product (Main, 2017). The sugar cane plantations along the coastal belt are the mainstay of KZN's agriculture. KZN is divided into one metropolitan municipality (eThekweni Metropolitan Municipality) and ten district municipalities, which are further subdivided into 43 local municipalities (previously 50, before the 2016 local government elections).



**Figure 1.1:** The KZN Province. KwaZulu-Natal Local Government Handbook, 2019

KZN falls in the second tier of the South Africa Government (which is the provincial government). It is the mission of the Department of Cooperative Governance (DCoG) is to ensure that all municipalities perform their basic responsibilities and functions consistently by:

- putting people and their concerns first;
- supporting the delivery of municipal services to the right quality and standard;
- promoting good governance, transparency, and accountability;
- ensuring sound financial management and accounting; and
- building institutional resilience and administrative capability (Municipality, 2002).

The municipality's fiscal and financial affairs in KZN are regulated under the Municipal Finance Management Act No. 56 of 2003 (MFMA). Its object is to secure sound and sustainable management of municipalities' fiscal and financial affairs by establishing norms and standards and other requirements (Oosthuizen & Thornhill, 2017). The South African Local Government Association (SALGA), a listed public entity, is an autonomous association of municipalities with its mandate derived from the Constitution of the Republic of South Africa. This mandate defines SALGA as the voice and sole representative of the local government. SALGA interfaces with parliament, the National Council of Provinces, cabinet, as well as provincial legislatures (South African Local Government Association, 2016).

Municipal Councils within any municipality have considerable powers as both the legislative and executive authority within a municipality. A Municipal Council is responsible for ensuring that laws and policies are formulated and implemented effectively to ensure the delivery of basic services to its community.

National legislation has regulated a separation between legislative and executive power and functions to allow checks and balances within the local government. As legislative authorities, Municipal Councils must ensure executive functions are performed lawfully and wisely. The council is also tasked with holding the municipal administration and Municipal Managers – as the municipality's Accounting Officer and Head of Municipal administration – accountable for the financial management of the municipality and its service delivery performance.



To assist the Council, the oversight functions are funneled through two important committees within municipal structures before reaching the Council, which exercises the ultimate oversight role. On the one hand, the Council in terms of Section 79 of the Municipal Structures Act, Act 117 of 1998 established Municipal Public Accounts Committees (MPACs). Their purpose is to perform an oversight function over the executive functionaries of the Council; on the other hand, municipal Audit Committees are structured more independently to perform a fairly external oversight role. The structural independence of Audit Committees is statutorily protected, at least in part, by ensuring that (i) the majority of its committee members and the chairperson are external appointments (not employed by the municipality in any capacity), (ii) at least three members must have the appropriate experience, and (iii) no Councillor occupies a seat as a member of the committee. The MFMA section 166 makes it compulsory for municipalities to establish an (or share an established) Audit Committee. This act also prescribes a single Audit Committee's concept to be shared among a district municipality and the local municipalities within the district and among a municipality and municipal entities under its sole control (MFMA, 2003:76).

- a) The Audit Committee must be an independent advisory body to the Council/Accounting Authority/Accounting Officer and the management and staff of the municipality on the following:
  - matters relating to internal financial control and internal audits;
  - risk management;
  - accounting policies;
  - the adequacy, reliability, and accuracy of financial reporting and information;
  - performance management;
  - effective governance; and
  - the MFMA and any other applicable legislation, performance evaluation, and any other issues.
- b) The Audit Committee is also expected to review the annual financial statements to provide an authoritative and credible view, its efficiency and effectiveness and its overall level of compliance with the applicable legislation.
- c) The Audit Committee should promote accountability and service delivery by evaluating and monitoring responses to risks and overseeing the internal control environment's effectiveness (MFMA, 2003:76).

Evidently, the Audit Committee is a committee of the Municipal Council and performs the legislative duties assigned to it by the MFMA (section 166), and other relevant duties as assigned to it by the Municipal Council, under its respective Audit Committee charter. It is recognised that Audit Committees perform an essential role in the governance framework of local government, mainly in the context of improved public sector accountability. They have a self-governing (independent) role in guiding the Municipal Council on the processes of financial reporting, risk management, internal control, and external audit matters, as part of the coherent assessment of the governance procedures and control environment of the local authority (Haonga, 2020).

Effective Audit Committees are critically mindful of their practices, roles, and responsibilities and embrace and fully understand what makes it necessary to fulfill them effectively (Hassan, Hijazi, & Naser, 2017). This invariably has a positive impact on good Corporate Governance, which involves better-informed decision-making, accountability for the stewardship and control of resources, and the efficient use of these resources to deliver quality public services and better outcomes for citizens. The presence of an independent and effective Audit Committee is endorsed globally, amongst other features, as a significant characteristic of good Corporate Governance.

## **1.2 Research Problem Statement**

The problem that is derived from the comprehensive academic literature is that modern Audit Committees in the public sector are not deemed to be an effective instrument (governance structure) of the governing body because the practices culminating in good Corporate Governance are not understood and supported by the governing bodies, or that the Audit Committees themselves are not cognisant of their practices, are not effectively constituted, or take on responsibilities outside of their remit.

Though both institutional arrangements (Municipal Public Accounts Committees and Audit Committees) have existed for quite some time; however, municipal maladministration and corruption reports are rife and on the rise. The Auditor-General's latest report on local government has highlighted its dismal performance and lack of accountability. All this begs the question: is municipal oversight flawed? This thesis explores whether or not the one oversight committee

(Audit Committee) is sufficiently empowered to perform its functions effectively; and what should be done to enhance their functioning. One of Audit Committees' core functions is to advise Municipal Council on internal financial control and internal audits.

However, the financial results of municipalities in KZN and in South Africa as a whole have always been extremely poor (Cooperative Governance & Traditional Affairs, 2009). Launched in 2009 by the late Minister for Cooperative Governance and Traditional Affairs (CoGTA), Honourable Sicelo Shiceka, Operation Clean Audit 2014 was the flagship of the fourth president of South Africa Jacob Gedleyihlekisa Zuma's Government's broader plan to "turnaround" local government (Powell, O'Donovan, Ayele, & Chigwata, 2014). Operation Clean Audit 2014 had two targets:

- First, by 2011, no municipality or provincial department should have a disclaimer or adverse opinion or fail to submit financial statements for auditing (No ADFS).
- Second, by 2014, all municipalities and provincial departments should achieve clean audit outcomes.

Running up to the target date, it was evident that the Operation Clean Audit 2014 target was ambitious and was certainly not be achieved, given that for the 2010-2011 financial year, only 5 (8%) of 61 KwaZulu Natal's municipalities achieved clean audit outcome, with one (01) municipality obtaining a disclaimer and adverse opinions, respectively. Consequently, Operation Clean Audit 2014 failed dismally across the whole of South Africa, with only 13 (21%) of 61 municipalities achieving clean audit outcomes for the 2013-2014 financial year in KwaZulu-Natal. A further indication of the turmoil faced by municipalities as they were downgraded to "junk status" in 2016 (with the exception of those in the Western Cape) was by Ratings Afrika (a rating agency), which reported that *"60% of the key local municipalities are in financial trouble!"* (Kocks, 2016).

The former Auditor General, Terence Nombembe in his report for the 2012-2013 financial year-end, said: *"a lack of "committed" leadership lies behind a sharp deterioration in financial management in municipalities"* (Times Media Pty Ltd [ZA], 2013). The current Auditor General, Kimi Makwetu in his report for the 2015-2016 financial year-end, said: *"municipalities lack accountability"* (Ndlendle, 2017). These clearly showed a piling up of problems, ranging from poor leadership to unaccountability by municipalities. As depicted in the following table,

municipalities' audit outcomes (from the 2009/2010 financial period [at the inception of Operation Clean Audit – Operation Clean Audit 2014] to 2018/2019 financial period) in KZN local government are not commendable.

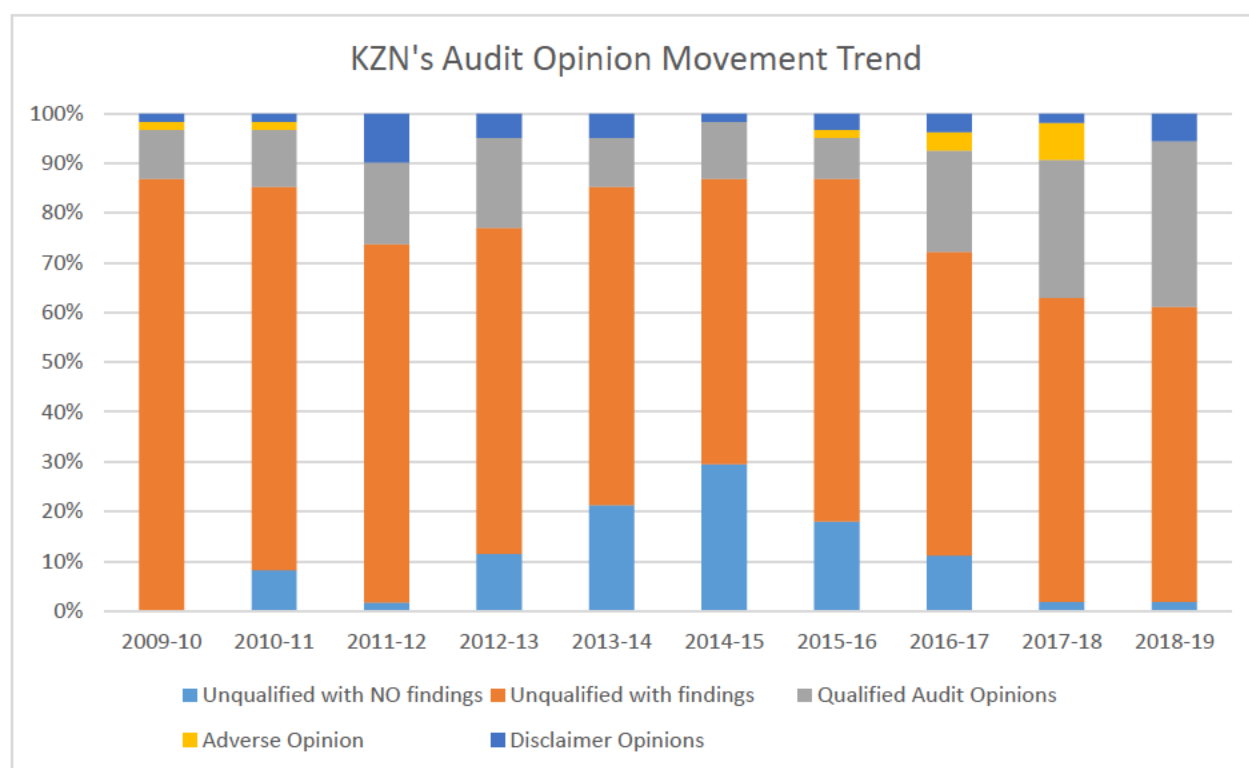
**Table 1.1:** Auditor General of Southern Africa's Annual General Reports for KwaZulu-Natal

<b>Audit Outcomes</b>	<b>Unqualified with NO Findings</b> (The financial statements are free from material misstatements)	<b>Unqualified with Findings</b> (The financial statements contain no material misstatements)	<b>Qualified Audit Opinions</b> (The financial statements contain material misstatements in specific amounts)	<b>Adverse Opinions</b> (The financial statements contain material misstatements that are not confined to specific amounts)	<b>Disclaimer Opinions</b> (The auditee provided insufficient evidence on which to base an audit opinion on)	<b>Total Number of Auditees</b>
<b>KZN 2009-10</b>	<b>0</b>	<b>53</b>	<b>6</b>	<b>1</b>	<b>1</b>	<b>61</b>
<b>KZN 2010-11</b>	<b>5</b>	<b>47</b>	<b>7</b>	<b>1</b>	<b>1</b>	<b>61</b>
<b>KZN 2011-12</b>	<b>1</b>	<b>44</b>	<b>10</b>	<b>0</b>	<b>6</b>	<b>61</b>
<b>KZN 2012-13</b>	<b>7</b>	<b>40</b>	<b>11</b>	<b>0</b>	<b>3</b>	<b>61</b>
<b>KZN 2013-14</b>	<b>13</b>	<b>39</b>	<b>6</b>	<b>0</b>	<b>3</b>	<b>61</b>
<b>KZN 2014-15</b>	<b>18</b>	<b>35</b>	<b>7</b>	<b>0</b>	<b>1</b>	<b>61</b>
<b>KZN 2015-16</b>	<b>11</b>	<b>42</b>	<b>5</b>	<b>1</b>	<b>2</b>	<b>61</b>
<b>KZN 2016-17</b>	<b>6</b>	<b>33</b>	<b>11</b>	<b>2</b>	<b>2</b>	<b>54</b>
<b>KZN 2017-18</b>	<b>1</b>	<b>33</b>	<b>15</b>	<b>4</b>	<b>1</b>	<b>54</b>
<b>KZN 2018-19</b>	<b>1</b>	<b>32</b>	<b>18</b>	<b>0</b>	<b>3</b>	<b>54</b>

Source: AGSA MFMA General Reports for KwaZulu-Natal Province (2009-2010; 2010-2011; 2011-2012; 2012-2013; 2013-2014; 2014-2015; 2015-2016; 2016-2017; 2017-2018; 2018-2019)

An audit of financial statements' objective is to express an audit opinion on whether the financial statements fairly present the financial position of auditees at financial year-end and the results of their operations for that financial year. "Clean Audit Outcomes" indicate strong financial management, internal sound controls, and a robust budgeting process. All of these elements bear witness to the fact that the municipality spends the funds at their disposal efficiently and effectively towards meeting the targets set out in its strategic plans, which will result in improved service delivery for the citizens of that area. "Clean audit outcomes" enhance public confidence, sound

Corporate Governance, and accountability significantly. A clean audit report issued for a municipality directly impacts the livelihood or lives of people in that area, as far as service delivery is concerned. The ten-year trend of audit movement in KZN is depicted:



**Figure 1.2:** Ten-Year Trend of Audit Opinions Movement in KZN. AGSA MFMA General Reports for KwaZulu Natal (2009-2010; 2010-2011; 2011-2012; 2012-2013; 2013-2014; 2014-2015; 2015-2016; 2016-2017; 2017-2018)

A survey conducted by the Institute of Directors in Southern Africa (IoDSA) in 2006 revealed that Audit Committees might not be as effective as they need to be (Ackermann & Marx, 2016).

A Senior Governance Specialist and Chief Executive Officer at the Institute of Directors in Southern Africa (IoDSA) in Southern Africa, Parmi Natesan, said *"Audit Committees play a key oversight role in the governance structure of both private and public sector entities — but they need to have the right knowledge and insights to perform this extremely important role. Public sector Audit Committees face numerous challenges in being able to fulfil this role effectively"* (Mugnaioni, 2013).

A fundamental question to be asked stems from the challenges of poor leadership, good Corporate Governance, municipal financial mismanagement, and municipal service delivery. In spite of the existence of regulatory and institutional frameworks, municipalities are still struggling to remain sustainable in order to satisfy basic community needs (Kanyane, 2014)

### **1.3 Research Aim and Objectives**

#### **1.3.1 Research aim**

The primary objective (purpose) of this study is to contribute to the understanding of the Corporate Governance practices, culminating to Audit Committee Effectiveness (ACE) in KZN local government, with a view to raising issues that must be addressed to further improve its effectiveness and enhance good Corporate Governance in the local government sphere.

#### **1.3.2 Objectives of the study**

The specific secondary research objectives of the study are:

- To investigate the current state of the Corporate Governance practices of Audit Committees in the KZN local government.
- To investigate the primary factors that affect the Corporate Governance practices of Audit Committees in the KZN local government.
- To identify major steps that can be undertaken to enhance the effectiveness of Audit Committee practices in Corporate Governance in KZN local government.
- To examine the relationship between the perception of the different respondent groups in respect of the current practices of Audit Committees in Corporate Governance in KZN local government.

### **1.4 Research Questions**

To achieve the objectives of the study, research focused on addressing the following research questions:

1. What are the Corporate Governance practices of Audit Committees in the KZN local government?
2. What are the primary factors that affect the Corporate Governance practices of Audit in the KZN local government?

3. What imperative measures can be taken to enhance the effectiveness of Audit Committee practices in KZN local government?
4. How do the perceptions of different respondent groups relate to the current practices of Audit Committee in KZN local government?

### **1.5 Significance and Contributions of the study**

In general, there have been limited academic studies (particularly in the public sector) focusing specifically on Audit Committee practice, although it has been commonly recognised as a very efficient mechanism for ensuring sound Corporate Governance. There is very little that is known about the current practices of Audit Committees (Turley & Zaman, 2014). In addition, most Audit Committee studies were performed in the context of developed countries, including the United States of America (Buallay, 2018). The scenario of Audit Committee activities in emerging economies is, therefore, still under review. For example, Colli and Colpan (2016) pointed out that, unlike the numerous Corporate Governance studies in developed countries, limited research has been carried out in emerging. In light of all the prevailing primary concerns, this study's findings will investigate and provide valuable insights into the Corporate Governance practices of Audit Committees in KwaZulu-Natal's local government and seek to emphasise the necessity for reform in this area. Furthermore, it will develop an understanding of the prevailing practices of Audit Committees in KwaZulu-Natal's local government. Lastly, it will contribute immensely to the accounting knowledge, Audit Committee and Corporate Governance literature and the significance of establishing an effective Audit Committee in the public sector.

Central on the prominence of this research is its contribution to the literature in the field of **Audit Committee Effectiveness**. The study by Collier and Zaman (2005), as quoted by Magrane and Malthus (2010) indicates a significant rise and harmonization in the use of Audit Committees internationally, including the European Commission's requirement public-interest entities in the European Union have an audit committee. Haonga (2020) reported that little empirical research had been conducted to investigate Audit Committees' actual effectiveness, especially those in the public sector.

Zhou, Owusu-Ansah, and Maggina (2018) make the crucial point, for example, that an Audit Committee formation did not provide evidence of the actual monitoring levels to be carried out. Thomas and Purcell (2019) noted that a corporation having an Audit Committee as part of its governance structure and having an **effective** Audit Committee are, of course, different matters. Therefore, this study is intended to reinforce the idea that establishing an Audit Committee is one thing, but establishing an **effective Audit Committee** is another.

Earlier studies primarily addressed two distinct Audit Committee Effectiveness frameworks. For instance, the Audit Committee Effectiveness model suggested by DeZoort, Hermanson, Archambeault, and Reed (2002) focused on Audit Committee's input variables (such as: composition, authority, resources, and diligence), while Turley and Zaman (2004) described an Audit Committee Effectiveness framework that was focused on the successful performance of Audit Committee's role (such as: roles in financial reporting, external auditing, and internal auditing).

It is therefore of utmost importance, meaningful and significant that the researcher investigates the Audit Committee Effectiveness by considering its input (e.g., composition), process (e.g., meeting), and output (e.g., role) dimensions. In line with this, the researcher has developed his own Audit Committee Effectiveness model (Figure 3.1), as presented in *Chapter Three*, with due consideration of all these two dimensions and investigates Audit Committees' effectiveness in KZN local government accordingly. Consequently, this research is justified and will make a substantial contribution to the current literature gap. The findings have implications for management, policymakers, and regulatory bodies to set up effective guidelines and other stakeholders to enhance good Corporate Governance practices in the local government. It will serve as a source of knowledge to other researchers in a similar area.



## 1.6 Structure of the Thesis

This thesis is separated into seven chapters. The problem is addressed in two related parts: The problem statement is contained in *Chapter One*, and a review of the related research, theory, and professional literature is described in *Chapter Two* and *Chapter Three*. The methods used for investigating the problem are included in *Chapter Four*. The outcomes are presented in two chapters: *Chapter Five* and *Chapter Six* which are devoted to reporting the results of the questionnaire survey and interview survey, respectively. Finally, *Chapter Seven* presents the conclusions and implications drawn from the results. The various chapters are described in more detail in the following sections.

**Chapter One:** In this chapter, a compelling case is made regarding the problem under investigation, with focus on why the particular study is needed. Also the presented purpose and objective of this study makes it more focused, the undergirding logic becomes evident, and the relationship between what is going to be studied and how the study will be conducted is made clearer. Finally, the research questions to be investigated are posed. They are succinct statements of the broad implications expected from the study and upon which hypotheses are postulated.

**Chapter Two:** This chapter presents a substantive literature of the theories that under gird the study and briefly summarises previously conducted studies most relevant to the topic under investigation. The theoretical support for the study and various Corporate Governance models underpin specific theoretical research literature to provide a comprehensive debate on the phenomenon.

**Chapter Three:** An empirical literature review that provides a narrative, depicting the logical connections among key elements (i.e. Audit Committee and Corporate Governance) of the theory, constructs, and/or phenomenon of interest are presented. It further represents the researcher's synthesis of literature on how to explain a phenomenon by mapping out the actions required in the course of the study from other researchers' point of view and own observations on the subject of research. The chapter examines the Audit Committees in the Corporate Governance arena.

**Chapter Four:** This chapter provides an examination of the study design and methodology. The research design is described in sufficient detail to allow readers to have a clear understanding of how the study will be conducted, and future researchers would know precisely what procedures to follow should they want to replicate this study. This chapter demonstrates the two stages of data collection, namely, the administration of the survey questionnaire, as well as semi-structured interview surveys.

**Chapter Five:** This chapter comprises the analysis, presentation and interpretation of the findings resulting from the first of the two data collection methods (i.e. questionnaire survey). The method involved sending (by post) questionnaires to the entire population (census survey). The analysis and interpretation of the questionnaire survey data is interpreted in a descriptive form.

**Chapter Six:** To supplement the questionnaire survey, the analysis, presentation, and interpretation of the findings resulting from the second of the two data collection methods (i.e. semi-structure interviews) is presented in this chapter. Interviews employed a blend of open-ended questions, often accompanied by follow-up why or how questions and explanations. The chapter also triangulates the outcomes of the interview survey with the outcomes of the questionnaire survey and analysis the results using grounded theory.

**Chapter Seven:** Lastly, this chapter presents a thesis overview and outlines the significant policy implications of the research. The section also recognises certain constraints in the studies and gives guidelines for further studies.

## **1.7 Conclusion**

In this introductory section, the study background is highlighted and the research issue is introduced briefly. It illustrates the current gap in literature and highlights the rationale for the research. This section also justifies the research by indicating the absence of empirical research, its contribution to accounting information, and its potential advantages for South Africa local government. In the end, the route map of how the thesis was drawn up was presented and discussed.

The researcher conducted an empirical literature review (commonly called a systematic literature review) in order to examine past empirical studies to answer the research question. The empirical review of literature concentrated on previous research result findings that the researcher wants to study e.g. construct reliability, validity, correlation-ship, strength of relationship between constructs.

# **CHAPTER TWO**

## **THEORETICAL LITERATURE REVIEW**

### **2.1 Introduction**

Based on existing knowledge, observations, and ideas, the researcher developed theories to explain phenomena, draw connections, and make predictions. The theoretical framework defines, discusses, and evaluates theories relevant to the research problem. It explains the key concepts, models, and assumptions that guide the project and show that established ideas from where work is grounded on. Ghauri, Grønhaug, and Strange (2020) noted that a strong theoretical framework shows why the researcher has chosen a particular approach to answer the research question. It also provides a clear basis for interpreting and understanding the relevance of the findings.

After refining the problem statement and research question(s) (in *Chapter One*), the researcher now explores what theories, ideas, and models other researchers have already developed. By presenting this information in order to frame the research and justify the overall approach. This part of the dissertation lays the foundations that support the researcher's analysis, helps interpret results, and makes broader generalisations. To learn the field and to explore pertinent issues and/or understanding from where ideas are grounded, a subset of literature has been based on its relevance to the topic, in relation to the following four themes:

- a) Theoretical Framework for Corporate Governance
- b) The Concept of Corporate Governance
- c) Corporate Governance Guidelines
- d) Audit Committee Guidelines

### **2.2 Theoretical Framework for Corporate Governance**

The fundamental theories in Corporate Governance began with the agency theory, expanded into stewardship theory and stakeholder theory, and evolved to transaction cost theory. However, these theories address the cause and effect of variables, such as the configuration of board members, Audit Committees, independent directors, and the role of top management and their social relationships rather than its regulatory frameworks. Hence, it is suggested that a combination of

various theories is best to describe an effective and good governance practice rather than theorizing Corporate Governance based on a single theory.

### 2.2.1 Agency Theory

Agency theory is defined as “*the relationship between the principals, such as shareholders and agents such as the company executives and managers*”, Alchian and Demsetz in 1972 expounded the agency theory, which has its roots in economic theory and further developed by Jensen and Meckling in 1976 (Elena, 2012). In this theory, shareholders who are the corporation owners or principals hire the agents (managers) to perform work. Principals delegate the running of the business to the directors or managers, who are the shareholder’s agents (Clark, 2004). Thus this theory rests on the assumption that the role of organisations is to maximize the wealth of their owners or shareholders (Blair, 1995).

As noted by Daily, Dalton, and Cannella Jr (2003), conceptually and simply, agency theory reduces the company to two participants, managers and shareholders. Shareholders expect agents (managers) to act and make decisions in their interest. However, the long-standing problem that managers act in their own interest, instead of serving the interests of shareholders and other stakeholders, is the one that gave rise to the “agency problem”. The obvious question is why those managers were not kept in check by companies’ Corporate Governance structures, and more specifically, the companies’ boards of directors. Adam Smith first highlighted this problem in the 18th century and then subsequently explored it by Ross (1973), and the first detailed description of agency theory was presented by Jensen and Meckling (1976). Hereafter, agency theory was known as a separation of ownership and control.

In her major study of agency theory, Eisenhardt (1989) pinpoints that most businesses operate under incomplete information and uncertain conditions. Such conditions expose businesses to two agency problems, namely, *adverse selection* and *moral hazard*. Adverse selection occurs when a principal cannot ascertain whether an agent accurately represents his or her ability to do the work for which he or she is paid. On the other hand, moral hazard is a condition under which a principal cannot be sure if an agent has put forth the maximal effort. In line with agency theory, the fundamental issue of Corporate Governance is how the shareholders (principals) ensure that self-interest serving managers act in the interest of shareholders, rather than their own (Bosse &

Phillips, 2016), because, as reported by Berle and Gardiner (1932), the company's assets may be used for the welfare of managers instead of maximizing the company's wealth when shareholders are unable to monitor managers adequately. The mere fact is that principals need quality information to motivate, monitor, and control managers; whereas managers have full control over the flow of this information, creates a complex situation of information asymmetry between principals and managers (Boučková, 2015). This information asymmetry then leads to agency problems of adverse selection and moral hazard (as mentioned and explained above).

Nadler, Behan, and Nadler (2011) cite that there is potentially more prevalence of agency problems in developing economies due to unceremonious Corporate Governance structures, which create room for a much weaker governance environment. A detailed examination of agency problems in developing economies by Saich (2010) demonstrated that variables, such as family ownership and oversight, state-owned companies, lack of legal protection for minority shareholder rights, concentrating ownership structures and strategy, and competitiveness in such markets had worsened the agency problem. In many emerging economies (as is the case with South Africa), many companies are controlled by families (Nölke, ten Brink, Claar, & May, 2015). Smith (1999) addressed this phenomenon by drawing on extensive factors such as emotions, sentiments, and informalities between principals and managers, resulting in weakened effective monitoring of family managers. This implies that family owners and managers of the family reduce the effectiveness of internal and external control mechanisms and expose their companies to a problem of self-control that harms shareholders and stakeholders alike. Several studies have recommended that independent, external directors on the board may bring some resolve to the agency problem. Jackling and Johl (2009), echoed by (Nölke et al., 2015) argue that the greater the number of outside directors on the board, the higher the corporate performance.

As already been alluded by the agency theory, shareholders may sometimes prioritise their own welfare at the expense of directors and other stakeholders and thus tend to influence leadership decisions to maximise short-term profit and maximise the company's wealth by earning sustainable long-term gains. As a consequence, interest disputes occur between owners and managers, which tend to develop exponentially. For accountability purposes, there needs to be clear overseeing over control activities and management decisions. However, these can be possible if principals are

involved in the entire process actively. However, principles of the high-cost participation and, in some instances, the absence of understanding and skills cannot be active in the process; but, due to its oversight responsibility to shareholders, the Board has to set up monitoring mechanisms (Azim, 2012). The Board of Directors generally employs experts and professionals to oversee management operations on its behalf. Still, under the Corporate Governance structure, the Audit Committee is a sub-committee to which the Board delegates certain of its key supervisory functions. In an investigation of non-U.S. companies trading shares in the U.S. market, Mohiuddin (2012) discovered that Audit Committee effectiveness can solve overseas company agency issues no matter which Corporate Governance pattern is followed in the home nation of the company (Corporate Governance models are discussed in 2.4 of this chapter). Firms with Audit Committees' effectiveness, in terms of composition and functioning, experience fewer levels of intensity of agency problems than those that do not have effective ACs (Block, 2012). Klein (1998) argued that Audit Committee reduced the agency problem by promptly allowing shareholders, creditors, and so forth to share unbiased accounting data by executives, thereby decreasing data asymmetry across insiders and external parties. Since executives do not often communicate with shareholders, this communication lacuna can lead to a distance in terms of confidence. The Audit Committee can serve as a bridge to this gap. Audit Committees can help to maintain contact between management and its shareholders (Nölke et al., 2015). Because the Audit Committee mainly works with oversight, it is more theoretically explained by the agency than by the other theories that affect a company's performance (Bédard, Coulombe, & Courteau, 2008; Mamun, Yasser, & Rahman, 2013). In view of all that has been mentioned so far, one may suppose that effective Audit Committees were recognised as an effective mechanism by researchers and practitioners to minimise the agency conflict in a company.

### **2.2.2 Stewardship Theory**

Davis, Schoorman, and Donaldson (1997b) defined this theory as *“a steward protects and maximises shareholders' wealth through firm performance because by so doing, the steward's utility functions are maximised”*. This theory stems from psychology and sociology and is distinct from agency theory in that it does not stress on the perspective of individualism (Donaldson & Davis, 1991), but rather on the role of top management, as stewards in an organisation, integrating their goals with that of the organisation and being satisfied and motivated only when organisational

success is attained. As a basis for a Corporate Governance framework, the stewardship theory suggests that management and board members in an organisation are motivated by some larger force than the desire for personal wealth. Agency theory argues that shareholder interests require protection by separation of incumbency of roles of board chair and CEO. However, on the other hand, stewardship theory argues shareholder interests are maximised by shared incumbency of these roles (Abid, Khan, Rafiq, & Ahmed, 2015). In this framework, stewards are company executives and managers who work for the shareholders and protect and make profits for them. Unlike the agency theory, the stewardship theory does not stress on the perspective of individualism (Van Puyvelde, Caers, Du Bois, & Jegers, 2012) but rather on the role of top management, as stewards in an organisation, integrating their goals with that of the organisation and being satisfied and motivated only when organisational success is attained.

There is, however, a large volume of published studies describing both agency and stewardship theory as being similarly pertinent to Corporate Governance issues; for example, Kashif (2008), in his study of two distinct financial markets (i.e. Malaysian and Australian) concluded that both theories are pertinent to Corporate Governance. Donaldson and Davis (1991) found that company returns have improved by combining both theories, rather than using one of the two.

Gilson and Gordon (2013) argues that stewardship theory assumes that agents have access to superior information and since principals cannot always monitor the activities of these agents, there is ample room for agents to take advantage and maximise their own interests at the expense of principals. Lastly, Davis, Schoorman, and Donaldson (1997a) construed that principals who are not directly involved in the day-to-day running of companies essentially feel at a disadvantage compared to agents with access to more information.

### **2.2.3 Stakeholder Theory**

Stakeholder theory was established in the field of leadership in 1970 and evolved by Freeman (2010) increasingly to include corporate responsibility in a large number of stakeholders. The theory of the stakeholders was based on a mixture of sociology and organisational disciplines (Greenwood & Van Buren III, 2010).

Stakeholder theory can be defined as *“any group or individual who can affect or is affected by the achievement of the organisation’s objectives”* (Freeman, 2010). Contrary to the agency theory,



where executives serve shareholders, stakeholder theory indicates management in organisations, including suppliers, employees, creditors, community, and company partners; thus having a network of interactions to serve. Some advocates of this theory even go as far as including the environment and future generations. This network component has been asserted to be important unlike the connection between owner-manager and employee in agency theory. Under this theory, managers should be cognisant of their decisions, as they impact a wider variety of constituents (Siebels & zu Knyphausen-Aufseß, 2012). The theory presupposes a collective and relational approach to business practice (Fassin, 2012).

Freeman, Wicks, and Parmar (2004) captured this theory's essence in two key questions (i) what the purpose of the firm is? and (ii) what is the responsibility of the management of the firm to its stakeholders?

#### **2.2.4 Transaction Cost Theory**

The theory of transaction costs has been a multidisciplinary law, economic, and organisational alliance. This theory attempts to view the company as an organisation that includes individuals with distinct opinions and goals (Lahti, Wincent, & Parida, 2018). Transaction cost theory is part of the New Institutional Economics research tradition. This theory has become a key element in analysing a broad spectrum of strategic and organizational problems that are of great significance for companies (Pearce, 1997).

Like agency theory, transaction cost theory also addresses the questions of how individual interests of owners as well as management can be coordinated in order to safeguard the shareholders' best interests. But one of the basic distinctions between agency theory and transaction cost theory is that the former considers that managers pursue their perquisites while the latter describes how managers are often opportunistic. As suggested by Williamson (1996), the central idea of transaction costs is for corporations in every transaction they perform to have enormous financial costs and associated economic advantages.

Larbs (2010) said: *“Transaction cost theory is based on the fact that companies have become so large and complex that price movements outside companies direct production and the markets coordinate transaction”*. Williamson (1996) pointed out: *“Transaction cost theory has been developed to facilitate an analysis of the comparative costs of planning, adapting and monitoring*

*task completion under alternative governance structure*". The Williamson (1996) research stated that the transaction cost theory assessment unit is a transaction when a commodity or service is transmitted across a distinct technology interface. The transaction cost theory is based on two human factors, according to Williamson (1996); first of all on limited rationality and opportunism, and then on three environmental variables, namely, on uncertainty, small numbers in trade, and assets.

The principal focus of transaction cost theory is the definition of determinants of market or hierarchical coordination of operations. In this context, the corporate limits should depend on the governance framework (Williamson, 2005), particularly as this governance structure ensures the company's ideal adaptability to modifications in supply and demand circumstances. One significant element of transaction cost theory is the fact that the focus is not only on the two ends of transaction management (hierarchy versus industry) but also on other hybrid forms and long-term contracts.

The transaction cost theory claims that market transaction costs may be lowered by processes other than the markets (Henten & Windekilde, 2016). Specifically, there are costs to "drafting, negotiating, and safeguarding any exchange or transaction" that is "friction" impeding smooth transactions (Hennart, 2010). Transaction cost theory argues that these transaction costs are as essential as the cost of manufacturing or perhaps more important.

Transaction costs are a significant component of the company's complete costs, as manufacturing expenses are much more simple than transaction costs. Transaction costs include ex-ante search and data costs, contract drafting and bargaining costs, and contract protection costs. The ex-post expenses involve the cost of input evaluation, output measurement, control, and implementation (Hennart, 2010).

## **2.3 The Concept of Corporate Governance**

The concept of Corporate Governance is a vast subject that enjoys a long and rich history. It's a topic that incorporates managerial accountability, board structure, and shareholder rights. The issue of governance began with the beginning of corporations, dating back to the East India Company, the Hudson's Bay Company, the Levant Company, and other major chartered companies during the 16th and 17th centuries (Cheffins, 2013). While the concept of Corporate

Governance has existed for centuries, the name didn't come into vogue until the 1970s (Tricker & Tricker, 2015). It was a term that was only used in the US. The balance of power and decision-making between board directors, executives, and shareholders has been evolving for centuries. The issue has been a hot topic among academic experts, regulators, executives, and investors (Geis, 2015).

After World War II, the US experienced strong economic growth, which had a strong impact on Corporate Governance history. Corporations were thriving and proliferating. Managers primarily called the shots, and board directors and shareholders were expected to follow (Veldman & Willmott, 2017). In most cases, they did. This was an interesting dichotomy since managers influenced the selection of board directors highly. Unless it came to matters of dividends and stock prices, investors tended to steer clear from governance matters (Kim, Sung, & Wei, 2011).

In the 1970s, things began to change as the Securities and Exchange Commission brought Corporate Governance to the forefront when they brought a stance on official Corporate Governance reforms. In 1976, the term "corporate governance" first appeared in the Federal Register, the official journal of the United State's federal government (Jacoby, 2018).

In the 1960s, the Penn Central Railway had diversified by starting pipelines, hotels, industrial parks, and commercial real estate. Penn Central filed for bankruptcy in 1970 and the board came under public fire. In 1974, the Securities Exchange Commission ((PSACF)) brought proceedings against three outside directors for misrepresenting the company's financial condition and a wide range of misconduct by Penn Central executives. Around the same time, the SEC caught on to widespread payments by corporations to foreign officials over falsifying corporate records. During this era, corporations started to form Audit Committees and appoint more outside directors. In 1976, the SEC prompted the New York Stock Exchange (NYSE) to require each listed corporation to have an Audit Committee composed of all independent board directors, and they complied. Advocates pushed to get governance right by requiring Audit Committees, nomination committees, compensation committees, and only one managerial appointee (Cheffins, 2013).

The 1980s brought an end to the 1970s movement for Corporate Governance reform due to a political shift to the right and a more conservative Congress. This era brought much opposition to deregulation, which was another major change in Corporate Governance history. Lawmakers put

forth The Protection of Shareholders' Rights Act of 1980, but it was stalled in Congress, was later approved, and published in 1994 (Griffith, 2015). Scholars maintained that market mechanisms would keep managers and shareholders aligned.

The 1980s was also referred to as the "Deal Decade." Institutional shareholders grabbed more shares, which gave them more control. They stopped selling out when times got tough. Executives went on the defensive and struck deals to prevent hostile takeovers. State legislators countered takeovers with anti-takeover statutes at the state level (Griffith, 2015). That, combined with an increased debt market and an economic downturn, discouraged merger activity. The Institutional Shareholder Services (ISS) was formed to help with voting rights. Shareholders struck back with legal defenses, but judges often favored corporate decisions when outside directors supported board decisions. Investors started to advocate for more independent directors and base executive pay on performance rather than corporate size.

The idea of Corporate Governance was quickly adopted in different parts of the world but with some major variations because circumstances vary from country to country (Claessens & Yurtoglu, 2013). Consequently, varieties of Corporate Governance frameworks were developed. Nevertheless, two main approaches of Corporate Governance can be identified, with distinctions arising from the different legal systems at work in different countries (Aguilera & Jackson, 2010). Countries that followed civil law (e.g., France, Germany, Italy, and the Netherlands) developed Corporate Governance frameworks that focused on stakeholders. In those countries, the role of Corporate Governance was to balance the interests of various key groups such as employees, managers, creditors, suppliers, customers, and the wider community (Solomon & Solomon, 2004). This approach was known as the insider model of corporate control as it recognised that the greatest control in a firm was held by those who were closest to its actual workings (Department of Treasury, 1997).

On the other hand, countries that had a tradition of common law (e.g., Australia, United Kingdom, USA, Canada, and New Zealand) developed Corporate Governance structures that focussed on shareholders' returns or interests. In their case, Corporate Governance was supposed to ensure that corporations achieved the objectives set by their owners. Moreover, shareholders could hold a firm's management responsible for attaining the firm's goals, including profits. This approach was

known as the outsider model of corporate control as it recognised the distance between the management of a firm and its owners (Department of Treasury, 1997).

Although the two approaches to Corporate Governance were different, they had a few similarities. For example, they held that the management boards of firms were to be elected by shareholders to set policies and then delegate to management the authority to manage the firms (Hilmer, 1998). In any case, most countries adopted Corporate Governance systems that were a mixture of the two extreme forms (Aguilera & Jackson, 2010).

The adoption of the Corporate Governance philosophy does not necessarily prevent corporate failures and scandals. Enron and WorldCom in the US, the Golden Quadrilateral in India and Saambou Bank, and Fidentia in South Africa are examples of noticeable corporate collapses. These corporations were accused because of their fraudulent accounting practices, weak regulations, and a general lack of business ethics (Marx, 2008). This era also became a wake-up call for many in emerged economies or countries because preceding these high profile collapses and insolvencies; numerous critics had only blamed emerging countries for lack of disclosure, transparency, and poor Corporate Governance practice (Kakabadse, Kakabadse, & Kouzmin, 2003). Consequently, there has been a debate about what needs to be included in a comprehensive Corporate Governance framework. The requirement for robust Corporate Governance is demonstrated by the numerous Corporate Governance standards and reforms which were advanced at both international and, of late, national levels, such as: the Sarbanes-Oxley Act in the U.S.A., Corporate Law Economic Reform Programme Act 2004 [CLERP 9] in Australia, Combined Code in the U.K., the Organisation for Economic Co-operation and Development [OECD] Code, and King I to IV in South Africa. The urgency of Corporate Governance gained thrust as a result of the ongoing global economic recession, and it is now a first-order issue in most of the economies where firms are often run by controlling shareholders (Albuquerque & Wang, 2008). More corporations in an increasing number of countries are progressively attempting to adopt better Corporate Governance practices (Garay & González, 2008). The history of Corporate Governance continues to be rewritten. How we define Corporate Governance will continue to be in a state of evolution in the coming years.

## **2.4 Corporate Governance Guidelines**

While it can be pointed out that the development of the codes and guidelines on Corporate Governance has been largely driven by widespread corporate collapse, financial crisis or similar crises (Mallin, 2012), however, there is no universal code of Corporate Governance, as various countries and international organisations have developed their own guidelines that they follow in the context of different countries (Hussain & Mallin, 2002). Several countries, over the two decades, have either introduced or revised Corporate Governance codes. Although with the noted differences between these codes, the aims are similar: increasing investor confidence and ensuring accountability and transparency. Contemporary discussions of Corporate Governance tend to refer to principles raised in three documents released since 1990: (i) The UK Corporate Governance Code (formerly known as the Combined Code) is a combination of various codes and reports of Corporate Governance since 1992, (J. Chen, Duh, & Shiue) The Organisation for Economic Co-operation and Development (OECD) are principles which were originally issued in 1999 and last updated in 2004 and (iii) The Sarbanes-Oxley Act of 2002 (commonly known as the Sarbanes–Oxley, Sarbox or SOX), enacted July 30, 2002. Also noted is the South African King Report on Corporate Governance, a ground-breaking booklet of guidelines for the governance structures and operation of companies in South Africa. Three further reports were issued since the first one in 1994 (King I), 2002 (King II), and 2009 (King III) and a fourth revision (King IV) in 2016.

### **2.4.1 The UK Corporate Governance Code**

The Code is essentially a consolidation and refinement of a number of different reports and codes concerning opinions on good Corporate Governance. The first step on the road to the initial iteration of the code was the publication of the Cadbury Report in 1992, which comes from Sir Adrian Cadbury, who chaired the Financial Aspects of Corporate Governance Committee of the United Kingdom (1992). The report was a reaction to the big business scandals linked to failures in governance in the UK. The Committee was established in 1991 following the insolvency of Polly Peck, a significant UK corporation, after years of false financial reports. The work of the Cadbury Committee has been groundbreaking, according to Garay and González (2008). The Cadbury report was based on the USA Treadway report's work but was a benchmark in many nations for corporate leadership (Monks & Minow, 1996).

Good Corporate Governance, the Cadbury report says, must cover four main elements, namely:

- i. Creation of a board of directors whose roles as directors or leaders vary from those of the executives of the firm.
- ii. Checks and balances in governance structures that have no unrestricted power to one person.
- iii. Having a well-balanced executive and non-executive board team.
- iv. Ensure that a committee manages and controls an organisation transparently (Jones & Pollitt, 2004).

At first, restricted to preventing economic fraud, the mandate of Cadbury remit was expanded to Corporate Governance in general when the Bank of Credit and Commerce International (BCCI) and Robert Maxwell scandals took place. The final report discussed financial, auditing, and Corporate Governance, and included three fundamental guidelines such as the separation of the CEO and Chairman of businesses; at least three non-executive directors should be on boards, two of whom should not have economic or personal relations to executives; and each board should have an Audit Committee composed of non-executive directors (Jones & Pollitt, 2004).

Initially, these suggestions were very contentious, even though they reflected modern “best practice” and encouraged them to extend throughout listed companies. At the same time, Cadbury emphasised that there was no such thing as “one size fits all.” In 1994, principles were annexed to the London Stock Exchange listing rules, and it was provided that companies were not required to comply with the principles but were required to explain why not to the stock market if they did not.

As a ‘research group’ on the executive compensation a further commission chaired by Sir Richard Greenbury, President of Marks & Spencer, was established shortly. It replied to public anger and to Prime Minister John Major's vague statements that regulation may be needed in spiraling executive pay, notably in privatised public utilities. The Greenbury Report came into force in July 1995. This suggested further modifications to the current Cadbury Code principles that each board should have a remuneration committee composed without executive directors, but possibly a

chairman; and directors should have long term performance-related pay, which should be reviewed annually in corporates and renewable accounts and agreements (Greenbury, 1995).

In 1998, Sir Ronald Hampel, who was Chair and Executive Director of ICI plc, chaired the third committee and suggested progress be reviewed every three years. The Hampel report then proposed consolidation of all the Cadbury and Greenbury principles into a “Combination Code.” The report added that the Board Chairman ought to be viewed by non-executive directors as the "leader"; institutional investors should consider voting for their shares in meetings, although the compulsory vote was refused and all forms of remuneration should be revealed, including pensions (Greenbury, 1995).

The concept was dismissed that the UK should follow the German two-tier board's structure or reforms in the EU Draft Fifth Directive on Company Law. The Turnbull Committee created a further mini-report the following year, recommending that managers be liable for inner financial and audit controls. During the next decade, several additional reports were released, including, in particular, the Higgs review by Derek Higgs, which focused on the activities of non-executive directors and the challenges posed by the collapse of Enron in the USA (Nordberg & McNulty, 2013). Paul Myners also finished a series of two main reviews on the institutional investors' position in the Treasury. Shortly after the crash of Northern Rock, the Walker Review created a banking industry-oriented report and suggestions for all businesses. In 2010, the Financial Reporting Council published a fresh Stewardship Code and a fresh version of the British Corporate Governance Code, which separates the problems.

The UK Corporate Governance Code comprises principles on five broad sections, which are (F. R. Council, 2012):

### **Section A: Leadership**

- An effective board, which is jointly accountable for the company's long-term achievement, should be each firm's leadership.
- The head of the company should clearly split the duties between the management of the board and its management. Nobody should have unrestricted decision-making powers.



- The Chairman is liable for the management and efficiency of the Board in all elements of its role.
- Non-executive managers should constructively challenge and assist create strategic ideas as part of their role as members of a unitary board.

### **Section B: Effectiveness**

- For the Board and its committees to efficiently discharge their corresponding responsibilities and obligations, they must have the suitable equilibrium of competencies, experience, independence, and expertise.
- The appointment of new directors to the board should be formal, strict, and transparent.
- Every director should be able to allocate the company enough time to fulfill its responsibilities effectively.
- All directors should be encouraged to join the board and frequently update and refresh their expertise and abilities.
- The board should receive the information in the appropriate form and quality in a timely manner in order to fulfill its duties.
- In order to ensure its own effectiveness and that of its boards and directors, the board must conduct a formal and thorough annual assessment.
- Subject to continuous satisfactory results, each director should be nominated for re-election on a periodic basis.

### **Section C: Accountability**

- The board should present an evaluation of the company's position and prospects that is balanced and understandable.
- In order to achieve its strategic goals, the Board has the responsibility to determine the nature and magnitude of significant risks to be taken by it. The board should maintain sound risk management and internal control systems.
- The board should set up official and transparent agreements to examine how corporate reporting, risk management, and internal control principles should be applied and maintain a proper connection with the company's auditor.

## **Section D: Remuneration**

- Remuneration levels should be adequate to attract, maintain, and incite the directors of the quality needed for the business's successful management. A substantial share of management's salaries should be organised so that the benefits are linked to corporate and individual results.
- The development of management remuneration policy and the fixing of individual directors' remuneration packages should be formal and transparent. No director should decide on his or her own salary.

## **Section E: Relations with Shareholders**

- A dialogue with shareholders should be established, based on mutual comprehension of goals. It is the duty of the board as a whole to ensure a satisfactory dialog with shareholders.
- To interact with investors and promote involvement, the Board should make use of the AGM.

### **2.4.2 The Organisation for Economic Co-operation and Development (OECD)**

The OECD Corporate Governance Principles, initially introduced in 1999 and adopted by the 30 OECD members (presently 36), have become a benchmark for nations across the globe. As a result of a thorough review process that led to the implementation of the OECD revised Corporate Governance Principles in the spring of 2004, it now reflects a worldwide consensus on the critical significance of excellent Corporate Governance to contribute to our economies' financial vitality and stability (Baker, 2012). Good Corporate Governance rules and procedures governing the relationship between corporate managers and shareholders and stakeholders, such as staff and creditors - support the development and financial stability through supporting market trust, financial market integrity, and economic efficiency. Recent company scandals have also brought out faults in Corporate Governance structures and the need to tackle this problem to the minds of governments, regulators, firms, investors, and the general public (Bruner, 2010).

The OECD's Corporate Governance principles provide particular advice on enhancing the legal, institutional, and regulatory environment underpinning Corporate Governance for policymakers, regulators, and market participants, focusing on publicly traded companies. They also offer practical advice and suggestions for stock exchanges, investors, companies, and others that play a part in sound management development. They were approved as part of financial stability (Bruner, 2010). Forum 12 main economic stability requirements; The OECD Principles are a global Corporate Governance benchmark and form the foundation of several government and private sector reform projects. The OECD started a review of the principles in 2003 in the process of comprehensive and open consultations to take account of the latest developments. In April 2004, the OECD governments decided upon the new Principles (Backer, 2011).

The overhaul of the Principles reflects the OECD countries' experience and that of emerging and developing economies and those engaged in the Regional Corporate Governance policy dialogue. OECD-created roundtables in partnership with the World Bank Group: The Roundtables held first in Asia, Eurasia, Latin America, Russia, and Southeast Europe held consultations with non-member nations. The lessons and findings of this job have been summarised in the publication *“Experiences from the Regional Corporate Governance Roundtables”* (OECD, 2004).

The OCED Principles offer advice in six sections through suggestions and annotations (OECD, 2004):

### **I. Ensuring the basis for an effective corporate governance framework**

This section discusses the role of Corporate Governance in encouraging transparent and equitable markets and effective resource allocation. The focus is on the quality and consistency of the various legislation components that affect Corporate Governance and the division of duties between authorities. The quality of oversight and implementation is being emphasised in specific. In addition, the section provides a fresh concept on the role of stock markets in promoting good governance.

### **II. The rights and equitable treatment of shareholders and key ownership functions**

This section defines shareholders' fundamental rights, including the right to information and involvement in important business choices through the shareholder meeting. The section also discusses the disclosure of control structures, such as various voting rights. New problems in this

section include the use of IT at shareholder meetings, the approval processes of related parties, and shareholder involvement in executive compensation choices.

### **III. Institutional investors, stock markets, and other intermediaries**

This is a fresh chapter that focuses particularly on institutional investors acting in a fiduciary position on the need for good financial rewards throughout the investment chain. It also discusses the need to identify and minimise disputes of interest which may jeopardise the integrity of proxy consultants, analysts, brokers, rating agencies, and others who provide investor-related assessment and guidance. It also includes fresh concepts regarding cross-border listings and the significance of fair and efficient stock market price discovery.

### **IV. The role of stakeholders in corporate governance**

This section discusses the principles that promote active co-operation among companies and stakeholders and highlight the significance of the recognition of the freedoms of legal and mutual contracts between stakeholders. The section also promotes prompt and regular access of stakeholders to information and their rights to remedy violations of their rights.

### **V. Disclosure and transparency**

This section defines key disclosure fields, such as economic and business outcomes, business goals, significant shareholdership, remuneration, transactions between related parties, risk factors, board members. New problems in this section include recognition of latest trends in non-financial data products which businesses can include voluntarily in their management reports, for instance.

### **VI. The responsibilities of the board**

This section offers advice on the board's important functions, including corporate strategy evaluation, leadership selection and compensation, the control of important corporate acquisitions and disposals, and the integrity of the corporate accounting and financial reporting systems. The board of directors' role in risk management, tax planning, and internal audit are new issues in this chapter. In addition, there is a latest principle that recommends board training and assessment and a recommendation for considering setting up specific board committees in fields like remuneration, audit, and risk management.

### **2.4.3 The Sarbanes-Oxley Act**

They were enacted as a reaction to a number of major corporate and accounting scandals, including those affecting Enron, Tyco International, Adelphia, Peregrine Systems, and WorldCom. These scandals cost investors billions of dollars when the share prices of affected companies collapsed and shook public confidence in the US securities markets. In 2002, Sarbanes-Oxley was named after bill sponsors U.S. Senator Paul Sarbanes (D-MD) and U.S. Representative Michael G. Oxley. As a result of SOX, top management must certify the accuracy of financial information individually. In addition, penalties for fraudulent financial activity are much more severe (Cuebas, 2010). Also, SOX increased the oversight role of boards of directors and the independence of the outside auditors who review the accuracy of corporate financial statements (Jeffrey Cohen, Krishnamoorthy, & Wright, 2010).

The SOX Act provides for certain important clauses on Corporate Governance, for example:

- The need to establish a separate Audit Committee (section 301).
- A company's senior management and financial officers sign a statement that adequate internal controls are in place to ensure that the financial statements do not contain any material misstatements (section 302).
- Independence of External Auditors (sections 201-209).

The SOX Law requires that the majority of independent directors to be held by listed companies. The argument is that, when the majority of directors are from management, the Board acting as a representative of the shareholders is not seen as objective in supervising the management (Jeffrey Cohen et al., 2010).

The act contains eleven titles or sections, ranging from additional corporate board responsibilities to criminal penalties, and requires the Securities and Exchange Commission to implement rulings on requirements to comply with the law. Harvey Pitt, the 26th chairman of the SEC, led the SEC in the adoption of dozens of rules to implement the Sarbanes-Oxley Act. It created a new, quasi-public agency, the Public Company Accounting Oversight Board, charged with overseeing, regulating, inspecting, and disciplining accounting firms in their roles as auditors of public companies. The act also covers auditor independence, Corporate Governance, internal control

assessment, and enhanced financial disclosure. The nonprofit arm of Financial Executives International, Financial Executives Research Foundation, completed extensive research studies to help support the act's foundations.

#### **2.4.4 The King Report on Corporate Governance**

South Africa's governance framework was developed in July 1993, when Mervyn E. King (South African retired Supreme Court judge) was invited by the Institute of Managing Directors in Southern Africa (IoDSA), to chair a committee on Corporate Governance (Padayachee, 2017). His perspective was to educate South African people in the newly democratic way of developing a free economy. The Commission published its first report in 1994, King I, King II in 2002, King III in 2009 and recently King IV in 2016 to promote Corporate Governance in South Africa to the highest standards. The core foundation of Kings I, II, and III was ethical and effective leadership. King IV is also no different as its fundamental focus areas are ethical leadership; the role of the organisation and society; company citizenship; sustainable development; stakeholder inclusivity, and integrated thinking and integrated reporting (King IV Report, 2016).

#### **KING I**

In 1994, the first King's report on corporate governance (King I) for South Africa was released. It laid down guidelines for listed companies, banks, and some state-owned enterprises' boards and directors. It included, but also promoted, an integrated approach to both financial and regulatory aspects involving stakeholders. It was applicable to all companies listed on the Johannesburg Stock Exchange's main board, large public entities as defined by the Public Entities Act of South Africa; banks, financial and insurance companies as defined by the Financial Services Acts of South Africa; and large unlisted companies. It defined "large" as companies with shareholder equity over R50 million but encouraged all companies to adopt the code.

The first King report included these key principles such as the membership and mandate of board of directors include the role of non-executive directors and guidance on the categories of people to be composed of non-executive directors; Board appointments and guidance for Executive Directors on the maximum term; determination and disclosure of executive and non-executive director's remuneration; Board meeting frequency; balanced annual reporting; the requirement for

effective Barac & Williams, 2016 auditing; affirmative action programmes; and the company's code of ethics (King I Report, 2016).

## **KING II**

The updated Code of Governance was in effect in March 2002 when, at the Earth Summit in Johannesburg in 2002, King called for a review of the report (King II) that included new parts on sustainable growth, the role of the Corporate Board and risk management. In addition to those types of organizations mentioned in King I, departments of State or national, regional or local government administration falling under the local government were subject to: the Municipal Finance Management Act, and public institutions or functionaries exercising power or performing a constitutional function, or exercising public authority or performing a public function in relation to any legislative function. As before, it urges all businesses to follow the values of the Code.

The second King report had the fundamental principles such as directors and their responsibility, risk management, internal audit, integrated sustainability reporting, and accounting and auditing (King II Report, 2016).

## **Legislative Enforcement**

As in the past, the legislation does not enforce the code. It co-exists, however, with a number of legislation that applies to companies and directors, including the Companies Act. In addition, further enforcement takes place by regulations such as the JSE Securities Exchange Listings Requirements.

## **KING III**

In an interview with Mervin King, he felt that King II's study's report was incorrect to include sustainable development as a separate chapter and that it was reported independently of other factors by businesses. The King III Report 2009, covering governance, policy, and sustainability, was incorporated into the next edition. Instead of an annual financial report and a separate sustainability report, the report suggests that organizations generate a detailed report on their enterprises and that businesses establish sustainability reports according to the Sustainability Reporting Standards of the Global Reporting Initiative. King III is applicable to all public, private, and non-profit entities as opposed to the earlier versions. King encourages all entities to adopt and

explain King III's principles as to whether or not these principles were applied. Since March 2010, the governance code has been applicable.

The report included a number of emerging global trends in governance such as alternative dispute resolution, risk-based internal audit, shareholder approval of non-executive directors' remuneration, and evaluation of board and directors' performance (King III Report, 2016).

A number of new principles were also incorporated to deal with elements previously not in the King reports: IT governance, business rescue, and fundamental and affected transactions in terms of the director's responsibilities during mergers, acquisitions, and amalgamations.

Once again, the legislation does not enforce the Corporate Governance Code. However, due to South African legislation evolutions, the Companies Act of South Africa of 2008 incorporated many of the principles set out in King II as law. There are also statutes applicable to certain King III principles in addition to the Companies Act, like the Public Finance Management Act and the Promotion of Access to Information Act.

- Integrated reporting
- The United Nations Global Compact and the Principles for Responsible Investment
- OECD Guidelines for Multinational Companies
- Global Reporting Initiative's G3 guidelines
- The United Kingdom Companies Act of 2006 (King IV Report, 2016).

## **KING IV**

On 1 November 2016, the King's Committee released the King IV Report on Corporate Governance for South Africa 2016 (King IV). With regard to financial years starting on or after 1 April 2017, King IV was successful. King IV fully replaced King III.

The new version was built on King III principles, but is more principle-driven and follows a methodology based on findings rather than law. This is in line with the new international sentiment that encourages greater openness and accountability. Since King III was released, there have been major Corporate Governance and regulatory changes, locally and internationally. While South African listed companies primarily implemented King III, other organizations have encountered difficulties in understanding and adapting the Code to their specific circumstances. The King IV Code is designed as a system that can be more readily extended to both listed and unlisted



enterprises, profit and non-profit organizations, as well as to private and public bodies. Additional guidance for different types of organizations and industries, such as small and medium-sized organizations, non-profit organizations, public sector organizations and departments, **municipalities**, and pension funds, is now included in the King IV Report.

King IV has the following elements: practices, principles, and governance outcomes. The practices are recommended at an optimum level of Corporate Governance and should be adopted by each organisation to achieve the principle. The governance outcome is the positive effect or benefits of good Corporate Governance for the organisation, and includes ethical culture, performance and value creation, adequate and effective control and trust, good reputation, and legitimacy.

King IV's philosophy is focused on ethical and effective leadership, company's role and responsibility in society, corporate citizenship; sustainable development; stakeholder inclusivity and responsiveness, and integrated reporting and integrated thinking. The 75 King III principles have been consolidated into 17 principles in King IV, each linked to very distinct outcomes (King IV Report, 2016)

## **2.5 Audit Committee Guidelines**

Some international guidelines recommend different aspects of an Audit Committee (including its composition, process, roles, and functions). Among these, the U.K. Combined Code on Corporate Governance (2003), the Treadway Report (1987), the BRC Report (1999), and the Sarbanes-Oxley Act (2002) are well recognised. In South Africa is the KING Report. A summary of these guidelines is presented in the following sub-sections:

### **2.5.1 The Combined Code on Corporate Governance for the UK**

The Combined Code on Corporate Governance (Combined Code) is a set of sound Corporate Governance principles and provides a code of best practice, which is aimed at companies listed on the London Stock Exchange (LSE). It is essentially a consolidation and refinement of a number of different reports and codes concerning opinions on sound Corporate Governance, including the Cadbury Committee (1992), the Greenbury Committee (1995), the Hampel Committee (1998), and the Turnbull Committee (1999). As already stated in Chapter Three, the Combined Code was

issued in 2003 in order to provide guidance on some key aspects of Corporate Governance, namely: directors, remuneration, accounting and auditing, and relations with shareholders. The Code is reviewed and updated on a regular basis by the Financial Reporting Council (FRC). Section C(3) of the Code outlines that the board should establish formal and transparent arrangements in Audit Committee's name for considering how they should apply the financial reporting and internal control principles and maintain an appropriate relationship with the company's auditors. A comprehensive guideline on Audit Committee practices has been given in the following six subsections (Combined Code, 2003; FRC, 2008):

- a) The board should establish an Audit Committee of at least three, or in the case of smaller companies, two independent non-executive directors. In smaller companies, the company chairman may be a member of, but not chair of the committee, in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the Audit Committee has recent and relevant financial experience.
- b) The main role and responsibilities of the Audit Committee should be set out in written terms of reference and should include:
  - Monitoring the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance;
  - Reviewing significant financial reporting judgments contained in them;
  - Reviewing company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;
  - Monitoring and review the effectiveness of the company's internal audit function;
  - Making recommendations to the board, for it to put to the shareholders for their approval in a general meeting, in relation to the appointment, re-appointment, and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
  - Reviewing and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant U.K. professional and regulatory requirements; and

- Developing and implementing policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed.
- c) The terms of reference of the Audit Committee, including its role and the authority delegated to it by the board, should be made available. A separate section of the annual report should describe the work of the committee in discharging those responsibilities.
- d) The Audit Committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.
- e) The Audit Committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the Audit Committee should consider whether there is a need for an internal audit function and make a recommendation to the board. The reasons for the absence of such a function should be explained in the relevant section of the annual report.
- f) The Audit Committee should have primary responsibility for making a recommendation on the appointment, reappointment, and removal of the External Auditors. Suppose the board does not accept the Audit Committee's recommendation. In that case, it should include in the annual report (and in any papers recommending appointment or re-appointment) a statement from the Audit Committee explaining the recommendation. It should set out reasons why the board has taken a different position.

### **2.5.2 The Treadway Report**

In 1987, the Treadway Report in the U.S.A. (known as the Report of the National Commission of Fraudulent Financial Reporting), offered the following eleven recommendations to enhance the effectiveness of Audit Committees, which were to be the foundation of corporate financial governance (Vanasco, 1994; Vinten, 2003; and Alleyne, 2006):

- The Audit Committee should have adequate resources and authority to discharge its responsibilities;

- The Audit Committee should be informed, vigilant, and effective overseers of the company's financial reporting process and its internal control system;
- The Audit Committee should review management's evaluation of the independence of the company's public accountants;
- The Audit Committee should oversee the quarterly as well as the annual reporting process;
- The SEC should mandate the establishment of an Audit Committee composed solely of independent directors in all public companies;
- The SEC should require the Audit Committees to issue a report describing their responsibilities and activities during the year in the company's annual report to shareholders;
- A written charter for the Audit Committee should be developed and the BoDs should approve, review, and revise it when necessary;
- Before the beginning of each financial year, the Audit Committee should review management's plans to engage the company's independent public accountant to perform management advisory services;
- Management should inform the Audit Committee of second opinions sought on significant accounting issues;
- Together with top management, the Audit Committee should ensure that internal auditing involvement in the entire financial reporting process is appropriate and properly co-ordinated with the independent public accountant; and,
- Annually, the Audit Committee should review the programme that management establishes to monitor compliance with the company's code of ethics.

### **2.5.3 The Blue Ribbon Committee**

The Blue Ribbon Committee (BRC), co-chaired by John Whitehead and Ira Millstein, was set up on 6 October 1998 by the Security and Exchange Commission ((PSACF)), the New York Stock Exchange (NYSE), and the National Association of Securities Dealers (NASD) in response to the concern expressed by Arthur Levitt, the chairman of the SEC, about the financial reporting process. In February 1999, the committee issued its report with some recommendations designed to (Blue Ribbon Committees, 1999):

- a) Strengthen the independence of Audit Committees;
- b) Increase the effectiveness of Audit Committees; and,
- c) Improve the relationship between boards and their Audit Committees, the activities of auditors, and management.

In December 1999, the SEC approved changes to its rules to implement several of the BRC's recommendations with respect to Audit Committee composition and practices. The seven board areas of Audit Committee on which the committee recommended are (Blue Ribbon Committees, 1999):

- a) Independence of the Audit Committee;
- b) Financial literacy of Audit Committee members;
- c) Audit Committee structure and process;
- d) Audit Committee relationship with management including the internal auditor and with the outside auditor;
- e) Practical improvements to Audit Committee oversight and enhancing the External Auditors' interaction with the Audit Committee;
- f) Instituting Audit Committee disclosure; and,
- g) Mandatory audit of the interim financial reporting.

#### **2.5.4 The Sarbanes-Oxley Act**

The Sarbanes-Oxley Act of 2002 (the Act) was approved by the U.S. House of Representatives by a vote of 423:3, and by the U.S. Senate by a vote of 99:0. It was signed into law on 30 July 2002 by the then-president George W. Bush (Murphy & Jensen, 2018). The main purpose of the Act was to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and for other purposes. The Act, more commonly referred to as SOX, was named after its sponsors, Senator Paul Sarbanes and Representative Michael Oxley. The fundamental groundwork of the Act is to provide investors and the public with increased trust in accounting and financial reporting. Throughout this review, various components of the Sarbanes-Oxley Act of 2002 are explored in greater detail, predominantly those dealing with Corporate Governance and internal controls. Discussions with practicing certified public accountants, along with opinions from other professionals in the business community, helps to assess the effectiveness and ultimate usefulness of the Act's fundamental objectives (Asare et al., 2013).

The Sarbanes-Oxley Act was created to protect investors' interests by improving the accuracy and reliability of corporate disclosures (Singer & You, 2011). The Act requires companies to make new disclosures on internal controls, ethics codes, and the composition of their Audit Committees on annual reports. Thus, these stringent requirements force companies to be more thorough about ensuring the validity of their financial reporting process. Under the Act, a five-member board will oversee auditors. Accounting firms are not allowed to provide other services to companies whose accounts they audit, and independent directors must sit on the Audit Committees. The Act states that an Audit Committee is a committee established by, and amongst, the BoDs of a company, for the purpose of overseeing the accounting, financial reporting process, and audits of the financial statements. Jeffrey Cohen et al. (2010) stated that the Sarbanes-Oxley Act enacted the following six requirements for the Audit Committees:

- The Audit Committee should be composed entirely of independent members of the BoDs;
- The Audit Committee should be directly responsible for the appointment, compensation, and oversight of the work of External Auditors;
- The Audit Committee should have the authority to engage advisors;
- The Audit Committee should be properly funded to carry out its duties effectively;
- The auditors must report to the Audit Committee on all critical accounting policies and practices' used by the client; and
- The SEC should issue rules requiring public companies to disclose whether at least one member of their Audit Committee is a 'financial expert'.

### **2.5.5 The KING Report**

King IV is structured as a Report that includes a Code, with additional, separate sector supplements for **Municipalities**, SMEs, NPOs, State-Owned Entities, and Retirement Funds. Municipalities in South Africa are not legally required to abide by the KING IV. However, the King Code contains both principles and recommended practices aimed at municipalities achieving good governance outcomes.

Whilst King IV is voluntary (unless prescribed by law or a stock exchange Listings Requirement) it is envisaged that it will be applicable to all organisations irrespective of their form or manner of

incorporation. The King Code principles of good governance are presumed to apply, whilst the practices should be applied on a ‘proportionality’ basis depending on the nature, size, and complexity of the organization. The functions performed by municipalities are derived from the Constitution of the Republic of South Africa, 1996 (the Constitution). The structural and institutional arrangements are different for the different types of municipalities, namely metropolitan, district, and local municipalities. The common feature is that they are accountable to the community they serve. In terms of section 152 of the Constitution the objects of local government (which consists of municipalities) are (King IV Report, 2016):

- to provide a democratic and accountable government for local communities
- to ensure the provision of services to communities in a sustainable manner
- to promote social and economic development
- to promote a safe and healthy environment, and
- to encourage the involvement of communities and community organisations in the matters of local government.

In order to apply the King IV Code to municipalities without having to repeat it in its entirety, it is necessary to explain how the terminology used in the Code could be interchanged for terminology applicable to municipalities. Although leadership structures in municipalities are not directly comparable to that of other organisations, the following can be used as a guideline when interpreting the terminology in the King IV Code in a municipal context:

**Table 3.1: Terminology in the King IV Code in a Municipal Context**

<b>A term used in King IV Code</b>	<b>The relevant term for municipalities</b>
Organisation	Municipality
Governing body	Municipal Council
Management	Administration
Members of the governing body	Councillors
Chair of the governing body	Speaker
CEO	The Municipal Manager or Accounting Officer
External auditor	Auditor General (AG) or accounting firm contracted to the AG
Shareholders	Municipalities do not have shareholders but can in many respects be equated to community members
Stakeholders	Primarily the community in which the municipality serves but including other stakeholders

Source: Wixley (2018)

The office of the mayor or executive mayor of a municipality does not have an equivalent in the King IV Code and in respect to these positions, the Structures Act and other pertinent legislation should be followed.



Audit Committee duties in relation to the appointment and independence of the auditor apply differently as the Auditor-General serves as the external auditor for a municipality. Furthermore, the composition of an Audit Committee of a municipality is prescribed by legislation and prevails over the recommended practices in the Code for the execution of the duties of the Audit Committee to provide substance to legislated duties.

King IV require Audit Committee members to be independent. Furthermore, it requires that the Audit Committee should, as a collective, have the necessary skill and experience to meet its obligations. The nominations committee should consider this prior to the AGM when they nominate members for the Audit Committee appointment. As a collective, the Audit Committee should have a good understanding of:

- internal financial controls
- external audit process
- internal audit process
- corporate law
- risk management
- sustainability issues
- integrated reporting, which includes financial reporting
- governance of information and technology
- the general governance processes within the company.

Audit Committees should regularly review their composition and membership to confirm that they encompass the knowledge and experience needed to be effective. In addition to industry knowledge, committee members should have a strong grasp of key financial reporting and accounting issues, such as going concern, revenue recognition, areas of significant judgement including goodwill measurements and accounting for intangible assets, pensions and other post-employment benefits, financial instruments, and other critical accounting policies, including how these policies compare to industry practices. Internal controls relevant to financial reporting are particularly important since these form the basis for the prevention and detection of fraud or error in financial reporting.

In order for the Audit Committee to function optimally, it is necessary for the members to be literate financially. Members of the Audit Committee should have a detailed understanding of financial reporting, which may include:

- An understanding of financial statements and international financial reporting standards (IFRS)
- an ability to assess the general application of IFRS in connection with the accounting for estimates, accruals, and reserves
- experience preparing, auditing, analysing or evaluating financial statements that present a breadth and level of complexity of accounting issues generally comparable to what can reasonably be expected to arise in the issuer's financial statements, or experience actively supervising those engaged in such activities
- an understanding of internal control over financial reporting
- an understanding of the Audit Committee's functions.

Lastly, King IV proposes that the names, qualifications, and experience of the members of the Audit Committee be disclosed. It is recommended that the disclosure should include information about the experience, qualifications, and attributes considered in the nomination process and the reasons individuals should serve on the company's board and / or Audit Committee.

#### **2.5.6 The Municipal Finance Management Act (MFMA)**

In South Africa, municipal finances consist of a range of systems which establish how funds are to be spent and to ensure that they are spent for the purposes for which they were allocated. They ensure that funds are spent within the realm of the law; thereby promoting public accountability. The Municipal Finance Management Act (MFMA) regulates the system as a whole. The act contains the appointment and all related functions of Audit Committees. When selecting members of Audit Committees, Council should take into account personal qualities, skills, and experience as well as independence – all of which are critical.

**Excerpt from National Treasury Circular 65 MFMA – Internal Audit and Audit and Audit Committee Qualities of members**

*One of the Audit Committee members should be appointed as the chairperson after the following factors have been considered:*

- Has good standing and ability to lead discussions;
- Creates a vision and provides direction at meetings;
- Builds municipal capabilities by guiding management based on expert knowledge and skills;
- Promotes and achieves quality outcomes at meetings;
- Has the ability to advise the Council or the BoD speedily and effectively of any impending non-compliance with the legislative framework;
- Has the ability to encourage other members to participate in Audit Committee meetings; and
- Conducts meetings in a manner that demonstrates a desire to establish effective communication with all stakeholders.

*In determining suitable candidates for an Audit Committee and maintaining a balanced composition, the Accounting Officer should seek to appoint candidates who have the ability to:*

- Perform the role as advisor to management;
- Communicate effectively with management;
- Review carefully information received and obtain clarification from management as and when appropriate;
- Raise relevant questions, evaluate responses and follow up on any matter that is unclear;
- Conduct responsibilities in the context of the municipality's strategic objectives and overall Corporate Governance of the Council;
- Act independently and be proactive in advising the Accounting Officer regarding issues that require further management attention;
- Encourage openness and transparency;
- Build relations with management;
- Have a professional approach to performing duties, and;

- Each committee member must be independent and skilled appropriately.

#### *Skills and experience:*

Members should be selected from different areas of expertise to enhance the Audit Committee's overall knowledge of the municipality or entity and the ability to discharge its obligations and provide appropriate recommendations to the Council. The roles and responsibilities of an Audit Committee can be used as a baseline to obtain relevant skills that members must possess. This will ensure that appointed members are competent to carry out their responsibilities as set out in the Audit Committee's charter.

## **2.6 Conclusion**

Corporate Governance is a broad term that describes the processes, customs, policies, laws, and institutions that direct the organisations and corporations in the way they act, administer, and control their operations. It works to achieve the goal of the organisation and manages the relationship among the stakeholders including the BoD and the shareholders. It also deals with the accountability of the individuals through a mechanism that reduces the principal-agent problem in the organisation.

There is no universal code of Corporate Governance; however, it has been noted by literature reviewed that events in the corporate world have led various countries and international organisations to develop some principles of Corporate Governance which may be followed in the context of different countries.

This chapter has focused on Corporate Governance literature including its theoretical underpinnings and developments across the world. The next chapter discusses an empirical literature review (commonly called a systematic literature review) to examine past empirical studies to answer stated research question.

# **CHAPTER THREE**

## **EMPIRICAL LITERATURE REVIEW**

### **3.1 Introduction**

Audit Committee, also known as the sub-committee of the board (Council), is not a new concept. The first Audit Committee was formed as early as 1872 by the Great Western Railway Company in the United Kingdom (UK) (Collier, 1993). The New York Stock Exchange (NYSE) further endorsed them in 1939. The intention of an Audit Committee is to enhance organisational governance, irrespective of whether the organisation is in the private or the public sector (Mohiuddin, 2012). The Audit Committee, as a subcommittee of the governing body, is regarded as a key instrument in good Corporate Governance. Its objective is to offer assurance on compliance and financial issues through increased scrutiny, efficient use of resources, and accountability (Magrane & Malthus, 2010b). They should always seek to guarantee the trustworthiness of the accounting information that is provided by the management. Levitt (2000) and Beasley, Carcello, Hermanson, and Neal (2009) reported that “an independent, competent, and committed Audit Committee is described as one of the utmost trustworthy custodians of the public interests”.

Audit Committees have become increasingly relevant over the past decades, as high-profile corporate collapse, such as Enron and WorldCom, has increased Corporate Governance expectations and requirements. The necessity for more Audit Committees (particularly for those Audit Committees to be more effective) has been galvanised through a combination of legislation and/or supported “best practice” guidelines (Magrane & Malthus, 2010a). Evidence has shown a substantial rise and co-ordination in the use of Audit Committees internationally, including the European Commission's requirement, which states that all public-interest organisations in the European Union have an Audit Committee (Collier & Zaman, 2005). Similarly, when the USA enacted the Sarbanes-Oxley Act (2002), it required, among other things, that companies utilise Audit Committees and disclose their composition in the organisation's annual reports. Moreover, numerous countries have introduced regulations intended at enhancing Audit Committee

effectiveness (for example, Australian Securities Exchange (ASX) Corporate Governance Principles and Recommendations, Sarbanes-Oxley Act, 2002 (SOX), The Combined Code on Corporate Governance (FRC, 2014) .

In South Africa, Audit Committees were first promulgated under the King Committee, led by Mervin King. The committee established the governance framework by issuing its first report in 1994, known as the King Report. It was intended at endorsing the maximum standards of good Corporate Governance in South Africa under the new democratic dispensation. This led to greater advances in the legislation and in the South African economy as a whole, which invariably stimulated the revision of the King Report to King II in 2002, King III in 2009 and a recently released King IV in 2016. The revision was also corresponding to the change in the Companies Act (Act No. 61 of 1973), and substituted with the new Companies Act (Act No. 61 of 2008), which incorporated some of the latest principles of Corporate Governance (Prinsloo & Pieterse, 2010).

A competent, committed, and independent Audit Committee has been described as one of the most reliable guardians of the public interests (Badolato, Donelson, & Ege, 2014). One of the main and foremost features of the Audit Committee is that it must be independent. Kusnadi, Leong, Suwardy, and Wang (2016) reported “independence” of Audit Committees as one the attributes of an effective Audit Committee. The Sarbanes-Oxley Act (SOX 2002), section (2) defines Audit Committee as:

*“A committee (or equivalent body) established by and amongst the BoDs of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer.”*

In South African local government, the MFMA defines Audit Committee as:

*“An Audit Committee is an independent body that advises the council, mayor, Municipal Managers /Chief Executive Officer and senior management on matters such as internal controls, risk management, performance management as well as compliance with legislation. The committee is required to provide assurance to the council on the adequacy, reliability, and accuracy of financial reporting and information.”*

On the other hand, the concept of Corporate Governance has always been described vaguely, and this has given rise to different understandings of what it actually involves. Corporate Governance is traced back to the early 1930s and was further accentuated in 1999 by the Organisation for Economic Co-operation and Development (OECD) in the wake of the economic recession (Mohiuddin, 2012). The recent (2008) financial crises have placed focus on the Corporate Governance of organisations, and public sector organisations have not been immune. Over the past decades, there has been a greater need for improving Corporate Governance and even more increased expectation placed on the effectiveness of Audit Committees. However, little consideration has been given to those in the public sector as opposed to those in the private sector. The term “corporate governance” has its origin from a Greek word, “kyberman” meaning to steer, guide, or govern. From a Greek word, it moved over to Latin, where it was known as “gubernare” and the French version of “governor” (Elena, 2012). The notion of Corporate Governance is hard to describe in a widely acceptable manner because there are different definitions in different countries. In addition, nations vary in cultural, legal, and historical developments from one country to another. This explains why the concept of Corporate Governance is a multifaceted subject and can be defined in different ways. Generally, Corporate Governance is a system by which companies are directed and controlled (Hopt, 2011). However, a description frequently used is the one drafted by the Cadbury Committee in the UK in 1992, which describe Corporate Governance as:

*“A set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered and controlled”.* (It was previously called the Combined Code (2) and later changed to the UK Corporate Governance Code in 2009)

In 2007 the Australian Securities Exchange Audit CommitteeGC (2007) defined Corporate Governance as:

*“The framework of rules, relationships, systems and processes within and by which authority is exercised and controlled within corporations. It encompasses the mechanisms by which companies, and those in control, are held to account”* (A. C. G. Council, 2007).

The Organisation for Economic Co-operation and Development (OECD) defines Corporate Governance as:

*“The system by which companies are run and controlled as well as the manner in which liabilities and rights are shared by the main actors (shareholders ) of an entity.”*

Though there are many definitions of Corporate Governance, there are two main notable sides of Corporate Governance, namely: **conformance** and **performance**. The first one entails supervising, monitoring, and being directly accountable to different stakeholders (Kamal Hassan & Saadi Halbouni, 2013:120), while performance entails the management’s (governing body’s) contribution in achieving performance. To learn the field and to explore pertinent issues and/or understanding surrounding the study constructs, a subset of literature has been based on its relevance to the topic, in relation to the following four themes:

- a) Overview of Audit Committee
- b) Corporate Governance in Developing Countries
- c) Corporate Governance in South Africa
- d) Role of Audit Committee in Corporate Governance

### **3.2 Overview of an Audit Committee**

An Audit Committee is essentially an oversight committee, for it is management who is responsible for the internal controls and the financial statements (Okpala, 2012). The committee, however, has to satisfy itself, on behalf of the board, and ultimately the Municipal Council, that key controls are operating, ethical practices are being reinforced, key accounting estimates and judgments are being properly made, and that internal and external audits are effective. Audit Committees have, in many ways, run the gauntlet – through corporate accounting scandals at the start of the millennium and the expanding responsibilities, the dot-com bubble of the late 90s, the 2007–2008 financial crisis and the subsequent reforms throughout the world, corruption investigations in global companies, and the dramatic escalation and impact of cybersecurity attacks (Kedar-Levy, 2015). The insights gained, and lessons learned have clearly set a high bar for Audit Committees, and the accelerating speed and complexity of doing business will, no doubt, keep pushing that bar higher. Technology and innovation, globalisation and geopolitical turbulence and



other disruptive forces are shaping risk and regulatory landscape that few could have envisioned. The researcher has thoroughly unpacked the notion of Audit Committees, which have over the years become more of an illusion or a “tick-the-box” exercise in the public sector sphere.

### **3.2.1 Composition of Audit Committees.**

There is some support for the proposition that Audit Committee composition is an important factor in effective monitoring (Aldamen, Duncan, Kelly, McNamara, & Nagel, 2012). Echoed in the NYSE- and NASD-sponsored Blue Ribbon Committee when its first recommendation addressed the composition of Audit Committees and called for Audit Committee members to be independent of management (BRC, 1999). Traditionally, researchers have looked beyond regulations to gain a more complete understanding of the characteristics that determine Audit Committee effectiveness. DeZoort et al. (2002) recognize three input factors (composition, authority and resources) and one process factor (diligence) as determinants of Audit Committee effectiveness.

Audit committee composition, the first input determinant of Audit Committee effectiveness, comprises independence and expertise. Independence is associated with reduced earnings management (Xie et al., 2003; Davidson et al., 2005; Vafeas, 2005), an increased likelihood to appoint a higher-quality audit firm (Lee et al., 2004; Chen et al., 2005) and an increased likelihood of monitoring the internal audit function (Scarbrough et al., 1998). Independence has been characterized as a willingness to confront management and ask probing questions (Krishnamoorthy et al., 2002), access to objective information (Gendron and Bédard, 2006) and tenure (Vafeas, 2005).

More recently, researchers have considered Audit Committee member accounting expertise as superior to financial expertise. Accounting expertise complements strong corporate governance (Krishnan and Lee, 2009) and is associated with improved accruals quality (Carcello et al., 2006; Dhaliwal et al., 2010) and fewer restatements (Carcello et al., 2006). DeFond et al. (2005) report a positive market reaction to the appointment of an accounting expert to the Audit Committee, but no reaction to the appointment of a financial expert.

In South African local government, Section 166(5) of the MFMA requires that the members of an Audit Committee must be appointed by the Municipal Council of the municipality Motubatse (2016). One of the members, who is not in the employ of the municipality, must be appointed as the chairperson of the committee. It is a substantially researched and recognized fact that the transparency of the appointment process of Audit Committees is directly correlated with the independence thereof (Hepworth, 2012). In South Africa, the appointment of Audit Committees in local government is mandated to each municipality's Municipal Council. However, more often than not, the Accounting Officer (Municipal Manager) and/or management team will take over this delegate duty of appointing Audit Committees, hence compromising the transparency (invariably the independence) of the appointment process and Audit Committee members as a whole. When selecting members of Audit Committees, Council should take into account personal qualities, skills, and experience, as well as independence – all of which are critical.

The King IV Report recommends that all members of the Audit Committee, including the chair, be independent, non-executive members of the governing body (Esser & Delport, 2018). The King IV Report further recommends that the Audit Committee should, as a whole, have the necessary financial literacy, skills, and experience to execute their duties effectively. This principle does not provide detailed guidance on the qualifications and skills of the Audit Committee. Regulation 42 of the Companies Regulations, 2011, however, does provide guidance on the qualifications for members of the Audit Committee for companies. This regulation indicates that at least one-third of the Audit Committee members should have academic qualifications, or experience, in economics, law, Corporate Governance, finance, accounting, commerce, industry, public affairs, or human resource management. The skillset needed will be determined by the specific needs and risks of the organisation and the industry in which they function. The establishment of an Audit Committee comprising members with the right skillset and suitable qualifications is fundamental to the effective functioning of the committee. The following table summarises different aspects of Audit Committees in local government in South Africa:

**Table 3.1: Legislations / Regulations / Codes on Audit Committees in South African local government**

<b>Matter</b>	<b>Municipal Finance Management Act (No.56 of 2003)</b>	<b>King Code of Governance Principles for South Africa (King IV)</b>
<b>Compliance requirements of the legislation / regulations / codes</b>	Compulsory compliance	Recommended compliance
<b>Applicability</b>	<p>Municipalities</p> <p>Municipal entities</p> <p>National and provincial organs of state to the extent of their financial dealings with municipalities</p>	All entities incorporated in and resident in South Africa on an apply-or-explain basis
<b>Relevant sections</b>	Section 166	Chapter 3
<b>Role in relation to the relevant governing body</b>	Independent advisory committee to the Municipal Council, the political office bearers, the Accounting Officer, and the management staff of the municipality, or the accounting authority, the Accounting Officer, and the management staff of the municipal entity	Sub-committee of the board (or other relevant governing Body i.e. Council)
<b>Membership</b>	<p>At least three persons, of whom the majority may not be in the employ of the municipality or municipal entity</p> <p>A single Audit Committee may be established for a district municipality and the local municipalities within that district municipality</p> <p>A single Audit Committee may be established for a municipality and municipal entities under its sole control</p> <p>Appointed members must have appropriate experience</p>	<p>At least three persons</p> <p>All members to be independent nonexecutives</p> <p>Minimum qualification and experience requirements</p> <p>The Audit Committee as a whole should have a good understanding of:</p> <ul style="list-style-type: none"> <li>integrated reporting, including financial reporting, and sustainability issues</li> <li>internal financial controls</li> <li>internal and external audit processes</li> <li>corporate law and risk management</li> <li>IT governance as it relates to integrated reporting and the governance processes within the company</li> </ul> <p>The Audit Committee should be chaired by an independent non-executive director</p> <p>The board chairman may not be a member of the committee but may attend by invitation</p>

Source: de Lange (2019)

### **3.2.2 Purposes of Audit Committee**

Audit Committee research is largely US based since the history of Audit Committees in the US is longer than elsewhere, although Audit Committee studies have also been undertaken in the UK (Adelopo, Jallow, & Scott, 2012), New Zealand (Wu, 2012), Australia (Baxter, 2010) and Malaysia (Alkdai & Hanefah, 2012). An important focus of this literature is “effectiveness”. However, discussion of effectiveness can only be meaningful in the context of a definition of purpose.

What is the purpose of an Audit Committee? An examination of the Audit Committee literature indicates that the answer to this question is not entirely clear. In the US, Cobb (1993) noted some disagreement between commentators during the 1980s on the purposes of the Audit Committee but identified four main functions: reduction of board liability, establishing a link between the external auditor and the board, the reduction of illegal activity, and the prevention of fraudulent financial reporting. The last two functions form the primary role of the Audit Committee according to the Treadway Report (Treadway Commission, 1987) and Spangler and Braiotta (1990) confirmed that Audit Committee members and those working with them shared the Treadway view of their purpose.

Ghafran and O'Sullivan (2013) in their study of Audit Committee formation in New Zealand suggested that Audit Committees are established to increase the credibility of audited financial statements, to help boards of directors in meeting their responsibilities, and to enhance auditor independence. Further evidence from New Zealand indicates that strengthening the role of non-executive directors is seen as a more important function of the Audit Committee than strengthening the external audit function – a similar perspective to the Australian view of Guthrie and Turnbull (Bédard & Gendron, 2010):

“Although many currently believe that Audit Committees were developed to protect investors... Audit Committees, in fact, were developed to protect non-executive directors from being misled by management.”

Porter and Gendall (1993) discussed Audit Committee development in Canada, the US, the United Kingdom, Australia, and New Zealand, identifying unexpected corporate failure and corporate

malpractice as the primary stimuli to their development. Teoh and Lim (1996) also explained the establishment of Audit Committees in Malaysia as a response to corporate scandals.

The establishment of Audit Committees in the United Kingdom has apparently been driven by concerns about the relationship between auditor independence and the quality of financial reporting, but clear statements of Audit Committee purpose, aims, or objectives, are difficult to find. Surveys of Audit Committee development in the UK by do not explore Audit Committee purpose. Marrian observed that Audit Committees were often set up on the prompting of an individual director who had Audit Committee experience elsewhere and identified specific events, such as imminent financial collapse, as stimuli to Audit Committee establishment Spira (1999) .

Collier and Gregory (1996) provided a list of twelve reasons for Audit Committee establishment ranked by questionnaire respondents but did not explain the choice of reasons included for ranking. In the subsequent discussion, he distinguished between reasons for establishment and catalysts leading to the establishment, but the basis of this distinction is not clear. The Cadbury Committee report (Cadbury Committee, 1992) provided an outline of Audit Committee structure and membership, terms of reference, and a range of duties for the Audit Committee. However, other than citing possible benefits arising from the Audit Committee establishment, it offered no explicit statement of Audit Committee purpose. As Ezzamel and Watson (1997) observed:

... the Cadbury Report does not spell out precisely what the new subcommittees are meant to achieve and how, other than by simply attending meetings, the non-executives are to hold executives more accountable through these new committees. This vagueness regarding purposes and means is most obvious with respect to the Audit Committee.

The lack of clarity in the definition of Audit Committee purpose and the differences of emphasis observed internationally make the assessment of Audit Committee effectiveness problematic. Despite this, a major concern of Audit Committee research has been the identification of the characteristics of an effective Audit Committee in order to provide models for practical emulation.

### 3.2.3 Attributes of Audit Committee

Extensive empirical research is undertaken on the attributes of Audit Committees and also the effectiveness thereof. Numerous number of scholarly studies on the attributes of Audit Committees focus mainly on the significance of committee member's independence, expertise, experience, and diligence. For instance, Bédard and Gendron (2010) reported that Audit Committee members should possess certain personal attributes in terms of competence and qualification. Hoitash, Hoitash, and Bedard (2009) reported that there is a positive relationship between Audit Committee attributes and the internal control quality of an entity. Raghunandan, Rama, and Read (2001) described Audit Committee quality as an independent and financially literate Audit Committee member. Furthermore, Sabia and Goodfellow (2005) reported that an Audit Committee could not be effective if it does not have correct, financially literate individuals as members. This study recognises that prominent attributes of effective Audit Committees are:

- a) **Audit Committee independence** – Members' independence is generally defined as "the absence of a relationship with the company that may interfere with the exercise of their independence from management and the company (BRC, 1999). Such independence may be impaired because of the presence of employment relationships, personal relationships, and/or business relationships. Independent Audit Committees serve as superior monitors of the financial reporting process (Jayanthi Krishnan, Wen, & Zhao, 2011) but there has been disagreement about the ideal proportion of independent directors for an Audit Committee. Research has tried to ascertain the impact of different proportions of Audit Committee independence on financial reporting quality but the results have been very mixed. Soliman and Ragab (2014), Badolato et al. (2014), and Ghosh, Marra, and Moon (2010) find no association between Audit Committee independence and earnings management but Sun, Lan, and Liu (2014), report that fully independent Audit Committee members constrain aggressive earnings management. A recent study by Chen, Martin, and Wang (2013) provides indirect evidence of the benefit of having an independent Audit Committee by documenting that such a committee may help ensure that an audit firm issues a going-concern opinion to financially distressed firms. Furthermore, the authors document that independent Audit Committees inhibit auditor dismissal following the issuance of a going-concern opinion for financially distressed firms. The inconsistent results derived from agency theory-based Audit Committee independence studies are not surprising, since

“the simple tallying of the affiliations of individual board members provides insufficient information to assess whether or not that board is active and independent” (Ghosh et al., 2010). A completely independent board could still be siding with management, particularly in scenarios where CEOs are involved in the board member selection process (Carcello, Hermanson, & Ye, 2011).

Khan, Muttakin, and Siddiqui (2013) reported that the existence of an independent Audit Committee is a sign of the firm’s commitment to good Corporate Governance practice. There are various prior studies from scholars such as: Bédard and Gendron (2010) and those who have determined that Audit Committee composition is a vital factor and the committee’s independence has been described as a pre-requisite of its effectiveness. This entails that Audit Committees should be independent of the organisation’s management in order to perform an oversight role and so protect the public’s (shareholder’s) interests. As a result, the persistence of accounting scandals has led to a profound reconsideration of the workings of Audit Committees, with special attention being paid to their composition and independence from managerial teams. Bédard and Gendron (2010) argued that more objective oversight of the financial reporting process can be ensured if the Audit Committee includes more independent members. Furthermore, Bédard and Gendron (2010) argued that an independent Audit Committee could improve financial reporting quality and credibility. Kantudu and Samaila (2015) highlighted the importance of Audit Committee independence for evaluating management actions in respect of risk assessment. The highly regarded BRC (1999) recommends that an Audit Committee should be composed only of directors who have no relationship with the firm that may interfere with its independence. Lastly, the Treadway Commission (1987), the Cadbury Report (1992), the American Law Institute (1994), the BRC Report (1999), and including our very own MFMA (2003), in the public sector, have all recommended that independent members (directors) should be included in the Audit Committees.

In South African local government, section 166(5) of the MFMA requires that the members of an Audit Committee must be appointed by the Council of the municipality, or, in the case of a municipal entity, by the Council of the parent municipality. One of the members, who is

not in the employ of the municipality or municipal entity, must be appointed as the chairperson of the committee. Councillors are not allowed to be members of an Audit Committee. When selecting members of Audit Committees, the Council should take into account personal qualities, skills, experience, as well as independence – all of which are critical.

- b) **Committee member's knowledge and experience** – The matters reported to Audit Committees are frequently of a technical nature (Dhaliwal, Naiker, & Navissi, 2010). Sound oversight by Audit Committee members would require members to possess sufficient knowledge of accounting and auditing to reach an independent assessment of matters presented to them (Abernathy, Beyer, Masli, & Stefaniak, 2015). Earlier survey research about Audit Committee effectiveness suggests that Audit Committee members' perceived expertise in accounting and auditing is related to committee effectiveness as defined by a panel of audit partners, internal audit directors, and chief financial officers (Kalbers & Fogarty, 1993). As in the case of independence, the expertise of Audit Committee members has also been operationalised in various ways (Lin & Hwang, 2010). Inter alia, an expert Audit Committee member has been defined as a member with: professional accounting qualifications or certification. Scholars such as: Bédard and Gendron (2010); Ghafran and O'Sullivan (2013); Cohen, Krishnamoorthy, and Wright (2017) had argued that members' knowledge and expertise or experience is directly associated with the effective functioning of an Audit Committee. To qualify as a financial expert, the SOX requires a director to have five attributes, namely (i) an understanding of Generally Accepted Accounting Principles (GAAP) and financial statements (J. Chen et al.); (ii) the ability to assess the general application of noted that since the main task of an Audit Committee is to oversee corporate financial reporting and the auditing process, its members should possess sufficient expertise to understand the issues to be investigated or discussed by the committee such principles in connection with accounting for estimates, accruals and reserves; (iii) experience in preparing, auditing, analysing, or evaluating the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities (Affairs); (iv) an understanding of internal controls and the procedures for financial reporting; and (v) an understanding of Audit Committee functions. While the SOX proposes a narrow definition of financial expertise, the SEC adopts a



broader definition of financial expertise, whereby an Audit Committee member can be deemed to be a financial expert if the member has either accounting, finance, or supervisory expertise.

A positive correlation has been found to exist between member's financial knowledge and Audit Committee effectiveness in many studies: for example, Treadway Commission (1987); DeZoort and Salterio (2001); Felo, Krishnamurthy, and Solieri (2003); and DeFond, Hann, and Hu (2005). To some extent, the goal of Audit Committee and independent auditors are very similar (i.e. fair practice in financial reporting and better judgment about the firm's financial matters). DeZoort (1998) found that an Audit Committee which has members with prior experience in auditing has greater credibility and less conflict of opinion with the external auditor. This is echoed by Pomeroy (2010) who found that Audit Committee members with accounting experience are particularly thorough in their investigations when accounting decisions are aggressive.

- a) **The size of the Audit Committee** – Authors such as Kalbers and Fogarty (1993); Pincus, Rusbarsky, and Wong (1989), and Pomeroy (2010) reported that the size of an Audit Committee is an influential factor for its effective functioning. Soliman and Ragab (2014) documented a positive relationship between the size of an Audit Committee and the quality of financial reporting, which is also consistent with Authors such as Pincus et al. (1989) reported that the size of an Audit Committee is an influential factor for its effective functioning the findings of Kantudu and Samaila (2015). The MFMA (2003) recognises that the Audit Committee can consist of as many members as the municipality wishes to appoint (but at least three). This is also consistent in global practices; for example, every firm listed under NYSE and NASDAQ must have an Audit Committee with a minimum of three members. However, some researchers, for example: Yermack (1996); Scarbrough, Rama, and Raghunandan (1998); Klein (2002b); Lin, Xiao, and Tang (2008); and Bédard and Gendron (2010) have argued that a large Audit Committee may not necessarily result in more effective functioning, as more members in the Audit Committee may lead to unnecessary debates in the meeting and delay proactive decision making. Although the MFMA requirement for the Audit Committee size is three members, in 2017, Deloitte

analysed a selection of the audit committee reports of the top 50 JSE listed companies with a primary listing in South Africa, ranked by market capitalization and found that the average size of the Audit Committees surveyed comprised four members (Marx & Mohammadali-Haji, 2014). They found that the Audit Committee size was approximately one-third the size of the full board, as a larger Audit Committee provides access to a deeper pool of skill and experience for the committee as a collective and inevitably enhances the quality of the discussions and decisions.

- b) **The authority and resources of the Audit Committee** – Authority and resource are two vital factors for an effective Audit Committee. Most Audit Committee guidelines, for example, the Treadway Report, 1987; the Cadbury Committee, 1992; the BRC, 1999; the Sarbanes-Oxley Act, 2002; and, the Combined Code, 1999, 2003) recommend that the Audit Committee should be provided with sufficient authorities and resources for its effective functioning. In the public sector, the Audit Committee is appointed by the Municipal Council, and report to Council in return. However, it is the duty of the municipal management (Municipal Managers, CFOs) to ensure that Audit Committees receive all relevant documents and support deemed fit to carry out their functions. The Audit Committee requires significant resources to perform effectively because of the wide scope of responsibilities (Ding & Jia, 2012). Lastly, Spira (2003) noted that it is deemed extremely important that the Audit Committees have unrestricted access to all relevant internal and external information to fulfill their oversight responsibilities.
- c) **The diligence of the Committee** – Member's diligence is very important in performing the responsibilities of an Audit Committee effectively and with integrity (Braswell, Daniels, Landis, & Chang, 2012). Kalbers and Fogarty (1993) also reported that Audit Committee member's diligence is one of the main components of its effectiveness. Diligence simply means conscientiousness in paying proper attention to a task, to giving the degree of care required in a given situation. The success of any committee largely depends on its member's sense of responsibilities and willingness to devote adequate time for the committee's activities. T. Lee and Stone (1997) explained diligence as willing to be effective. Member's diligence is reflected by their willingness to undertake responsibilities and the time devoted

to them. Pomeroy (2010) mentioned that members who are willing to be active and effective in the Audit Committee should have a probing attitude in mind which helps in assessing various management decisions. Because diligence is extremely subjective when observed directly, many researchers have used Audit Committee meeting frequency as a proxy of diligence (Raghunandan & Rama, 2007)

- d) **Meetings of the committee** – The frequency of Audit Committee meetings has been recognised by many researchers including Spira (2003); Anderson and Tushman (2004); Li, Mangena, and Pike (2012) and Soliman and Ragab (2014). The meetings are not mere rituals devoid of interest to managers and auditors (Gendron, Be´dard, & Gosselin, 2004); instead, meaningful and substantive meetings are consistent with an agency perspective (Beasley et al., 2009). The MFMA (2003) recognises that Audit Committees in the municipalities should hold a minimum of four (4) meetings per each accounting period (year). The Audit Committees may hold more than this, and as they deem fit, or when there are more issues to further discuss and/or follow up on.

### **3.2.4 Role of Audit Committee**

Although the Audit Committees have existed in practice for a long time, the perceptions of Audit Committees' role have evolved continuously (Ghafran & O'Sullivan, 2013). The early advocates argued that an Audit Committee mainly reviews the financial statements prepared by the management before they are given to BoDs. The roles of Audit Committees have expanded substantially in the last two decades. For instance, as required by the Treadway Commission (1987), the Audit Committees should oversee the company's internal control and co-ordinate the work of Internal and External Auditors (Hämäläinen and Pette (1993); Guthrie and Turnbull (1995); the BRC (1999)). Later, Audit Committees' roles were further expanded to include monitoring of the management's financial performance or accountability and the internal controls, as well as to be a means to enable non-executive directors to oversee the ethical behaviours of the management in respect of compliance with regulations and the company's codes of conduct DeZoort, Hermanson, and Houston (2002). It is quite evidently clear that in recent years the Audit Committee has become one of the main pillars of the Corporate Governance system in companies around the world.

In the South African local government, the Audit Committee is a committee of the Council and performs the statutory responsibilities assigned to it by the MFMA (section 166), and other relevant responsibilities delegated to it under its charter by the Council. The Audit Committee is an independent advisory body that must (MFMA, 2003:76):

- (i) Advise the Municipal Council, the political office-bearers, the Accounting Officer, and the management of the municipality on matters relating to: internal financial control and internal audits; risk management; accounting policies; the adequacy, reliability, and accuracy of financial reporting and information; performance management; effective governance; compliance with the Act, the annual Division of Revenue Act and any other applicable legislation; performance evaluation; and any other issues referred to it by the municipality.
- (ii) Review the annual financial statements to provide the Council of the municipality with an authoritative and credible view of the financial position of the municipality, its efficiency and effectiveness, and its overall level of compliance with this Act, the annual Division of Revenue Act, and any other applicable legislation;
- (iii) Respond to the Council on any issues raised by the Auditor-General in the audit report;
- (iv) Carry out such investigations into the financial affairs of the municipality as the Council of the municipality may request, and
- (v) Perform such other functions as may be prescribed. In addition to these legislated duties, as required by King III, the Audit Committee should: oversee annual/integrated reporting; ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities; satisfy itself of the expertise, resources, and experience of the company's finance function; be responsible for the overseeing of internal audit; be an integral component of the risk management process, and oversee the external audit process; report to Council and stakeholders on how it has discharged its duties.

Although an Audit Committee performs different types of responsibilities, the key areas where an Audit Committee plays significant roles are:

- (a) **Role in financial reporting** – Ensuring reliable financial information is one of the most important functions of the Audit Committee (Oji & Ofoegbu, 2017). There is pressure from the oversight role for the Audit Committee to get more involved to ensure the integrity of

the financial reporting process. The role of an Audit Committee in overseeing financial reporting has been studied by a huge number of researchers such as Bédard and Gendron (2010); Spira (2002); Smith (2003); Gendron and Bedard (2006); Turley and Zaman (2007); Ben Marx and van Dyk (2011). These scholars have generally noted that Audit Committees are expected to: *Review all financial statements (whether interim or annual) all existing accounting policies, key management estimates, judgments, and valuations where they are thought to be material to the financial statements; evaluate the adequacy of financial statement disclosures; review the adequacy of organisation's structure (including management's implementation of internal controls); and review all significant transactions, especially those that are non-routine and those that might be illegal, questionable, or unethical.*

Jeffrey Cohen, Gaynor, Krishnamoorthy, and Wright (2007) noted that Audit Committee (composition, authority, resources, and diligence) would influence the financial reporting quality. Beasley and Salterio (2001) echoed this in their finding that the first potential factor that can affect the financial reporting quality is the Audit Committee composition. The composition of the Audit Committee has been the focus of many governance reform efforts. Lastly, Audit Committees with independent members appear to be more active, more involved in Audit Committee functions, and less likely to be involved in actions that impinge on financial reporting quality (Van der Nest, 2008).

- (b) **Role in internal auditing** – Spira (2007) mentioned that Audit Committee members should be able to comprehend the firm's total internal control process so that they can prevent and/or mitigate financial reporting failure and potential management frauds effectively. The Audit Committee is responsible for monitoring the integrity and performance of a firm's internal audit functions (Alzeban & Sawan, 2015). The Audit Committee can strengthen the entity's internal audit function by ensuring that management has established, and is maintaining, an adequate and effective internal audit structure (Soh & Martinov-Bennie, 2011). Beasley et al. (2009), studying the Audit Committee oversight process within forty-two U.S. public companies, found that Audit Committee members largely depend on Internal Auditors in evaluating the effectiveness of internal control over financial reporting. The study also reported the necessity of frequent meetings between

Audit Committee members and Internal Auditors, which supports the view of Braiotta, Hickok, and Biegler (1999).

(c) **Role in external auditing** – The Audit Committee is a valuable instrument for initiating direct contact with the independent (external) auditor, participating in the selection of the external auditor, and promoting effective communication between the independent auditor and corporate directors (Beasley et al., 2009). Al-Mamun, Yasser, Rahman, Wickramasinghe, and Nathan (2014) claimed that the Audit Committee is responsible for hiring the external auditor and overseeing audit quality. Meanwhile, Kirk and Siegel (1996) argued that External Auditors need the support of the BoDs in performing their duties objectively and with integrity. To work independently, the External Auditors need to have access to some relevant resources of the firm. At the same time, their activities need to be monitored and evaluated in order to ensure their accountability. Bédard and Gendron (2010) mentioned that one of the main responsibilities of Audit Committees is to oversee the external audit function, including the selection, compensation, work, and independence of the External Auditors. In respect of the effective functioning of Audit Committee, Zain and Subramaniam (2007) emphasised the need for a good relationship between External Auditors and Audit Committee through private meetings and informal communication. Therefore, an Audit Committee can play a significant role in dealing with External Auditors in terms of their appointment, resources, independence, monitoring, and evaluation.

(d) **Other roles (as instructed by Council or the Audit Committee Charter)** – Apart from the above three broad roles, an Audit Committee performs some other various roles for the municipality (company), including advising on risk management strategies, overseeing the compliances of regulatory and ethical issues, and bridging the gap between Municipal Council (board), Management, Internal Auditors and External Auditors. Carcello, Hermanson, and Neal (2002) described the Audit Committee as a “communication bridge” between management and the internal and external auditor. Similarly, Al-Mamun et al. (2014) stated that the Audit Committee provides a useful “bridge” between both internal and External Auditors, and the board, helping to ensure that the board is fully aware of all

relevant issues related to the audit. These other roles may be contained in the Audit Committee charter or as per instruction from the respective Municipal Council.

In the light of the above discussion (section 3.2.3 and 3.2.4), it would be more comprehensive, justifiable, and acceptable if Audit Committee effectiveness is evaluated (investigated) considering its input (e.g., Audit Committee composition), process (e.g., Audit Committee meeting), and output (e.g., Audit Committee roles) dimensions to determine its significance (section 3.2.6).

### **3.2.5 Audit Committee Effectiveness**

Over the past decades, it has also emerged quite prominently that having an Audit Committee in place is never enough; but that the Audit Committee must be “effective”. The researcher has already acknowledged (from literature) that the Audit Committee is one of the key mechanisms of Corporate Governance (Owolabi & Dada, 2011), and its effectiveness is crucial for sound Corporate Governance practices in the organisation (Khan et al., 2013). Campbell (1990) and Vicknair, Hickman, and Carnes (1993) reported that the lack of effective Audit Committee practice is a significant factor behind the rigorous financial problems of companies. However, Cameron (1986) identified some limitations when he surveyed studies of organisational effectiveness. He observed that evaluations of effectiveness are problematic with regard to the arbitrary selection of criteria and confusion between determinants and indicators. Furthermore, Lee and Stone (1997), in explaining the purpose of their study, noted that: “actual effectiveness is impossible to observe”. Lastly, Baugher (1981) suggested that there is often no single model for defining effectiveness in any given situation. This is evident also where Cameron and Whetten (1981) noted that the words ‘effectiveness’ and ‘efficiency’ are often confused.

A large number of studies, for example, Jenkins and Robinson (1985); Kalbers (1992); Kalbers and Fogarty (1993); Porter and Gendall (1998); Raghunandan et al. (2001); ; Dellaportas, Leung, Cooper, Ika, and Ghazali (2012); Inaam and Khamoussi (2016) and Oussii and Taktak (2018)) focused on Audit Committee effectiveness have used the word “effectiveness” to mean the “carrying out or fulfilling its specific oversight responsibilities or duties”. On the other hand, various other studies (for example: Braiotta, 1986; Verschoor, 1989; Lee and Stone, 1997; Turley and Zaman, 2002; Watts, 2002; Zain and Subramaniam, 2007) have used “discharging their

oversight responsibilities” for the definition of Audit Committee effectiveness. DeZoort (1998) defined effectiveness as: *"a committee's collective ability to meet its oversight objectives"*. In addition, Baugher (1981) noted that: *"The investigator should determine which type of effectiveness is of the greatest concern to the constituency or constituencies to which he or she must report"*. DeZoort et al. (2002) have further given a definition of an effective Audit Committee (which included its comprehensive roles and responsibilities), that is: *"An effective Audit Committee has qualified members with the authority and resources to protect shareholders' interests by ensuring reliable financial reporting, internal controls, and risk management through its diligent oversight efforts"*.

In line with the current study, De Zoort, Hermanson and Reed (2002:40) further identified the following four determinants of Audit Committee effectiveness:

1. **Composition:** expertise, independence, integrity, and objectivity
2. **Authority:** responsibilities and influence on management and auditors
3. **Resources:** an adequate number of members, access to management, External Auditors and Internal Auditors
4. **Diligence:** incentive, motivation, and perseverance

It is clear that the above determinants of Audit Committee effectiveness place major emphasis on the quality of members of the committees. Sufficient numbers of members, quality, expertise, as well as authority, and support from management will have a beneficial effect on the performance of Audit Committees in the South African public sector. Bedard and Gendron (2006) evaluated the effectiveness of Audit Committees in three corporations, using the following measurement criteria:

- Audit committee composition
- Audit committee authority
- Audit committee resources
- Audit committee diligence
- Background of Audit Committee members
- Quality of Audit Committee documentation
- Matters emphasised in audit committee meetings, such as: financial statements, the effectiveness of internal control, and evaluation of internal and external auditing



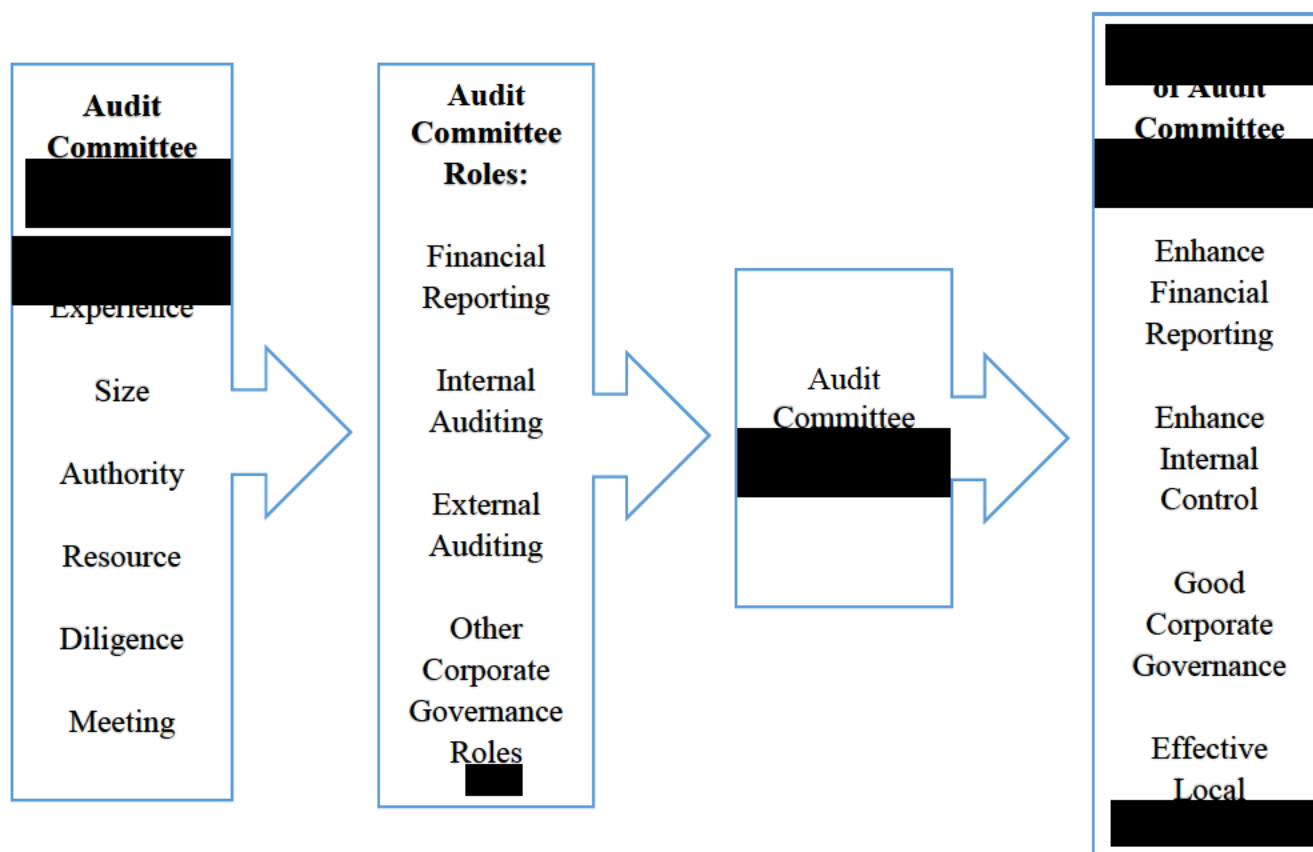
The above criteria are key quality elements that will influence the functioning and effectiveness of any Audit Committee. There is again a major emphasis on member quality but they also identify five key responsibility areas, namely financial reporting, risk management, governance, internal control, and the evaluation of the audit process (Bedard et al. 2004). Certain benefits will accrue to the organisation if the Audit Committee functions effectively. When these characteristics prevail in an Audit Committee, there will be definite advantages for the organisation. The benefits of an effective Audit Committee are listed by the National Treasury (2001:14) such as independent internal audit activity, which operates efficiently and effectively, is ensured; risk management practices are applied to the organisation; sound corporate governance practices are applied; the system of internal control is adequate and functioning effectively; and fraud and corruption are being dealt with effectively. According to Rainsbury (2004:5), Audit Committees with independent members appear to be more active, more involved in Audit Committee functions and less likely to be involved in actions that impinge on the quality of financial reporting.

It is clear from the above discussion that previous studies have discussed two different frameworks of Audit Committee effectiveness. For example, DeZoort et al. (2002) reviewed 37 empirical studies published between 1987 and 2002 and provided a framework with four fundamental determinants of Audit Committee effectiveness, namely: composition, authority, resources, and diligence. On the other hand, instead of focusing on the determinants of Audit Committee effectiveness, Turley and Zaman (2004) and Kalbers and Fogarty (1993) analysed the effectiveness of Audit Committees using a framework which focused on performing Audit Committee's roles successfully. However, while having the "right people" as Audit Committee members and while providing them with concrete responsibilities and resources are important inputs to Audit Committee effectiveness, they are not sufficient to ensure effectiveness (Bedard and Gendron, 2010). Instead, the process by which Audit Committee members assess information and oversee activities is important in this respect. In fact, the process is a very important mechanism of an Audit Committee that explains how characteristics are translated into organisational outcomes. Gendron et al. (2004) noted that the Audit Committee process is an important factor in developing a better understanding of Audit Committee effectiveness. Bedard and Gendron (2010) explained that the dimensions of an Audit Committee process include: Audit Committee meeting, meeting agenda, questioning, and leadership. However, performing Audit Committee roles successfully

depends on the input factors (i.e. composition, authority, resource, and diligence) and the processes by which an Audit Committee functions (e.g. meeting process).

### 3.2.5.1 The Audit Committee Effectiveness Model

The literature discussed in this chapter indicates that although the effectiveness of an Audit Committee is reflected by its roles (e.g. role in financial reporting, internal audit, external audit and others), it is still dependent on a number of Audit Committee attributes (e.g. independence, experience, size, authority, diligence and meetings). The empirical evidence also supports this positive impact of AC effectiveness. The researcher has designed the following Audit Committee Effectiveness model (Figure 3.1) to depict the various factors that influence Audit Committee Effectiveness as well as the significance of an effective Audit Committee, as discussed in the succeeding section of this chapter (Section 3.2.7):



**Figure 3.1:** Audit Committee Effectiveness Model. Self-generated

The figure shows that the attributes of an Audit Committee (i.e. independence, size of the Audit Committee, authority & resources of the committee and diligence) and its decision making process (i.e. meetings) have obvious influences in whether or not it carries out their roles successfully. These attributes have a positive impact on Audit Committee oversight roles, and responsibilities as delegated by the Municipal Council. The key functional areas where AC contributes are: financial reporting, internal auditing, external auditing, and a other roles as delegated by Municipal Council. This means that the effectiveness of an Audit Committee is heavily influenced by the input factors (e.g. independence, members' experience, authority and diligence, and size). An effective Audit Committee thus safeguards stakeholders' interests. The main outcomes of an effective AC are in: (i) enhancing credible financial reporting; (ii) enhancing internal control; (iii) ensuring good Corporate Governance; and (iv) leading to effective local government. The model has guided the development of the survey questionnaire and interview checklist which are used in this study. More specifically, the survey instruments cover all of the Audit Committee attributes and roles that are included in the model.

### **3.2.6 Significance of Audit Committee Effectiveness**

An effective Audit Committee is critical in enhancing the effective oversight of the financial reporting process and ensuring high-quality financial reporting. Empirical studies have revealed that the existence of an effective Audit Committee is associated positively with the quality of financial reporting (Bédard & Gendron, 2010). The significance of the Audit Committee effectiveness in preventing misstatement in financial reporting has been highlighted in many studies, including Magee and Tseng (1990) and Carland, Carland, and Dye (1991). An effective Audit Committee is now treated as a principal player in ensuring good Corporate Governance and rebuilding public confidence in the financial reporting of a firm. A well-functioning Audit Committee leads to the improvement of corporate financial reporting and the decrease of earnings management or financial frauds, as well as the increase of unqualified auditor reports (Wild, 1996; Carcello and Neal, 2000; DeZoort and Salterio, 2001; Klein, 2002b; Sharma, 2004; Bedard et al., 2004)

In their study, Bryan et al. (2004) found a positive association between the Audit Committee effectiveness and the firm's earning. An effective Audit Committee serves as an important Corporate Governance mechanism to boost investors' confidence in good Corporate Governance,

to improve the trust in financial reporting processes, and it lends more credibility to the audited financial statements (McMullen, 1996; Spira, 1999b; the SEC, 1999, 2003; Rezaee et al., 2003). The significance of an effective Audit Committee is visible in enhancing the quality of statutory auditing, which ultimately leads to better financial reporting. For example, Kunitake (1983) studied 580 AMEX listed firms and concluded that the firms without Audit Committees in place change External Auditors more frequently than those firms with Audit Committees. García-Meca and Sánchez-Ballesta (2009) noted that the existence of AC reduces errors and irregularities in financial statements and enhances the credibility of financial reporting, which is consistent with the conclusion of McMullen (1996). Mohiuddin and Karbhari (2010) concur that effective AC reduces financial frauds and disputes in the company and also ensures earning information to stakeholders. It is the researchers' view that an effective Audit Committee will increase community confidence in the financial reporting of any municipality, thus ensuring good Corporate Governance.

In contrast, there are a number of studies that have found opposite results; for example, Beasley (1996) found that there was no significant relationship between the presence of Audit Committee and the likelihood of fraud or error. Furthermore, Pucheta-Martinez and Fuentes (2007) revealed that the presence of the Audit Committee has little or no impact on the quality of financial reporting. However, it is widely accepted that an Audit Committee plays an important role in assuring the quality of financial reporting and corporate accountability. As a liaison between the external auditor and the board, the Audit Committee minimises information asymmetry between them, facilitates the monitoring process (Klein 1998b; Sori et al., 2007), and enhances good Corporate Governance. An effective Audit Committee also contributes significantly to the establishment of a rigorous internal control function in the company, which ultimately reduces irregularities and fraudulent activities in the municipality's affairs. Zain and Subramaniam (2007) highlighted the leadership role of the Audit Committee in supporting and guiding Internal Auditors. They also argued that an Audit Committee is perceived to hold an authoritative position which helps it to question the decisions made by management.

The establishment of local government, which is enshrined in the Constitution, serves as the mechanism for the devolution of authority to local communities (De Mabior, 2006). In Chapter 7 of the Constitution, it is stated that local government must offer a democratic and accountable

sphere of government and that it should also establish mechanisms for sustainable service delivery for its local communities. This is further reiterated in Chapter 3 (on Cooperative Governance), which states that each sphere of government is required to provide for an effective, transparent, accountable, and coherent government. Therefore, the Constitution provides the basis for an effective local government system for South African communities. An effectively functioning local government is believed to improve service delivery, which can be achieved through the effective utilisation of allocated public resources. The complexities of local government operations and an increasing need for effective management of its resources (SALGA, 2012) require local government to have an effective governance system in place to entrench accountability (Deloitte, 2010). Therefore, the establishment of audit committees plays a significant role in realising the goals of local government (Chaka, 2013).

It is clear from the above discussion that an effective Audit Committee contributes significantly to ensuring the fair and sound practice of financial reporting, establishing rigorous internal control, enhancing good Corporate Governance through safeguarding stakeholders' interest and leading to effective local government (as depicted in figure 3.1 above).

### **3.3 Corporate Governance Practices in Developing Countries**

Since 2001, Corporate Governance has received rehabilitated global importance due to a plethora of corporate collapses (Vasudev & Watson, 2012). The experiences of the developed countries reveal that good Corporate Governance reduces risk, stimulates performance, improves access to capital markets, enhances the marketability of goods and services, improves leadership, increases the value of the corporations, enables the corporation to acquire external finances more easily and at a lower cost (Hafeez & Muhammad, 2016). On the other hand, in the case of developing and emerging economies, the need for Corporate Governance extends beyond resolving problems resulting from the separation of ownership and control. Developing and emerging economies are constantly confronted with issues such as the lack of property rights, the abuse of minority shareholders, or contract violations. Furthermore, developing economies do not have a strong, long-established financial institution infrastructure to deal with Corporate Governance issues (Claessens & Yurtoglu, 2013).

International investors are hesitant to lend money or buy shares in a corporation that does not subscribe to good Corporate Governance principles. Transparency, independent directors, and a separate Audit Committee are especially important. Some international investors will not seriously consider investing in a company that does not have these things. This reason led to several organisations popping up in recent years to help adopt and implement good Corporate Governance principles (Shipilov, Greve, & Rowley, 2010). The Organisation for Economic Co-operation and Development (OECD), the World Bank, the International Finance Corporation, the U.S. Commerce and State Departments, and numerous other organisations have been encouraging governments and firms in Eastern Europe to adopt and implement corporate codes of conduct and good Corporate Governance principles. The Center for International Private Enterprise (2002) lists some of the main attributes of good Corporate Governance. These include:

- Reduction of risk,
- Stimulation of performance,
- Improved access to capital markets,
- Enhancement of marketability of goods and services,
- Improved leadership. and
- Demonstration of transparency and social accountability.

This list is by no means exhaustive. However, it does summarise some of the most important benefits of good Corporate Governance. All countries, whether developed or developing, face similar issues when it comes to Corporate Governance. However, transition economies face additional hurdles because their corporate boards lack the institutional memory and experience that boards in developed market economies have. They also have particular challenges that the more developed economies do not face to the same extent. Some of these extra challenges include:

- Establishing a rule-based (as opposed to a relationship-based) system of governance;
- Combating vested interests;
- Dismantling pyramid ownership structures that allow insiders to control and, at times, siphon off assets from publicly owned firms based on very little direct equity ownership and thus few consequences;
- Severing links such as cross-shareholdings between banks and corporations;

- Establishing property rights systems that clearly and easily identify true owners even if the state is the owner (when the state is an owner, it is important to indicate which state branch or department enjoys ownership and the accompanying rights and responsibilities);
- Depoliticising decision-making and establishing firewalls between the government and management in corporatised companies where the state is a dominant or majority shareholder;
- Protecting and enforcing minority shareholders' rights;
- Preventing asset-stripping after mass privatisation;
- Finding active owners and skilled managers amid diffuse ownership structures; and
- Cultivating technical and professional know-how (CIPE, 2002).

Corporate Governance is now an international topic due to the globalisation of businesses. It is acknowledged to play a major role in the management of organisations in both developed and developing countries (Claessens & Yurtoglu, 2013). Nevertheless, Davies and Schlitzer (2008) note that Corporate Governance practices are not uniform across nations. In fact, the OECD (1998) acknowledges the lack of a single model of Corporate Governance practice that is applicable to all organisations even within one country. Consequently, every country adopts a unique set of Corporate Governance procedures that are based on factors such as the country's legal and financial system, corporate ownership structures, culture, and economic circumstances (Mulili & Wong, 2011).

Much work has been done on Corporate Governance in the private sector as opposed to the public sector. KZN municipalities are classified as the public sector sphere of government, and it is appropriate to investigate Corporate Governance practices, with a special focus on public sector organisations in these developing countries.

### **3.3.1 An overview of corporate governance practices of public sector organisations in developing countries**

Effective and efficient management of public sector organisations is an issue of concern in many countries. Mauro, Cinquini, and Grossi (2017) argue that public sector organisations are increasingly being held more accountable for their performance and are therefore expected to operate efficiently and effectively. This means that public sector organisations have to search for

ways to improve their activities. Notable approaches include the use of performance contracts. Similarly, activity-based management practices can increase transparency and efficiency when conducting government activities, thereby assisting public sector organisations to achieve their objectives (Christensen, Lægreid, & Rovik, 2020).

Historically, some public sector enterprises were formed to create employment for large numbers of people. However, in recent years, public sector management has become increasingly results and customer-focused (Jarrar & Schiuma, 2007; Kealesitse, O'Mahony, Lloyd-Walker, & Polonsky, 2013). This can be partly attributed to a growing unwillingness among many communities and governments to accept the continuation of historic commitments simply because they are historic. Some countries have also noticed diminishing differences between the private and public sectors. For instance, private sector organisations are now expected to take more social responsibility measures while the public sector is witnessing the need to focus on customers and to justify their existence (Meier & O'Toole Jr, 2011). The contemporary business environment pays great attention to target, measurement, accountability, productivity gains, and the continued relevance and value of specific activities or programmes. The proper management of public sector organisations is, therefore, an issue of concern in developed and developing countries.

It has been noted that the concept of governance has existed for centuries. However, many African economies began to pay particular attention to the ideals of good governance at the beginning of the 1980s (Bevir, 2012). According to Elahi (2009), the term good governance was first mentioned in a 1989 World Bank report on Sub-Saharan Africa but since the 1990s many donor agencies have sought the pursuit of good governance. Currently, Corporate Governance is a buzzword in the business world.

Corporate Governance systems have evolved in a number of developing African countries (Aguilera & Jackson, 2010). However, Rwegasira (2000) argued that the concept of Corporate Governance is not necessarily the best solution for developing economies. This is because a number of developing countries face numerous problems that include unstable political regimes, low per capita incomes and diseases. Such problems require more elaborate solutions than simply adopting Corporate Governance concepts. Moreover, there is a general lack of research in Corporate Governance practices in developing countries, especially countries in the African



continent (Okeahalam, 2004). This lack of research can be attributed to the fact that, for a long time, the issue of Corporate Governance did not receive adequate attention in the developing world. Yakasai (2001) observes that historically the ability of managers to run organisations was never questioned. Consequently, there was little concern for Corporate Governance or information disclosure and transparency. That situation has changed and the concept of Corporate Governance is currently acknowledged to play an important role in the management of organisations in developing economies.

Tsamenyi, Enninful-Adu, and Onumah (2007) argue that developing countries are often faced with a multitude of problems that include uncertain economies, weak legal controls, protection of investors, and frequent government intervention. These problems make it even more necessary for developing countries to adopt effective Corporate Governance structures. The pressures of an increasingly globalised world economy, democratisation, IMF/World Bank's economic reforms and the recent financial scandals in the West have forced a number of developing countries to adopt the Corporate Governance ideals (Ahunwan, 2002; Gugler, Mueller & Burcin, 2003; Reed, 2002). It has also been suggested that improved Corporate Governance systems can serve as an incentive for attracting foreign investment (Ahunwan, 2002). In fact, it is poor economic performance and high international debt levels in emerging markets that forced the World Bank, IMF, and the IFC to intervene in an effort to improve the Corporate Governance systems of these markets (Reed 2002).

A number of developing countries have embraced Corporate Governance ideals. However, developing countries practice Corporate Governance models that are different from the models adopted by developed countries Rabelo and Vasconcelos (2002). This is partly due to the unique economic and political systems found in developing countries. argued that developing countries are poorly equipped to implement the type of Corporate Governance found in the developed market economies because developing countries are characterised by state ownership of firms, interlocking relationships between governments and financial sectors, weak legal and judiciary systems, and limited human resource capabilities.

Corporate Governance structures in developing countries are weak. Consequently, several measures have been suggested on how to improve such structures. Notable suggestions include the use of equity instead of debt for growth, increasing overall investor confidence through increased transparency, strengthening of capital market structures and encouraging the use of competition to improve performance of domestic firms (Reed, 2002). The concept of competitions as a way of encouraging improvements in productivity has been adopted in many parts of the world (Marwa, 2012). Competitions mainly involve rewarding firms that excel in stated areas and they can be administered at a national level. Firms that have adopted total quality management (TQM) ideals often use the Malcolm Baldrige framework as a quality control tool for their activities.

### **3.4 Corporate Governance Practices in South Africa**

Between 1961 and 1994, South Africa was virtually isolated from the global economy (Mathieson, 1998; Sethi and Williams, 2000). Because of the country's oppressive political environment, the United Nations excluded South Africa from participating in international organisations and imposed economic and trade sanctions against the country, serving to effectively stifle its economic growth. These tariffs and political isolation also protected South African firms from foreign competition, as financial sanctions kept international institutions out of the domestic market and domestic firms out of the international capital markets (Malherbe & Segal, 2001). Consequently, corporate practices and national laws and regulations fell far behind international norms, and, by the late 1980s, many of South Africa's corporations were unfocused entities run by complacent and entrenched managers.

Political reform started in 1986 with the repeal of certain apartheid legislation, but it was not until the collapse of apartheid in 1994 that South Africa re-entered the global economy (Malherbe and Segal, 2001; Sethi and Williams, 2000). South Africa was then accepted back into international organisations, and business and diplomatic relations with the rest of the world began to develop and expand. These changes revealed both tremendous opportunities and tremendous challenges for South Africa's burgeoning global market. To compete in this new business environment effectively, South African corporations were compelled to address and embrace improved standards of Corporate Governance. Several influential forces led to the rapid overhaul of

Corporate Governance practices, among them market pressures, a shift in corporate control structures and economic crises in emerging markets.

When foreign financial institutions returned to South Africa in 1994, investors demanded reform in both corporate structures and Corporate Governance practices in exchange for their infusion of capital (Korac-Kakabadse, Kouzmin, & Kakabadse, 2002). Investors wanted assurances that corporations practised accountability, transparency, and fairness to all stakeholders.

Historically, South Africa's corporate sector was dominated by six mining finance houses which were large, centrally controlled conglomerates with a domestic focus (Malherbe and Segal, 2001; Frémond and Capaul, 2003). These introverted and closely-held firms bred and sustained unacceptable governance and business controls marked by elaborate control structures and conflicts of interest. By 1999, South Africa's new government oversaw the dismantling of its six mining houses. The resulting restructuring transformed the control structure of South Africa's largest companies, and, by the end of 2001, the number of minority-controlled firms listed on the Johannesburg Stock Exchange (JSE) was reduced by 40 percent. In addition, in 2000, the JSE announced that it would add no new listings of firms with low-voting shares or pyramid structures.

It was not until the 1997–1998 “emerging markets” financial crises in Asia, Russia, and Brazil, that the quality of Corporate Governance in developing economies came under close scrutiny (Taylor, 2013). In 1997, currencies and asset prices plunged throughout Asia, as capital fled from these once favoured countries. The Asian crisis, like the Russian and Brazilian crises, had a devastating impact not only on the economies of the affected countries but also on other developing countries perceived to be similarly situated (Vaughn & Ryan, 2006). Experts argue that the crises may have been directly attributable to widespread poor Corporate Governance in emerging economies.

This period of dramatic political reform, intense market pressure, and global scrutiny left South Africans with the understanding that high-quality Corporate Governance is essential for developing countries (Aguilera & Jackson, 2010). Government and economic enterprises alike recognised that improved Corporate Governance policies and standards could contribute to their

country's ability to achieve sustained productivity growth and economic stability, both of which are crucial for long-term national development. In response, South Africa developed and implemented several innovative and comprehensive Corporate Governance reform initiatives i.e. The King Report on Corporate Governance, The Insider Trading Act.

Today, South Africa stands out among emerging markets as a particularly interesting case in which to investigate how processes of Corporate Governance reform unfold (Andreasson, 2011). It is Africa's largest and most sophisticated economy (McNulty, Zattoni, & Douglas, 2013), and its financial institutional structures are advanced, as compared to other emerging markets. According to Mervyn King (personal communication, August 25, 2006), the doyen of South African Corporate Governance and chairman of the King Committee on Corporate Governance, South Africa's "first world" financial infrastructure is "extraordinary for an emerging market." As a result, foreign institutions are now major private equity holders in the South African economy - an important sign of confidence in and approval of South Africa's capital markets and financial infrastructure.

South Africa's colonial legacy and resultant ties with Britain have ensured that "corporate law and corporate practice have been adopted mainly from the U.K." (Andreasson, 2011). Key actors shaping South Africa's evolving Corporate Governance regime understand the U.K. link as very important, in terms of institutions and history as well as in spirit (e.g., M. King, personal communication, August 25, 2006). These actors include board directors, leaders of private sector institutions such as the JSE, and government-instituted regulators such as the Financial Services Board (FSB). King (2006, personal communication, August 25, 2006) related South African developments to British corporate history, from Gladstone and the Limited Liability Act of 1855 to Adrian Cadbury's committee on Corporate Governance and its resultant 1992 Cadbury Report. He emphasised on several occasions how South African Corporate Governance and corporate culture more generally are firmly rooted in the British tradition (Andreasson, 2011). It is London's gentlemen's agreements and emphasis on principles and cultivation of personal relationships (cf. Morgan & Quack, 2005; Vogel, 1996), whether these are myth or reality, rather than strictly legislated compliance with rules whose effectiveness has not been demonstrated that are viewed by South African directors and executives as the proper model for South Africa.

On balance, South Africa's approach to Corporate Governance fits the traditional Anglo-American model as outlined by Reed (2002). This model includes (a) a single-tiered board structure where only shareholders are represented; (b) an active stock exchange that is a leader among emerging markets and ensures that financial markets play a dominant role; (c) a banking system that plays a secondary role, in which banks are not in control of companies and avoid too close relations with clients; and (d) a general commitment to a market-driven economic policy in which industrial policy plays a lesser role, manifested most clearly in the government's Growth, Employment, and Redistribution (GEAR) macroeconomic policy framework. Concessions made to labour with the 1998 Employment Equity Act and to affirmative action advocates with the 2003 Broad-Based Black Economic Empowerment Act, as well as hints of a more active industrial policy in an evolving "post-GEAR" environment, suggest a mixed picture on this final variable (Andreasson, 2007).

Reformers have to tread carefully when considering changes to South Africa's governance system because the country's political transition has not produced a similarly comprehensive economic transformation (Andreasson, 2011). The lack of transformation has resulted in conflict between societal demands for "pro-poor" policies associated with populist pressures for socioeconomic transformation and business demands for "market-friendly" policies based on liberalisation and deregulation. In balancing these conflicting demands, the South African government has so far prioritised the need to pursue an internationally credible policy of business accommodation (Andreasson, 2011). This means delegating issues of broad-based socio-economic transformation to a future in which, presumably, business-friendly policies have produced a stable macroeconomic environment and sufficiently healthy public finances to then allow for robust spending on development.

Although maintaining a stable macroeconomic environment and maintaining a generally business-friendly climate have been key priorities for the post-apartheid government, it remains determined to ensure that corporations play a positive role in the country's development. South Africa has consequently undergone a comprehensive change to its Corporate Governance regime in the past decade (Vaughn & Ryan, 2006). These changes are a response to economic globalisation as well

as pressures for a transformation of state-business relations. The country's King reports on Corporate Governance, published in 1994, King I, King II in 2002, King III in 2009 and recently King IV in 2016, have become notable examples of how an emerging market can devise its own solutions to aligning Corporate Governance with international best practice while also addressing corporate social responsibility and needs for broad-based development.

### **3.5 Role of an Audit Committee in Corporate Governance**

The Audit Committee is arguably the most important of the subcommittees which are formed by the governing body (Goergen, Mallin, Mitleton-Kelly, Al-Hawamdeh, & Chiu, 2010). A growing number of studies (such as: Genron and Bedard, 2006; Turley and Zaman, 2007; Sori et al., 2007; Chen et al., 2008 and Beasley et al., 2009) have recently been undertaken which emphasise the roles of the Audit Committee in strengthening overall Corporate Governance. Corporate Governance has a positive impact on corporate auditing processes and vice versa (Lin and Liu, 2009; Turley and Zaman, 2001). The true effectiveness of auditing is subject to the actuality and the development of the Corporate Governance environment, including Audit Committee practice (Mohiuddin, 2012). Jallow, Sarens, Abdolmohammadi, and Lenz (2012) further noted that Corporate Governance plays an important role in enhancing the effectiveness of the audit function. In the effort to devise ways of bringing about good governance in companies, one of the issues that have taken increasing importance is how best to harness the oversight process to achieve more fully the goal of quality corporate financial reporting. This brought about the idea of Audit Committee, which is at the core of the corporate financial reporting process (BRC, 1999).

Most, if not all, of the Audit Committee activities and responsibilities, are related directly or indirectly to the Audit Committee roles in Corporate Governance. The Audit Committee's composition, competence, independence, and expertise are strongly correlated with the organisation's Corporate Governance. The increasing demand for Corporate Governance and accountability related to the BoD, particularly the recent lawsuits and investigations, made the creation of Audit Committees an extremely necessary step. The Audit Committee reviews the organisation's annual, quarterly, and monthly reports. It issues its reports and recommendations to the BoD, and annually issues a report submitted to the shareholders (as part of the organisation's annual report) describing its activities and responsibilities during the year. The Audit Committee

has relationships with almost all of the organisation's stakeholders (e.g., the BoD, management, Internal Auditors, External Auditors, and, to a certain extent, shareholders and financial statement users), as well as the governing and regulatory bodies (Ghafran & O'Sullivan, 2013).

The Auditor General of South Africa, as well as the big four audit firms, Price Waterhouse Coopers, Deloitte, Ernst & Young, and KPMG, recommended certain oversight practices for Audit Committees to follow, providing guidelines about the audit responsibility in evaluating and strengthening corporate controls. The SEC confirmed its interest in Audit Committees by: (a) urging registrants to form Audit Committees comprised of outside directors; (b) requiring all publicly held companies' proxies to disclose information about the existence and composition of their Audit Committees; and (c) requiring publicly held companies to state the number of Audit Committee meetings held annually and to describe their Audit Committees' function. Similarly, in South African local government, Audit Committees are a requirement by law (section 166 of the MFMA), and their role is to (MFMA, 2003:78):

- a) advise the Municipal Council, the political office bearers, the Accounting Officer and the management of the municipality or municipal entity on matters relating to:
  - internal financial control and internal audits;
  - risk management;
  - accounting policies;
  - the adequacy, reliability, and accuracy of financial reporting and information;
  - performance management;
  - effective governance;
  - compliance with the Act, the annual Division of Revenue Act and any other applicable legislation;
  - performance evaluation; and
  - any other issues referred to it by the municipality or municipal entity.
- b) review the annual financial statements to provide the Council of the municipality or, in the case of a municipal entity, the Council of the parent municipality and the BoD of the entity, with an authoritative and credible view of the financial position of the municipality or

municipal entity, its efficiency and effectiveness and its overall level of compliance with this Act, the annual Division of Revenue Act, and any other applicable legislation;

- c) respond to the Council on any issues raised by the Auditor-General in the audit report;
- d) carry out such investigations into the financial affairs of the municipality or municipal entity as the Council of the municipality, or the Council of the parent municipality.
- e) perform such other functions as may be prescribed.

In addition to these legislated duties, as required by King IV, the Audit Committee should (King IV Report, 2016):

- oversee annual/integrated reporting;
- ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities;
- satisfy itself of the expertise, resources, and experience of the company's finance function;
- be responsible for overseeing of internal audit;
- be an integral component of the risk management process;
- oversee the external audit process;
- report to Council and stakeholders on how it has discharged its duties.

### **3.6 Conclusion**

Audit Committees today face a host of competing priorities in an ever changing regulatory and governance landscape. In recent years, the Audit Committee has become a more common mechanism for ensuring sound Corporate Governance in firms (Kallamu & Saat, 2015). With support from the board, along with the cooperation of employees and management team of the firm, the Audit Committee can perform its assigned duties duly (Kenkel, 2010). The main attributes of an Audit Committee may be abridged as: composition (selection and nomination process), knowledge and expertise of Audit Committee members, independence from management; access to information; resources, diligence, and meetings. The Audit Committee is responsible to perform multiple roles in any municipality, and its effectiveness requires the ability of members to perform these roles properly.



This chapter commenced with a monograph on the overview of Audit Committees. The concept (evolution) of Corporate Governance and Corporate Governance developments around the world, together with its guidelines, practices in developing countries, and in South Africa at large, have been discussed with reference to the related literature. The chapter finally presented the role of Audit Committees in Corporate Governance. Discussion of literature in this chapter argues that one of the key mechanisms under a Corporate Governance system is the Audit Committee which is the research issue of this study. Therefore, it is important to review the studies conducted underpin Corporate Governance in the next chapter.

## **CHAPTER FOUR**

### **RESEARCH DESIGN AND METHODOLOGY**

#### **4.1 Introduction**

The chapter focuses on the research methodology applied in this study. It further outlines a clear relationship to the research objectives that are already outlined in section 1.4 of Chapter 1. Research methodology may be defined in at least three ways: a body of rules and postulates that are employed by researchers in a discipline of study a particular procedure or set of procedures and the analysis of the principles of procedures of inquiry that are followed by researchers in a discipline of study (Blaikie & Priest, 2019).

Examining the variables related Audit Committee practices and the contribution of these variables to the improvement of Corporate Governance demands a dynamic research approach that is firmly rooted in both qualitative and quantitative epistemology. This is necessary to ensure that the respondents in a study of this magnitude and complexity are not denied their subjective views on the phenomena being studied, while the objectivity of the entire research enterprise is guaranteed.

The main aim of the study is to explore and understand how Audit Committees affect or contribute to good Corporate Governance. As mentioned in chapter 1, the review of the literature indicates that quite extensive research has been undertaken on Audit Committees and Corporate Governance, predominantly in the private sector and companies listed on the stock exchange. There is a huge gap in Audit Committee research in the public sector, or specifically, on local government municipalities. In line with this thinking, this study is based on a mixed methods research approach which is explained in detail in the following sections: Section 4.3 outlines the research designed and methods used in the study. Section 4.4 outlines the study population and sample. Section 4.5 details the study's data collection methods employed (i.e., questionnaire and interviews). Details on the analysis of data collected in section 4.6. Section 4.6 outlines the validity, reliability and trustworthiness of the data. Section 4.8 details the ethical considerations in of the study and finally, the chapter is concluded in section 4.8.

## **4.2 Research Questions of the Study**

### **Research Question One**

What are the Corporate Governance practices of Audit Committees in KZN local government?

### **Research Question Two**

What are the primary factors that affect the practices of Audit Committees in Corporate Governance in KZN local government?

### **Research Question Three**

What imperative measures can be taken to enhance the effectiveness of Audit Committee practices in KZN local government?

### **Research Question Four**

How do the perceptions of different respondent groups relate to the current practices of Audit Committee in KZN local government?

## **4.3 Research Design and Paradigm**

The research design is a blueprint or plan for the collection, measurement, and analysis of data, created to answer your research questions (Sekaran, 2016). It is the next step taken by researchers following the formulation of the research objectives and questions (Ritchie, Lewis, Nicholls, & Ormston, 2013). A research design specifies the structure of research, and its function is to ensure that the evidence obtained would enable the researcher to answer the research questions as unambiguously as possible (Vogt, Gardner, & Haeffele, 2012). From the definitions of research provided above, it follows that research is a planned activity aimed at establishing new facts and information about a particular phenomenon. The research process involves the identification of a particular problem or area of interest, translating that problem into a research problem, collecting data, analysing the data, and reporting the findings of the research.

The study used a mixed method design in order to collect data, and thus subsequently answer the above stated questions. A mixed method in social science research, (i.e. a combination of both qualitative and quantitative methods) is a method that offers the opportunity for 'triangulation' since it incorporates 'multiple research strategies' effectively. Methodological works on this research paradigm have been reinforced by several authors, such as Creswell, Plano Clark,

Gutmann, and Hanson (2003); Tashakkori and Creswell (2007); Sharp et al. (2012); Power and Gendron (2015); Kumar (2019). The mixed method approach combines qualitative and quantitative approaches of collecting data and/or analysis, simultaneously or sequentially (chronologically), in order to better comprehend the research problem.

There are some unique advantages of employing the mixed method approach in research. For example, it enables triangulation, which theoretically should highlight if there are any inherent biases in the data sources and allows for its neutralisation when that data is used in conjunction with other data sources and methods (Fielding, 2012). Östlund, Kidd, Wengström, and Rowa-Dewar (2011) argue that mixed methods research is more than simply collecting both qualitative and quantitative data; it implies that data are integrated, related, or mixed at some stage of the research process. They further indicate that the underlying logic to mixing is that neither qualitative nor quantitative methods are sufficient in themselves to capture the trends and details of the situation...when used in combination, both qualitative and quantitative data yield a more complete analysis, and they complement each other. In pursuit of the same argument regarding the logic of mixed methods research, Harrison III (2013) indicate that mixed methods research includes the use of induction which refers to the discovery of patterns, a deduction which involves testing theories and hypotheses, and abduction, which refers to uncovering and relying on the best set of explanations for understanding one's results. Morse (2016) mentioned that a mixed method strategy offers:

- More comprehensive understanding from multiple perspectives and lenses,
- More insightful understanding from fresh and creative perspectives,
- Greater validity, and
- Greater value consciousness and diversity of values.

In addition, Punch (2013) found that the combination of methods helps to capitalise the strengths of the two approaches and compensate for the weaknesses of each approach. When various methods reach the same conclusion, the results become more robust and this enhances the reliability of the findings.

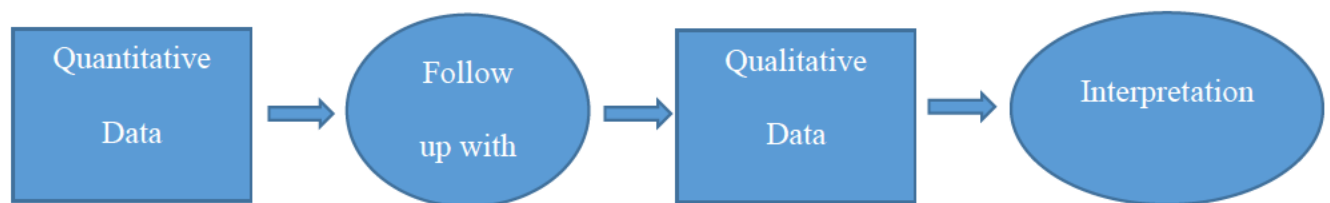
The study is located in a pragmatism research paradigm as it mostly fits with the mixed methods research because the choice of design and methods was done keeping in view the research questions and focus of the research. Morgan (2014) states that pragmatism is particularly

appropriate for mixed methods research and notes that there are a variety of ways these methods can be used. Morgan (2014) labels pragmatism as a "paradigm of choices", because there are many complex choices available to integrate the strengths of the qualitative and quantitative methods based on the nature of research. At the same time, Morgan (2014) also warns about the "oversimplified" meaning of what works and suggests that the quality issues such as knowledge validity, should be considered critically before deciding on the methods to be used. Grafton, Lillis, Ihantola, and Kihn (2011) also stress the need to justify the use of mixed methods to achieve the purpose and validity of knowledge.

#### 4.3.1 Choosing the method for this study

There is no outright method of collecting data that is always appropriate for similar types of research. Choosing a suitable method for any study hinges mainly on the nature of the research, the data to be collected, and the research purposes. The research methods are determined by the nature of the research question (Creswell, 2013). The primary objective of this study is to contribute to the understanding of the practices of Audit Committees in Corporate Governance and in KZN local government, which is in the public sector sphere of government. The researcher elicited opinions from four fundamental respondent groups, namely Municipal Managers, Finance heads (Chief Financial Officers), Audit Committee Chairpersons, and Internal Auditors.

Therefore, this study followed the Explanatory Sequential Mixed Method design (QUAN → qual).



**Figure 4.1:** Explanatory Sequential Mixed Method design (QUAN → qual). Creswell (2014: 220)

The combination of a qualitative and a quantitative approach was considered necessary as it ensured that an all-inclusive investigation was achieved and that adequate data collected in response to the stated research questions. The use of both methods to collect data also enabled the triangulation of the outcomes and made the study more robust and reliable.

The first phase of collecting data was the administration of a questionnaire survey to gather opinions from four distinct and very important sample groups (as already outlined) on the practices of Audit Committees in Corporate Governance in KZN local government. The questionnaire survey aimed to obtain the respondent's opinions on current practices of the Audit Committee on a 5-point Likert Scale to answer the stated research questions.

The first stage aided in necessitating the second phase of the data collection process for this study, which was semi-structured interviews that commenced after the completion of the first phase of collecting data (i.e., questionnaire survey). The main purpose of the interview survey was to supplement the questionnaire survey results and further obtain an in-depth understanding of the practices of Audit Committees in Corporate Governance in KZN local government, which may not have been achieved through the use of a questionnaire survey alone.

#### **4.4 Population and Sampling**

When conducting research, it is essential to describe clearly the surveyed population and to ensure that the sampled population provides a precise depiction of the entire study population (Thomas, 1996, cited in (Mohiuddin, 2012)). The researcher established a complete set of elements (persons or objects) that possess some common characteristics defined by the sampling criteria, followed by the portion of the population to which the researcher has reasonable access. The selected persons chosen for participation in a study were identified based on the position (role) they hold in KZN local government municipalities.

After prospective participants were identified, the researcher approached and invited them to participate in the study. They were presented with the information sheet and were further informed about their right to refuse participation, and that participation was voluntary. When they agreed to participate, they were also made aware of their right to withdraw from partaking in the interview. They were further informed that the information that they provided in the interviews would also be treated with confidentiality; they were not required to disclose their identifying details. Finally, they were presented with consent forms for their participation and for the audio tape recording that they signed to give their consent.

#### **4.4.1 Quantitative sample**

As per the KZN LG Handbook dated 20 February 2017, there is one metropolitan municipality (eThekweni Metropolitan Municipality) and ten (10) district municipalities, which are further subdivided into forty-three (43) local municipalities (The Local Government, 2017). The current study's population was relatively small, and therefore the sample for quantitative data was the whole population itself, which is called a "census survey." A total of 54 municipalities formed the population and sample.

The key participants in this study were the Municipal Managers, Finance Heads (CFOs), Audit Committee Chairpersons, and Internal Auditors. Those municipalities that may have been identified as not having an Audit Committee in place were to be excluded from the study sample for three reasons; namely, the objective of the study is to contribute to the understanding of the Corporate Governance practices of Audit Committees in the KZN local government and the respondents were requested to offer their perception towards practices of Audit Committees (J. Chen et al.); one of the four survey respondent groups was the Audit Committee Chairperson; lastly, the Municipal Finance Management Act (MFMA) section 166 requires that all municipalities have an Audit Committee in place or share one.

Choosing these four sample groups as survey participants were deemed appropriate because of their involvement with and knowledge about the Audit Committees in KZN local government. The Municipal Manager is the Head of municipal administration and the Accounting Officer of any municipality and invariably, all Audit Committees report directly to Municipal Managers; likewise, it was acceptable to elicit opinions of the Audit Committee Chairpersons because they know the Audit Committee practices conceivably more than any other group. The Finance Head (CFO) is a standing invitee to all Audit Committee meetings, and they play an integral support system for any effective Audit Committee; and the internal audit by far plays a never-changing pertinent role in supporting Audit Committees' practices through ensuring good internal controls (or general role in internal auditing). The last two groups of respondents (Finance Heads and Internal auditors) are more knowledgeable on issues surrounding Audit Committee practices but almost not included in the "day-to-day" functioning of Audit Committees. That was precisely why these two groups were considered more appropriate in obtaining that much valuable, objective, and independent opinion regarding the Audit Committee practices.

**Table 4.1: Sample of Questionnaire Survey**

<b>Key participants</b>	<b>Questionnaire surveys</b>
Municipal Managers	54
Audit Committee Chairpersons	54
Chief Financial Officers (Finance Heads)	54
Internal Auditors	54
<b>Total</b>	<b>216</b>

#### 4.4.2 Qualitative sample

Samples in qualitative research tend to be small in order to support the depth of case-oriented analysis that is fundamental to this mode of inquiry (Vasileiou, Barnett, Thorpe, & Young, 2018a). Additionally, qualitative samples are purposive, that is, selected by virtue of their capacity to provide richly textured information relevant to the phenomenon under investigation. Research experts argue that there is no straightforward answer to the question of ‘how many’ and that sample size is contingent on a number of factors relating to epistemological, methodological, and practical issues. Denzin and Lincoln (2011) recommend that qualitative sample sizes are large enough to allow the unfolding of a ‘new and richly textured understanding’ of the phenomenon under study, but small enough so that the ‘deep, case-oriented analysis’ of qualitative data is not precluded. Vasileiou et al. (2018) posit that the more useable data are collected from each person, the fewer participants are needed. The researcher took into account the parameters, such as the scope of the study, the nature of the topic (i.e., complexity, accessibility), the quality of data, and the study design, to contrive the following sample for interviews.

**Table 4.2: Sample of Interview Survey**

<b>Key participants</b>	<b>Interview surveys</b>
Municipal Managers	3
Audit Committee Chairpersons	3
Chief Financial Officers (Finance Heads)	3
Internal Auditors	3
<b>Total</b>	<b>12</b>



## **4.5 Data Collection Methods**

Primary data collection is an important piece of many research projects. Using proper techniques ensures that data is collected in a scientific and consistent manner. Improving data collection techniques will enhance the accuracy, validity, and reliability of research findings. Ultimately, using these methods will help to achieve the goal of carrying out high-quality research with credible findings. During the last twenty years, the collection of information in surveys has undergone a transformation in the means by which data is gathered. Mail surveys and face to face interviews provided the primary mechanisms for collecting data during 1940-1970 (Lyberg & Kasprzyk, 1991).

In this study, data was collected from all local government municipalities in the KZN. KZN is divided into one metropolitan municipality (eThekweni Metropolitan Municipality) and 10 district municipalities, which are further subdivided into 43 local municipalities. Permission or gatekeeper's letter to collect data was obtained from the Cooperative Governance and Traditional Affairs (CoGTA) department. This data was collected in two phases (phase 1 and phase 2), namely, the administration of questionnaires (quantitative), where a Likert scale questionnaires were mailed or hand delivered to the four respondent groups that are mentioned in 4.3.1, above. This phase was substantiated by phase 2, where a set of semi-structured interviews were conducted to a sampled group, in order to gather opinions on research issues.

### **4.5.1 Questionnaire Survey (QUAN)**

'Surveying' is the process by which the researcher collects data through a questionnaire (O'Leary, 2014). A 'questionnaire' is the instrument for collecting the primary data (Cohen, 2013). 'Primary data' by extension is data that would not otherwise exist if it were not for the research process and is collected through questionnaires and/or interviews (O'Leary, 2014). In other words, a questionnaire is a series of questions asked to individuals to obtain statistically useful information about a given topic. When properly constructed and responsibly administered, questionnaires become a vital instrument by which statements can be made about specific groups, people, or entire populations. Questionnaires are used frequently in quantitative marketing research and social research (Trueman, 2016). Closed or Structured Questionnaires are a method of research, which was advocated by Zohrabi (2013). It is a positivist research method that includes the low level of

involvement of the researcher and a high number of respondents (the individuals who answer the questions).

They predominantly facilitate in collecting a wide range of information and in describing the characteristics of a large population (De Vaus & de Vaus, 2013). Oppenheim (1992) reported the following advantages of the questionnaire survey method by mail:

- The most obvious appeal of the mail questionnaire is the low cost. The lower cost is particularly useful when the sample number is large.
- This method gives respondents the opportunity to think freely or to consult other people rather than give immediate answers as in the case of interviews. Thus, it is useful in avoiding error arising from interviewer bias.
- Through this method, researchers can reach respondents who live in widely dispersed addresses or abroad.
- The mail questionnaire provides greater anonymity for respondents.
- The questionnaire method is also preferable when a question demands a considered answer, or if answers require respondents to consult personal documents or other people.

#### ***4.5.1.1 Questionnaire design and structure***

There is no single way of assessing the effectiveness of Audit Committees in South African public/private sector (Motubatse, 2018). The survey questionnaires used in this study are adapted from emerging and leading practices to assist in the self-assessment of an Audit Committee's performance and a PhD study by Mohiuddin (2012). They were adapted to suit the public sector sphere of the government of the South African context. Thorough cognisance was made of the role of questionnaires, which is to elicit the information that will enable the researcher to answer the objectives of the survey (Brace, 2018). The first task with any survey is to define the objectives that the study is to answer. To do this the questionnaire must not only collect the data required but also collect it in the most accurate way possible. Collecting accurate data means getting the most accurate responses; therefore, the survey questionnaires used in this study were considered suitable in achieving study objectives and subsequently answer research questions. They provided accurate, good-quality information as the sequence of the different topics that are covered by the questionnaire, the sequence of individual questions and the sequence in which prompted responses

are most suited, given that it could have all dramatically affected the accuracy and reliability of the data collected.

Bourque and Fielder (1995) suggested that questions should be as easy as possible, short, and detailed, in order to help potential respondents fill out the questionnaire without the need for assistance, a sentiment echoed by . Cognisance was given to the fact that long questionnaires discourage the target respondents from completing the instrument and, consequently, it is either not fully completed or not returned at all. The aim of the questionnaire survey in this study was to obtain opinions on the current practices of Audit Committees in Corporate Governance in the KZN local government. Hence, it required the construction of the questionnaire in such a way that it was specific enough to reveal answers to the questions, yet general enough to allow respondents not to reveal any sensitive information. A closed-ended question offers a selection of answers from which the respondent is asked to select one. Hence, all questions in this instrument are close-ended and have been constructed according to the Likert Scale, as supported by Hussey and Hussey (1997); Zikmund (2000) and Nemoto and Beglar (2014) for cases similar to the current study.

Conducting a questionnaire survey is the process of translating concepts into measurable variables, it also allows the collection of a large volume of data from a sizeable population in a highly economical way (Nardi, 2015). The current study includes a sizeable population and a large volume of data needs to be collected in the most economical way possible. Questionnaire surveys are a valuable method of collecting a wide range of information from a large number of individuals, often referred to as respondents. Adequate questionnaire construction is critical to the success of a survey. Inappropriate questions, incorrect ordering of questions, incorrect scaling, or bad questionnaire format can make the survey valueless, as it may not reflect the views and opinions of the participants accurately. The technique has to ensure that all questions to respondents are in the same context (De Vaus & de Vaus, 2013). Bell (2014) and O'Leary (2014) emphasise thoughtfulness about the order of questions, considering logic and ease for respondents. O'Leary (2014) goes into further detail regarding issues with organisation and length; too lengthy and respondents are less likely to complete the questionnaire.

The questionnaire used in the current study is divided into two sections, namely, sections A and B. Section A outlines the biographical details of the respondents i.e. gender, age, qualifications, work experience. Section B is the main section of this questionnaire and is further subdivided into

three parts. Part I aims to gather opinions from respondents about prevailing Audit Committee practices in KZN local government municipalities. There are fifty (50) statements that are grouped into eight (8) different aspects that seek to do this. They are:

**a) Composition**

*Chapter One* noted that the MFMA section 166 makes it compulsory for municipalities to establish an (or share an established) Audit Committee. Section 166(2-6) further prescribes for the establishment, duties, requirements and composition of these committees. In the study, eight statements (Statements 1 to 8) investigated the Audit Committee's experience, knowledge and independence because these elements were noted (through literature) as influential elements in the Corporate Governance practices of Audit Committees. Rupley, Almer, and Philbrick (2011) noted the appropriate Audit Committee composition as one of the determinants of Audit Committee Effectiveness. Audit committee composition, the first input determinant of Audit Committee effectiveness, comprises independence and expertise. Independence is associated with reduced earnings management (Xie et al., 2003; Davidson et al., 2005; Vafeas, 2005). Guidelines (discussed in *Chapter One*) on the composition of Audit Committees in terms of the attributes of members, its independence and size have also been given in the Treadway Report (1987); the BRC (1999); the Sarbanes-Oxley Act (2002); the Combined Code (2003) and the King IV (2016). Therefore, the statements included in this section are:

- S1: The Audit Committee members are appointed in consultation with the Audit Committee chairperson.
- S2: The Audit Committee members have sufficient knowledge on the municipality's environment.
- S3: The Audit Committee members have sufficient knowledge on Accounting and/or Auditing practices.
- S4: The Audit Committee members have sufficient experience in Accounting and/or Auditing.
- S5: The Audit Committee members are capable of mediating problems in performing their duties.
- S6: The majority of Audit Committee members are independent/external members.
- S7: The chairperson of the Audit Committee is an independent/ external members.

S8: The size of the Audit Committee is appropriate for carrying out its duties properly.

Therefore the null hypothesis for this group of questions is:

***Ho (1): Differences observed in the mean scales of responses within four sample groups (Audit Committee Chairperson, Company Secretary, Finance Head and External Auditor) with respect to composition of the Audit Committees are statistically insignificant.***

#### **b) Authority and resources**

The second input determinant of Audit Committee effectiveness defined by DeZoort et al. (2002) is authority. Authority is derived from the Audit Committee charter and Municipal Council. Resource is the third input determinant of Audit Committee effectiveness (DeZoort et al., 2002). This recognises the Audit Committee's need for sufficient resources in order to efficiently carry out its responsibilities. Resource availability refers to the committee's access to management, Internal and External Auditors and to the size of the committee (DeZoort et al., 2002). Separate meetings with Internal and External Auditors that are not attended by management will increase impartial knowledge sharing and minimise information asymmetry between the Audit Committee and management (Raghunandan et al., 2001; Cohen et al., 2007), enhancing the effectiveness of the Audit Committee. To obtain opinions on the authority and resources provided with the Audit Committees in KZN local government, statements 9 to 13 are:

S9: The Audit Committee has adequate authority in order to carry out its responsibilities.

S10: The Audit Committee has ready access to relevant information if required.

S11: The Audit Committee receives prompt responses from the management in carrying out its duties.

S12: The Audit Committee is provided with sufficient resources including secretarial support to carry out its duties.

S13: The non-executive Audit Committee members are adequately paid for their time and efforts.

The null hypothesis for this group of questions is:

***Ho (2): Differences observed in the mean scales of responses within four sample groups with respect to authority and resources provided to the Audit Committees are statistically insignificant.***

### **c) Diligence**

The level of planning, vigilance, and activity of Audit Committee members in carrying out their duties is referred to as Audit Committee diligence (Kalbers and Fogarty, 1993). Due to the fact that vigilance is an unobservable feature, it has been operationalised as the amount of meetings conducted, with the presumption that an Audit Committee that meets more regularly is more likely to perform its obligations (DeZoort et al., 2002; Davidson et al., 2005). Using this measure, diligence has been associated with a reduced likelihood of financial statement fraud and non-fraudulent misstatements (Abbott and Parker, 2000; Abbott et al., 2004), restatements (Abbott et al., 2004), earnings management (Xie et al., 2003; Vafeas, 2005), enhanced financial statement disclosure (Kent and Stewart, 2008). The statements (statements 14 to 18) included in this section are:

S14: The Audit Committee has a charter which outlines its objectives, duties and responsibilities.

S15: The Audit Committee charter is reviewed annually.

S16: The Audit Committee members have a clear understanding of their responsibilities.

S17: Members of the Audit Committee readily assume their responsibilities.

S18: The Audit Committee members devote sufficient time to the affairs of the committee.

The null hypothesis for this group of questions is:

***H<sub>0</sub> (3): Differences observed in the mean scales of responses within four sample groups with respect to diligence of the Audit Committees are statistically insignificant.***

### **d) Meeting**

The number of meetings is a crude measure of Audit Committee activity and diligence (Menon and Williams, 1994) as a significant level of Audit Committee activity takes place outside formal meetings (Gendron and Bédard, 2006; Turley and Zaman, 2007). It has been argued that frequent meetings can indicate a lack of effectiveness (Bédard and Gendron, 2010). The statements (statements 19 to 26) included in this section are:

S19: The agendas of the Audit Committee meetings are finalised by the chairperson.

S20: The chairperson cooperates with other committee members before finalising the agenda of the meetings.

S21: The agenda and related materials are provided to members fairly ahead of the meetings.

S22: All members can express their views freely and independently in the meetings.

S23: The frequency of the Audit Committee meetings is sufficient to carry out its responsibilities.

S24: The duration of the Audit Committee meetings is sufficient for a full discussion of important issues.

S25: Non-members attend the Audit Committee meetings if required or invited.

S26: The minutes of the Audit Committee meetings are circulated to all members of the Municipal Council.

The null hypothesis for this group of questions is:

***H<sub>0</sub> (4): Differences observed in the mean scales of responses within four sample groups with respect to the effectiveness of Audit Committee meetings are statistically insignificant.***

#### **e) Role in financial reporting**

Statements 27 to 32 focused on the roles of Audit Committee in financial reporting process. Traditionally, the primary role of Audit Committee has been to monitor the integrity of the financial statements produced by management (Eyenubo, Mohammed, & Ali, 2017). In recent times, this major role has been expanded beyond the annual financial statements to encompass the quarterly financial reports. As a result, Audit Committees are becoming more interested in corporate reporting oversight, as opposed to financial reporting oversight. The statements included in this section are:

S27: The Audit Committee reviews the integrity of Municipality's financial statements.

S28: The Audit Committee reviews accounting policies and any changes made therein.

S29: The Audit Committee reviews accounting estimates and judgments done in preparing financial statements.

S30: The Audit Committee reviews the compliance of the Accounting Standards (e.g. IAS, IFRS etc.) in preparing financial statements.

S31: The Audit Committee reviews the clarity and completeness of disclosures in financial statements.

S32: The Audit Committee reviews other information (e.g. the Auditor General's report, financial highlights etc.) presented in the annual report.

The null hypothesis for this group of questions is:

***Ho (5): Differences observed in the mean scales of responses within four sample groups with respect to Audit Committee's role in financial reporting are statistically insignificant.***

**f) Role in external auditing,**

Turley & Zaman (2004) note that the impact of Audit Committees on the external audit process is an important issue about which there is limited research evidence. Prior research suggests that auditors perceive Audit Committees to be lacking in effectiveness and power, playing a passive role rather than engaging in an active two-way exchange with auditors (Cohen et al., 2002; Turley & Zaman, 2004). However, the findings of Stewart and Munro (2007) held greater emphasis on Audit Committees and their role in external auditing. External Auditors, who have direct access to Audit Committee can better identify and evaluate the impact of a range of diligence characteristics on actual Audit Committee effectiveness. Statements 33 to 40 were included in this group to solicit the role of Audit Committee in external auditing:

S33: External auditors are appointed and/or removed upon the recommendation of the Audit Committee.

S34: The Audit Committee assesses and reviews the expertise and resources of the external auditors.

S35: The Audit Committee reviews and approves the terms of the Engagement Letter (EL) prepared for the external auditors.

S36: The Audit Committee monitors the external audit firm's compliance with the existing ethical and regulatory requirements in South Africa.

S37: The Audit Committee reviews the findings of the annual audit obtained by the Auditor General/external auditors.

S38: The Audit Committee reviews the management's responsiveness to the Auditor General's findings.



S39: The Audit Committee meets with the external auditors without the presence of the management to discuss any issues, problems or reservations arising from the audit.

S40: The Audit Committee reviews and monitors the independence and effectiveness of the external auditing process.

The null hypothesis for this group of questions is:

***H<sub>0</sub> (6): Differences observed in the mean scales of responses within four sample groups in relation to Audit Committee's role in internal auditing are statistically insignificant.***

**g) Role in internal auditing, and**

Statements 41 to 48 solicited respondents to investigate the roles of Audit Committee in internal auditing process of the company. Lary and Taylor (2012) noted that Audit Committees play an important role in the monitoring of internal control as they rely on Internal Auditors for much of its information concerning corporate activities. Regulators and others recently highlighted the increasingly important role of internal auditing in supporting and interacting with the Audit Committee to ensure the integrity and quality of financial reporting. The observations of Barua, Rama, and Sharma (2010) suggested potential complementary and substitution effects between the Audit Committee and internal auditing, and thus raise important implications for future research. The statements included in this section are:

S41: The Audit Committee recommends and approves the appointment or termination of the heads of the internal audit division.

S42: The Audit Committee approves and reviews the charter of the Internal Auditors.

S43: The Audit Committee assesses and reviews the annual internal audit work plan.

S44: The Audit Committee reviews the annual internal audit reports, budget and other findings.

S45: The Audit Committee reviews and monitors the management's responsiveness to the Internal Auditor's findings and recommendations.

S46: The Audit Committee meets with the head of the internal audit function without the presence of the management.

S47: The Audit Committee enhances the independence of the Internal Auditors of the municipality.

S48: The Audit Committee monitors and evaluates the effectiveness of the internal audit function.

The null hypothesis for this group of questions is:

***H<sub>0</sub>(7): Differences observed in the mean scales of responses within four sample groups in relation to Audit Committee's role in external auditing are statistically insignificant.***

#### **h) Overall practices**

The two statements (statements 49 and 50) attempted to explore the perception of participants about the overall effectiveness of Audit Committee in the municipality. These generic statements were challenging to include in the above sections, but were imperative that the researcher solicits responses on these. The two statements included in this section are:

S49: The Audit Committee can work independently.

S50: The Audit Committee is effective.

The null hypothesis for this group of questions is:

***H<sub>0</sub>(8): Differences observed in the mean scales of responses within four sample groups with respect to overall perception on independence and effectiveness of the Audit Committees are statistically insignificant.***

Part II explores factors or challenges that may be affecting Audit Committee practices in KZN local government municipalities. Lastly, part III solicits suggestions from respondents on their perceptions on how Audit Committee effectiveness may be enhanced in KZN local government municipalities. The questions within the questionnaires were a structure with the following specific requisites:

- Should be clear and easy to understand,
- The layout is easy to read and pleasant to the eye,
- The sequence of questions easy to follow, and,
- Should be developed in an interactive style.

#### ***4.5.1.2 Questionnaire data collection procedure***

Surveys can be administered in four ways: through mail, by telephone, in person or online. When deciding which of these approaches to use, researcher considered: the cost of contacting the study participant and of data collection, the literacy level of participants, response rate requirements, respondent burden and convenience, the complexity of the information that is being sought and the mix of questions in the questionnaire. When compared, the researcher decided on mail questionnaires as an unequivocal mode of data collection for the following summarised advantages and disadvantages:

- *Advantages:* Low cost; respondents may have be more willing to share information and to answer sensitive questions; respondent convenience- can respond on their own schedule.
- *Disadvantages:* Generally lower response rates; only reaches potential respondents who are associated with a known address; not appropriate for low literacy audiences; no interviewer (hence interviews, as a second mode of data collection), so responses cannot be probed for more detail or clarification; participants' specific concerns and questions about the survey and its purpose cannot be addressed.

In the distribution of questionnaires, the researcher thoroughly considered the need to ensure confidentiality, to include a return date, to formulate a plan for 'late or no responses', and to record data as soon as it arrives.

#### ***4.5.1.3 Questionnaire pilot study and pre-testing***

The term pilot study is used in two different ways in social science research. It can refer to so-called feasibility studies which are "small scale version, or trial run, done in preparation for the major study" (Hazzi & Maldaon, 2015) or it can also be the pre-testing or 'trying out' of a particular research instrument (Chenail, 2011). One of the advantages of conducting a pilot study is that it might give advance warning about where the main research project could fail, where research protocols may not be followed, or whether proposed methods or instruments are inappropriate or too complicated. In the words of De Vaus (1993:54) "*Do not take the risk*" Normally, once you've finished designing your survey questionnaire, find 5-10 people from your target group to pretest it. If you can't get people from your exact target group then find people who

are as close as possible. In this study, the researcher chose two groups who were close to the target groups, namely, academics and External Auditors.

Academics possess the theoretical knowledge of Corporate Governance and Audit Committees as a whole. They are also well vested when it comes to research and methods used, together with instruments to collect data. A second eye from an academic ensured that the instrument used was worded correctly, of a suitable length and that all questions asked would conceivably be answered by targeted respondents with ease. On the other hand, External Auditors have the technical knowledge of the working of Audit Committees in industry, together with the application of the relevant legislation as promulgated in the public sector. One of the functions of External Auditors is to test the practices and effectiveness of an Audit Committee within that given audited accounting period. They have the tail end of the functions of Audit Committees in both the public and private industries.

The following table illustrates the total of 10 individuals from the two above mentioned groups who were chosen for formal pretesting. The overall response rate was 100% (i.e. a total of 10 questionnaires).

**Table 4.3: Response Rate of Questionnaire Pilot Study**

<b>Pilot Study Groups</b>	<b>Questionnaires Sent</b>	<b>Responses Received</b>	<b>Response Rate (%)</b>
Academics	5	5	100%
External Auditors	5	5	100%
<b>Total</b>	<b>10</b>	<b>10</b>	<b>100%</b>

The above pilot study took place from 4 November 2018 to 14 December 2018. The researcher received lucrative insight, ideas, and comments about the questionnaire content, sequence, and wording. However, no major amendments were made to any key content, except for the cover letter sent to respondents by the researcher, which was summarised so that it is easier to read and comprehend. This is fundamental as each respondent is most likely to make a decision on whether or not to fill in and return the questionnaire from reading through the cover letter; as a consequence this needed to be made simple, clear, and straight to the point.

#### ***4.5.1.4 Validity and Reliability of the questionnaire***

Validity is the ability of an instrument to measure what it is intended to measure, the degree to which the researcher has measured what he has set out to measure (Heale & Twycross, 2015), the extent to which an empirical measure adequately reflects the real meaning of the concept under consideration (Drost, 2011). On the other hand, reliability is the ability of an instrument to create reproducible results (Venkitachalam, 2014). A questionnaire is said to be reliable if we get same/similar answers repeatedly. Though reliability cannot be calculated exactly, it can be measured by estimating correlation coefficients.

Questionnaires generally have low validity because they do not explore questions in any detail or depth. Complex issues requiring a respondent to explain their reasons for believing something are difficult to explore. Where closed questions are used, the respondent is restricted to answers using categories provided by the researcher and there is little opportunity to qualify the meaning of answers (Trueman, 2016). However, the fact that postal questionnaires can be anonymous means respondents may be encouraged to answer questions truthfully in the knowledge that they cannot be identified. This may increase the validity of their responses. Researchers are normally concerned with two types of validity, namely *content validity* and *construct validity*.

Content validity is the extent to which a measuring instrument covers a representative sample of the domain of the aspects measured. Researchers evaluate the content validity of an instrument by first agreeing on what elements constitute adequate coverage of the problem. The questionnaire used in the current study covers all-important aspects identified within the literature already discussed in *Chapters Two and Three* of this thesis. Lastly, the duration taken to complete the questionnaire was checked and timed to ensure that it was not long enough to discourage respondents from completing it.

Construct validity is the most important type of validity. It assesses the extent to which a measuring instrument measures accurately a theoretical construct it is designed to measure (Venkitachalam, 2014). Construct validity is much more difficult to validate, as researchers want assurance that their measurement has an acceptable degree of validity. The questionnaire used in this study contains clear and direct questions, indicating that construct validity is acceptable. Moreover, the

use of interviews as an additional method to gather data contributed positively to construct validity. Finally, the use of a Five-Point Likert scale in the questionnaire has also contributed to improving the construct validity.

Assessing the reliability of data is imperative before making any statistical analysis. Reliability is measured in aspects of *stability*, done to ensure that the same results are obtained when used consecutively for two or more times, where a *test-retest method* is used. In addition, *internal consistency* is used to ensure all subparts of an instrument measure the same characteristic (homogeneity), where the *split-half method* is used. Finally, *equivalence*, is used when two observers study a single phenomenon simultaneously, where *inter-rater reliability* is used (Venkitachalam, 2014).

The validity and reliability of a questionnaire survey have already been established, the instrument used was adapted from the Financial Reporting Council's guidance on Audit Committee and a study conducted by Mohiuddin (2012), to suit the South African public sector context.

#### **4.5.2 Interview Survey (qual)**

In general, there are four types of personal interviews: structured, semi-structured, unstructured, and focus group interviews (Bell, 2018).

Structured interviews (also known as standardised interviews or researcher-administered surveys) are a quantitative research method commonly employed in survey research. The aim of this approach is to ensure that each interview is presented with exactly the same questions in the same order (Sekaran, 2016). This ensures that answers can be reliably aggregated and that comparisons can be made with confidence between sample subgroups or between different survey periods.

Unstructured interviews or non-directive interviews are interviews in which questions are not prearranged. These nondirective interviews are considered to be the opposite of structured interviews which offer a set amount of standardised questions. The form of the unstructured interviews varies widely, with some questions being prepared in advance in relation to a topic that

the researcher or interviewer wishes to cover Sekaran (2016). They tend to be more informal and freeflowing than a structured interview, much like an everyday conversation.

Focus group interviews are a “group comprised of individuals with certain characteristics who focus discussions on a given issue or topic” (Sekaran, 2016). According to Dilshad (2013), “focus groups consist of a small group of people, usually between six and nine in number, who are brought together by a trained moderator (the researcher) to explore attitudes and perceptions, feelings and ideas about a topic”. Focus group interviews provide a setting for the relatively homogeneous group to reflect on the questions asked by the interviewer.

The study made use of semi-structured interviews. In semi-structured interviews, questions follow a less rigid format (than those on structured interviews). Although still using standardised questions (covering socio-biographical details like age, sex, and educational qualification), there are also open-ended questions designed to elicit more qualitative information. The strength of semi-structured interviews arises in the process of “open discovery” when the matters explored change from one interview to the next as different aspects of the topic are revealed (Sekaran, 2016).

When choosing the type of interviews, the researcher was cognisant of the objective of interviews that they need to allow respondents to further develop their views since the closed questions of questionnaires lock respondents into arbitrarily limited alternatives (Bryman, 2016). However, in the semi-structured interview method, the researcher enjoys flexibility in terms of the sequence of questions, response options, and probing questions. The researcher provides some structure based on research interests and interview guide, but works flexibly with the guide and allows room for the respondent’s more spontaneous descriptions and narratives. These interviews were conducted face-to-face and recorded. Interviewees were selected randomly and a consent form signed by each respondent to ensure confidentiality and anonymity. The questions were open-ended and probing in order to get in-depth answers.

#### ***4.5.2.1 Interview schedule design and structure***

Interviews are primarily done in qualitative research, occur when researchers ask one or more participants general, open-ended questions, and record their answers Creswell (2012), who

recommends using only open-ended questions during interviews, since they are primarily qualitative. While every interview requires a somewhat different structure, certain principles and techniques are applicable to all. The researcher was cognisant of the fact that well planned and conducted semi-structured interviews are the result of rigorous preparation. The development of the interview schedule, conducting the interview, and analysing the interview data all require careful consideration and preparation. In addition, each interviewing schedule should have the following three major parts: (1) the opening (2) the body (3) the closing.

The opening (starting questions) was designed to make the respondent/interviewee feel welcomed and relaxed. In addition, they clearly indicated the objectives of the interview, made it clear what topic areas were being addressed, and set the tone for the interview. The body of the interview schedule always listed the topics to be covered and potential questions (i.e., composition of Audit Committees, diligence of Audit Committees, factors affecting Audit Committee effectiveness). The researcher utilised moderately scheduled interviews that contained major questions and probing questions under each. This schedule still allowed some freedom to probe into answers and adapt to the situation. In addition, this type of schedule aided in recording answers, as audiotapes are utilised to allow for transcription that is more consistent.

The closing maintained the tone set throughout the interview and was brief but not abrupt. The researcher (interviewer) summarised the main issues discussed during the interview and asked all interviewees to share and elaborate freely, as deemed appropriate, any issues relating to Audit Committee practices in KZN local government municipalities that might have not been covered in the interview and which they felt were important.

In this way, the researcher saw it best to start with questions that participants could answer easily and then proceeded to more difficult or sensitive topics. This helped to put respondents at ease, built up confidence and rapport, and generated rich data that subsequently developed the interview further.

#### ***4.5.2.2 Interview data collection procedure***

Qualitative methods, such as interviews, provide a 'deeper' understanding of social phenomena than would be obtained from purely quantitative methods, such as questionnaires (Newing, 2010). The study utilised interviews to supplement questionnaires, and seek deeper meaning and understanding on the topic. The researcher conducted one-on-one interviews between an



interviewer and the participant, meant to gather in-depth information on the Corporate Governance practices of Audit Committees in KZN local government municipalities. Twelve interviews were conducted, nine face-to-face and three telephonically. All interviews were recorded, with prior consent from participants upon signing the provided consent form. In maintaining strict confidentiality of all participants, the researcher made use of pseudonyms (fictitious names) in qualitative research analysis and is quite typical of asking participants to choose their own pseudonym.

#### ***4.5.2.3 Interview pilot study and pre-testing***

Piloting the main study is strongly recommended by (Thabane et al., 2010), as this “might give advance warning about where the main research could fail, where research protocols may not be followed” (Hazzi & Maldaon, 2015). Qualitative interviews offer rich and detailed information in understanding people’s experiences. However, qualitative inquiry might be difficult for the inexperienced researcher to perform the interview adequately (Sutton & Austin, 2015). Piloting for interview is an integral aspect and useful in the process of conducting qualitative research as it highlights the improvisation to the major study.

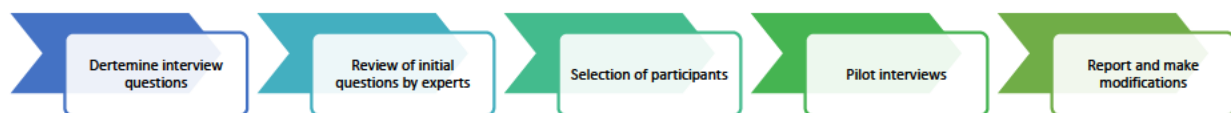
The researcher deemed it fit to pre-test the research instrument (semi-structured interview), to assess whether the proposal was workable. Lastly, Castillo-Montoya (2016), in her work, reflected about her experience interviewing known participants and stated that it may appear contrived and unnatural. For these reasons, the researcher selected the following sampled participants, which were not included in the selected main project sample:

**Table 4.4: Response Rate of Interview Pilot Study**

<b>Pilot Study Groups</b>	<b>Interviews Conducted</b>	<b>Responses Received</b>	<b>Response Rate (%)</b>
Municipal Manager	1	1	100%
Audit Committee Chairperson	1	1	100%
CFO (Finance Head)	1	1	100%
Internal auditor	1	1	100%
<b>Total</b>	<b>4</b>	<b>4</b>	<b>100%</b>

The interview was guided by open-ended questions on issues related to Corporate Governance practices of Audit Committees in KZN local government. Subsequently, the supervisory committee members reviewed the interview questions pertaining to its language, wording, and relevance. At this point in the process, one starting question was modified accordingly. Pilot study participants were selected and permission sort to engage them. In pilot interviews, Dikko (2016) suggests that the participants should share as similar criteria as possible to the group of participants for the major study. Likewise, Moser and Korstjens (2018) also share a similar notion. The researcher had given the inclusion criteria of the participant beforehand. The pilot study was conducted from 4 March 2019 to 15 March 2019. A letter of informed consent was given to each of the participants, interviews were recorded using digital IC recorders, and ranged in time between approximately 14 and 27 minutes each. The interview should not exceed 90 minutes to consider other commitments of participants (Jacob & Furgerson, 2012).

After the pilot study was completed, the researcher had the opportunity to transcribe verbatim, manage, and code the data. The lessons in transcribing and managing the data enabled the researcher with some knowledge on how to summarise the transcripts and to identify codes. Without a doubt, the significance of the pilot study assisted researcher to refine strategies before embarking on the major study phase. There were two modifications made, however, the researcher gained valuable experience and insight as a result of piloting the study. The pilot study steps carried out abled the researcher to obtain necessary information to address the aim of the study. The following Figure 4.1 describes the process undertaken:



**Figure 4.1:** Steps in conducting the pilot study. Self-generated

## **4.6 Data Analysis Method**

Data obtained from any research needs to be analysed and interpreted for it to be useful in meeting research objectives and answering the research questions (Palinkas et al., 2015). Kerlinger (1986) pointed out three different motives for the use of statistical analysis, namely: firstly, to reduce large quantities of data to a manageable and understandable form; secondly, to aid in the study of population and samples; and thirdly, to assist decision-making and to enable the deduction of reliable inferences. While the previous section of this chapter has illustrated various methods of data collection, this section stated the statistical tests used to report the questionnaire survey responses and interview survey responses of sampled respondents in respect of different aspects of Audit Committee practices in KZN local government.

### **4.6.1 Questionnaire Survey**

Although the data have been analysed after conducting the questionnaire survey, much thought has been given to the testing and analysis of results during the questionnaire design. The first step in analysis, especially in surveys, is the editing and coding of collected data. The researchers usually check the data to make sure it is as accurate as possible, consistent with other facts secured, uniformly entered, as complete as possible, and arranged to facilitate coding and tabulation. The statistical analysis of collected data can be used for two purposes, which are commonly referred to as descriptive and inferential (Rovai, Baker, & Ponton, 2013). The selection of statistical tests for analysing data depends on some factors Siegel (1988) that include: the number of groups involved (independent variables), the number of subjects in each group, whether the groups were related or independent, and the measurement scale of the data values.

There are two broad classifications of statistical tests used in data analysis, namely, parametric and non-parametric. The use of parametric tests is said to be appropriate when the following assumptions are adhered to (see Kinnear and Gray, 2009; Siegel, 1995; Siegel and Castellan, 1988):

- The observations must be independent of error,
- The observations must have equal variance in the various treatment populations,
- The observations must be drawn from normally distributed scores in the treatment of population, and
- The variables must have been measured in at least an interval scale.

Conversely, non-parametric tests in social science research are as equally important as their parametric counterparts. Siegel and Castellan (1988) argued that behavioural scientists rarely have data that satisfy the assumptions of the parametric test, which includes achieving the sort of measurement that permits meaningful interpretation of parametric tests. This technique is considered distribution-free due to the fact that it makes no assumption about the distribution of scores in the population. In fact, the nonparametric techniques do not necessitate measurement on an interval scale and do not require the data to fulfil the strict assumptions of the parametric methods, such as normality and homogeneity of variance. It is clear that the use of the nonparametric techniques is more appropriate in this study, as the collected data is weaker than that of an interval scale. Moreover, the statistical test utilised is determined by the information in the scale. It is important to note that nonparametric techniques have been constructed to elude the requirement of numerous statistical assumptions as in the parametric techniques. Bereson and Levine (1992) and Siegel and Castellan (1988) documented a number of advantages of employing the nonparametric tests, namely:

- Non-parametric methods may be used on all types of data;
- Depending on the parametric procedures selected, non-parametric methods may be almost, or are even equally, as powerful as the classical procedures when the assumptions of the latter are met and may be quite a bit more powerful when the assumptions of the classical procedures are not met;
- Non-parametric methods are generally easy to apply when the sample sizes are small;
- Non-parametric methods make fewer, less stringent assumptions than the classical procedures;
- Non-parametric methods permeate the solution of the problem without testing the parameters of the population; and,
- Non-parametric methods may be more economical than classical procedures, since the researcher may increase power and yet save money, time, and labour by collecting large samples of data which are more grossly measured and, therefore, solve the problem faster.

Having considered that the questionnaire survey responses of this study are of the opinion type on a scale-based options, it was decided that nonparametric tests would be used in the present study

to facilitate statistical analyses. According to Gliner, Morgan, and Leech (2011), a statistical analysis should involve both descriptive and inferential types of analysis. The statistical techniques used for the purpose of analysing the data relevant to this research are reviewed in the following section.

#### ***4.6.1.1 Descriptive Statistics***

The descriptive statistical technique refers to transformation from raw data to a form that is organised and easy to interpret for descriptive information. They provide simple summaries about the sample and the measures. This technique normally involves the calculation of mean, median, frequency distribution, percentage distributions, rank, skewness, kurtosis, and standard deviation (SD) to help the researcher describe the characteristics or average scores and the variability of scores in the sample (Cronk, 2019). They, however, do not make provisions to conclude beyond the data that have been analysed or reach conclusions regarding any hypotheses made. They are simply a way to describe our data (Maxwell, 2010).

Descriptive statistics are very important because if we simply presented our raw data it would be hard to visualise what the data was showing, especially if there was a lot of it. Descriptive statistics therefore enables us to present the data in a more meaningful way, which allows simpler interpretation of the data. The current study has used descriptive statistical measures (such as means, medians, frequency distribution, percentage, rank, and standard deviation) to state current practices of Audit Committees in KZN local government.

#### ***4.6.1.2 Analytical Statistics***

The analytical, or inferential, method is the process whereby conclusions and generalisations are derived from the raw data. These are techniques that allow for the use of samples to make generalisations about the populations from which the samples were drawn. The process starts from data collection, is followed by descriptive analysis, and completed by analysis of significance and differences (Rea & Parker, 2014). Therefore, the current study employed analytical statistics for two purposes: (1) the estimation of parameter(s) and (2) testing of statistical hypotheses.

### ***(i) Testing the Significance of Responses***

The significance of the responses towards 50 statements of the questionnaire was examined by using the Wilcoxon Signed Rank Test. For nonparametric sets of data, the Wilcoxon Signed Rank Test can be used as a substitute of one sample t-test in parametric statistics (Chan, 2003). A Wilcoxon Signed Rank test is a nonparametric test that can be used to determine whether two dependent samples were selected from populations having the same distribution. The test computes the difference between the sample mean and the hypothesised value. Therefore, the mean score of responses was compared with 3 (the mid score of the 5 point scale) to examine the significance of agreement or disagreement using a Wilcoxon Signed Rank Test.

### ***(ii) Testing the Hypotheses***

Kerlinger (1986) mentioned four different reasons for using statistical analysis, which are:

- (i) To reduce a large quantity of data to a manageable and understandable form,
- (ii) To aid in the study of the population and samples,
- (iii) To assist decision making, and
- (iv) To enable the deduction of reliable inference.

Many statistical tools could be used for analysing the data collected from the questionnaire survey. However, the main objective of the analyses was to investigate the Corporate Governance practices of the Audit Committees in KZN local government. The idea was to generate an indicator to measure the variability of an individual response within a particular distribution. This study aimed to make inferences from sample statistics to the population parameters. Therefore, hypothesis testing was done to compare the opinions of respondents on the current Corporate Governance practice of the Audit Committees in all KZN municipalities. In order to test the stated hypotheses, the researcher carried out two nonparametric tests, namely: The Kruskal-Wallis One-Way Analysis of Variance Test Score, and the Mann-Whitney U Test. The following discussions briefly introduce these two testing techniques.

*a) The Kruskal-Wallis Test*

The Kruskal-Wallis Test is the non-parametric version of the parametric ANOVA Test for calculating the difference in the population mean. It is a test of one-way, between-groups analysis of variance, that allows a comparison of three or more groups (Dwivedi, Mallawaarachchi, & Alvarado, 2017). Borg and Gall (1983) stated that the Kruskal-Wallis Test is "*a statistical technique used to compare categorical data. It also gives a comparison of the distribution of individual variables from two or more different groups and produces a measure of relationship, called the contingency coefficient, which is similar to the correlation coefficient*". In addition, the conditions that should be met for the appropriateness of using the Kruskal-Wallis Test include: the data must be a random sample from a large population, the expected number in each category should not be too small, and the rule of thumb is to demand that at least five counts be expected in each category (Siegel and Castellan, 1988). When the obtained value of Kruskal-Wallis (H) test is significant, this indicates that at least one of the groups is different from at least one of the others. To identify the differing group, Kruskal-Wallis pairwise comparison (six pairs of four groups<sup>24</sup> i.e. 1&2; 1&3; 1&4; 2&3; 2&4; 3&4) has been conducted.

*(i) Analysing the Significance of Test Results*

To analyse the statistical test results in Chapter Five, the researcher has assumed a 5% level of significance (i.e. a probability or p level of 0.05 or five times out of a hundred has been considered). When the p-value of a statistics is less than the significance level, the value of the statistic is said to be significant. The conventional probability, or p-value, for deciding that a result is not due to chance, has been set as equal to, or less than, 0.05 (i.e. five out of a hundred). If we are willing to accept a 5% chance of making an error, we can construct a 95% confidence interval (Weisberg et al, 1996; Cramer, 1998). If the probability is less than 0.05, then it is thought unlikely to have been due to chance. If, on the other hand, the probability level of an outcome is above 0.05, then that result is statistically nonsignificant, in the sense that it is considered likely that it could have been due to chance (Cramer, 1998). In other words, the p-value is the probability that the null hypothesis is true. If the p-value is less than 0.05, we would say that the result is significant at the 0.05 level (Weisberg et al, 1996). To sum up, Kinnear and Gray (2000) posited:

- (i) If the p-value is greater than 0.05, H is accepted and the result is not significant;

- (ii) If the p-value is equal to or less than 0.05 but greater than 0.01, H is rejected and the result is significant beyond the 5 per cent level; and,
- (iii) If the p-value is less than 0.01, H is rejected and the result is significant beyond the 1 per cent level.

#### **4.6.2 Interview Survey**

The responses obtained from the interview survey have been analysed following a 'Grounded Theory' approach. Grounded theory is most accurately described as a research method in which the theory is developed from the data, rather than vice versa. That makes this an inductive approach, meaning that it moves from the specific to the more general. Strauss and Corbin (1990) defined grounded theory as:

*"... a qualitative research method that uses a systematic set of procedures to develop and inductively derive grounded theory about a phenomenon".*

Strauss and Corbin (1998) further defined grounded theory as:

*"... the theory derived from data, systematically gathered and analysed through the research process. In this method, data collection, analysis and eventual theory stand in close relationship to one another".*

The primary objective of grounded theory is to expand upon an explanation of a phenomenon by identifying the key elements of that phenomenon, and then categorising the relationships of those elements to the context and process of the research. The basic idea of the grounded theory is to read and re-read a textual database (for example, field notes) and discover or label variables called categories, concepts and properties, and their interrelationships. The ability to perceive variables and relationships is termed 'theoretical sensitivity' and is affected by a number of factors, including one's reading of the literature and one's use of techniques designed to enhance sensitivity. There are three methods of analysis involved in grounded theory from which sampling procedures are typically derived, which are: open coding, axial coding, and selective coding (Strauss & Corbin, 1998).



**Open coding** is that part of the analysis concerned with identifying, naming, categorising, and describing phenomena found in the text, essentially, each line, sentence, and paragraph. The process of naming or labelling things, categories, and properties is known as coding. Coding can be done very formally and systematically or quite informally. In grounded theory, it is normally done quite informally. For example, if, after coding much text, some new categories are invented; grounded theorists do not normally go back to the earlier text to code for that category. However, maintaining an inventory of codes with their descriptions (i. e. creating a codebook) is useful, along with pointers to the text that contain them (Parker & Roffey, 1997).

**Axial coding** is the process of relating codes (categories and properties) to each other, via a combination of inductive and deductive thinking. To simplify this process, the grounded theorists emphasise causal relationships, and fit things into a basic frame of generic relationships (Oktay, 2012).

**Selective coding** is the process of choosing one category to be the core category, and relating all other categories to that category. The essential idea is to develop a single storyline around which everything else is draped. There is a belief that such a core concept always exists. Selective coding is about finding the driver that propels the story forward (Suter, 2012).

In analysing the interview responses in the study, the researcher followed the basic stages of grounded theory. Firstly, the ‘critical instances’ of the interview transcripts were highlighted. This stage excluded things like digressions, repetitions, and other irrelevant material. Secondly, ‘open coding’ was done to assign the quotes to categories. A category is an abstract conceptual label which summarises the key characteristics of a passage. This was a relatively more time-consuming stage which involved working through the transcripts in turn to collect numerous quotes and examples of each existing category and to identify new ones. Many categories were identified from the first transcript and then progressively fewer new categories from each successive transcript, as the proportion of new information decreases. The process of assigning quotes to categories was repeated for one transcript by a second, independent person, to check the reproducibility of assigning quotes to categories. At the end of this stage, an initial list of categories was produced to facilitate the next stages. Thirdly, the researcher performed ‘axial coding’ which involved

refining this list by deleting or combining some categories, followed by making connections between the categories and defining properties, for instance context and preconditions. Finally, 'selective coding' was done and this involved the identification of a core category or broad theme from which the general findings were inferred. In this research, the researcher tried to attract interviewees by means of the prepared questions that let them tell a story about the scenario of Audit Committee practices in KZN local government.

#### **4.6 Validity, Reliability and Trustworthiness**

As this study entails the use of both qualitative and quantitative research data, the concepts used to express validity and reliability are broader than those traditionally associated with quantitative research. When working with qualitative data, the concepts of trustworthiness, dependability, transferability, and credibility are also used. According to Kivunja and Kuyini (2017), validity is the degree to which the interpretations and concepts have mutual meanings between the participants and the researcher. Reliability, on the other hand, according to Girden and Kabacoff (2010), is the degree to which the findings of the research are independent of accidental circumstances. It is closely related to assuring the quality of field notes and guaranteeing the public access to the process of the publication of the research results. Kivunja and Kuyini (2017) define reliability as the extent to which results are consistent over time, and are an accurate representation of the total population under study. If the results of a study can be reproduced under a similar methodology, then the instrument is considered to be reliable.

In order to ensure the validity and reliability of the content of the two questionnaires, the official statisticians from the School of Mathematics, Statistics, and Computer Science in the College of Agriculture, Engineering and Science at the University of KwaZulu-Natal reviewed the questionnaire. The questionnaire was further piloted in the manner outlined in *Section 4.5.1* (above) to test their validity and reliability. Triangulation, thick description, and peer review were processes undertaken for ensuring validity and reliability, legitimising the data, and finally lending credibility to the research report were used for this study.

#### 4.6.1 Triangulation

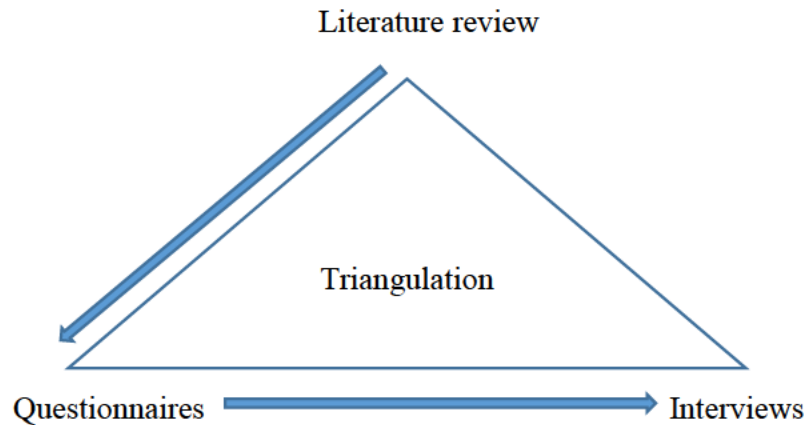
In the social sciences, triangulation refers to the application and combination of several research methods in the study of the same phenomenon by combining multiple observers, theories, methods, and empirical materials, researchers hope to overcome the weakness or intrinsic biases and the problems that come from single method, single-observer, and single-theory studies.

Heale and Forbes (2013) define triangulation as the use of two or more methods of data collection to study a particular phenomenon. Ncube (2015) refer to the work of Bailey-Beckett and Turner (2001:2) who indicates that “...by combining multiple observers, theories, methods, and empirical materials, researchers can hope to overcome the weakness or intrinsic biases and the problems that come from single-method, single observer, and single-theory studies. Often the purposes of triangulation in specific contexts are to obtain confirmation of findings through convergence of different perspectives. The point at which the perspectives converge is seen to represent reality.”

Triangulation is viewed as a verification procedure whereby researchers search for convergence among multiple and different sources of information to form themes or categories in a study. It is a system of sorting through the data to find common themes or categories by eliminating overlapping areas. Triangulation was employed in this study.

Extensive literature reviewed provided themes (i.e. composition of Audit Committees, diligence of Audit Committees, authority and resources of Audit Committees), from where questions were developed under each of the themes and sampled participants were asked to participate in the questionnaire survey and finally, twelve participants partook in interview surveys. For the purpose of this study, the three sources of data are placed at the points of a triangle, where each data source provides a philosophical starting point for the other data sources.

The three data sources for this study, and how they were triangulated, are represented in the following diagram:



**Figure 4.2:** Triangulation of data sources. Self-generated

The figure represents the three data sources used in this study, namely: literature review, questionnaires, and interviews. The literature review was used to provide secondary data which assisted the researcher to formulate themes and questions for the questionnaires. The findings from the analysed questionnaires informed the types of questions which were included in the interview schedule. Four types of triangulation are identified by Denzin (1994). Only two of these were used for the purposes of this study, namely data triangulation and methodological triangulation.

Data triangulation concerns itself with the use of various data sources, and in this study, interviews, questionnaires, and an in-depth literature review were conducted. Methodological triangulation concerns itself with the use of both qualitative and quantitative methods in the same study (Jogulu & Pansiri, 2011). Triangulation offered the following benefits for this study: it provided additional sources of valuable insight that could not be obtained from the literature review alone; it minimised the inadequacies of single-source research by engaging three data sources which complemented and verified each other, and it also provided richer and more comprehensive information in the sense that the researcher was able to draw information from various sources including the face-to-face interviews which provided first hand experiences of participants.

#### **4.6.1 Thick description**

Thick description is a procedure that is used in qualitative research to ensure validity and reliability. This procedure is concerned with describing the setting, the participants, and the themes of a qualitative study in rich detail. Thick description has been used in this study in the presentation of the qualitative research findings where the actual words of the participants have been used constantly. The purpose of thick description is that it creates “verisimilitude”, that is, statements that produce for the readers the feeling that they have experienced, or could experience, the events being described in the study.

The purpose of reporting the findings using thick description is to provide as much detail as possible for the readers. It also enables the readers to make decisions about the applicability of the findings to other settings or similar contexts. In this study, the researcher has described in detail the themes in *Chapter Two*, the background of KZN in *Chapter One* - where the research took place, and all the samples of participants have been thoroughly described.

#### **4.6.1 Peer review**

The third and last procedure for ensuring validity and reliability in this study is peer review. Peer review is the review of the data and research process by someone who is familiar with the research or the phenomena being explored (Anney, 2014). A peer reviewer provides support, plays devil’s advocate, challenges the researcher’s assumptions, pushes the researcher to the next step, and asks in-depth questions about methods and interpretations (Amankwaa, 2016). This procedure was used during both phases of data collection and interpretation. The peer reviewers were an experienced colleague who has already completed his PhD and is a senior lecturer at the University of KwaZulu-Natal, together with an experienced audit manager at the office of the Auditor General of South Africa, who holds a PhD in similar area of study (local government municipalities). The peer reviewers have expertise and knowledge of the subject matter of the thesis and provided quality advice and feedback.

## **4.7 Ethical Considerations**

Clough and Nutbrown (2002:84) comment as follows with regard to ethics in research: *“.....in order to understand, researchers must be more than technically competent. They must enter into chattered intimacies, open themselves to their subjects’ feeling worlds, whether these worlds are congenial to them or repulsive. They must confront the duality of represented and experienced selves simultaneously, both conflicted, both real.....”* In keeping with Clough and Nutbrown’s view above, the researcher took into account the same considerations, and protected the feelings, welfare, and rights of the participants (see Appendix 1 for a copy of the ethical clearance certificate from the Ethics Committee at the University of KwaZulu-Natal).

In concert with the rules and regulations of the university with regard to conducting research using human subjects, the following ethical considerations were taken into account during the course of the research. These considerations applied to both the quantitative and qualitative research sections of this study.

### **4.7.1 Permission**

The researcher obtained written permission and gatekeeper’s approval from the Acting Deputy Director General: Local Government of the Cooperative Governance and Traditional Affairs in the KZN province to conduct this research, in order to ensure that it is a legal exercise. The letter of permission is provided in Appendix 2.

### **4.7.1 Confidentiality and privacy**

Confidentiality refers to handling the information concerning the respondents in a confidential manner. Respondents were assured that their names and the names of the municipalities they work for or are Audit Committee members at, would be dealt with in the strictest confidence. Maintaining anonymity is essential in qualitative research (by using a pseudonym). Maintaining confidentiality is somewhat more challenging, however, the use of pseudonyms (fictitious names) in qualitative research is quite typical, as is asking if participants can choose their own pseudonym. After transcribing, the tapes were kept in a safe and confidential place. After the study has been completed and a report written, the tapes will be destroyed.

This aspect includes the principle of trust in which the researcher assured the participants that their trust would not be exploited for personal gain or benefit, by deceiving or betraying them in the research route or its published outcomes (Kamanzi & Romania, 2019).

#### **4.7.1 Voluntary participation and informed consent**

The principle of voluntary participation was explained to all the respondents and they were also informed that they had the right to withdraw (at any time) from the study. The principle of informed consent was attached to the questionnaires and verbally explained to the interviewees. Both principles entailed explaining the research process and its purposes to the participants.

#### **4.8 Conclusion**

The present chapter has explained the research approach adopted in this study. It presented the factors that have influenced the choice of these techniques and approaches. It also reported the procedures followed in the design and development of the close-ended questionnaire. This chapter has also explained how the pilot study was carried out to develop the questionnaire, how it was conducted, and the benefits that had been gained from the parties of piloting. It has provided details of the questionnaire survey procedures followed in the study. Furthermore, the chapter discussed the second phase of data collection which consisted of semi-structured interviews, and the piloting of these interviews. In brief, the chapter has given an elaborate picture of the research methodological issues of the study and discussed how these have been addressed. The next chapter presents in more detail the descriptive and inferential analyses of data obtained through the questionnaire survey.

## **CHAPTER FIVE**

### **ANALYSIS AND DISCUSSION OF THE QUESTIONNAIRE SURVEY FINDINGS**

#### **5.1 Introduction**

This chapter will present the results obtained through a questionnaire survey from respondents involved in the investigation of the practices of Audit Committees in Corporate Governance in all KwaZulu Natal local government municipalities. A total of 80 questionnaires were completed by respondents among 216 questionnaires dispatched. In this research, descriptive and inferential statistics have been adopted to analyse the data using a 5% significance level.

The structure of this chapter is as follows: the background for respondents is provided in Section 5.2, the description statistics of the responses are highlighted in Section 5.3, and the statistical test results of surveying data are discussed in Section 5.4. Finally, the chapter is summarised by Section 5.5.

#### **5.2 Background of Respondents**

In social sciences research, personnel characteristics of respondents have a very significant role to play in expressing and giving the responses about the problem. Keeping this in mind, in this study a set of personal characteristics, namely, education, qualification, position held, and experience of the questionnaire survey, respondents are discussed in this section in order to facilitate a better understanding on their background.

##### **5.2.1 Education**

Education is a complex topic for survey measurement, and the individual's educational attainment is only a narrow snapshot of possible measures relating to an individual's educational experience (Smith, 1995). It is, however, a pervasive concept in social science theories, and accordingly, one of the most used variables in social science research using individual level data. It is, therefore, crucial that reliable and valid measure of educational attainment is acquired. Even if not of direct theoretical relevance for a specific piece of research, it is standard practice to control for individual's educational attainment, given this variable correlates substantially with many other



variables. Therefore, the highest educational degree (of each of the respondents) of the four sample groups, is presented in the following table.

**Table 5.1: Analysis Depicting the Educational Qualification of Respondents**

<b>Highest Qualifications</b>		<b>Current position held</b>				<b>Total</b>
		<b>Municipal Manager</b>	<b>Audit Committee Chair person</b>	<b>CFO (Finance Head)</b>	<b>Internal Auditor</b>	
Diploma	Count	0	4	0	0	4
	% within Current position held	0.0%	11.4%	0.0%	0.0%	5.0%
Degree	Count	3	6	3	3	15
	% within Current position held	25.0%	17.1%	14.3%	25.0%	18.8%
Honours/CTA	Count	0	7	11	9	27
	% within Current position held	0.0%	20.0%	52.4%	75.0%	33.8%
Masters	Count	9	18	7	0	34
	% within Current position held	75.0%	51.4%	33.3%	0.0%	42.5%
<b>Total</b>	<b>Count</b>	<b>12</b>	<b>35</b>	<b>21</b>	<b>12</b>	<b>80</b>
	<b>% within Current position held</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

The table depicts that the majority of Municipal Managers (75%) hold a Masters degree and the remaining (25%) hold a Bachelors degree. This was not surprising, as one would expect that the Accounting Officer of a municipality be a highly educated individual, with a postgraduate degree. Their position within the municipalities encompasses extensive managerial expertise.

The majority of Audit Committee Chairpersons hold a Masters degree (51.4%), with 20% holding an honours degree, 17.1% holding a basic degree and those with a diploma are 11.4%. It also indicates a good spread of educated individuals, as one expects Audit Committee Chairpersons to be industry professionals, i.e. lawyers, accountants, auditors. Setiany, Hartoko, Suhardjanto, and Honggowati (2017) concluded that an Audit Committees is a committee that supports the board of commissioners' role, which requires certain qualifications. With these qualifications, audit Committees is expected to give maximum oversight to the practice of a company's financial disclosure. Also, Chen and Komal (2018) requires that at least one member of Audit Committees should have an education background in accounting or finance, and the other members should be able to read and understand financial statements.

The majority of CFOs and Internal Auditors hold an honours degree (52.4% and 75%, respectively). This was also in accordance with the education system in South Africa. CFOs and Internal Auditors normally study until honours level, and then specialise in their respective field, for example, an expectation is that a CFO of a municipality will be a chartered accountant. This individual would have studied at University until honours level, completed a learnership (with a SAICA registered office), then have written the two SAICA qualifying examinations, namely, the Initial Test of Competence (ITC) and the Assessment of Professional Competence (APC), and then registered as a Chartered Accountant (South Africa). The position is presumed the same for Internal Auditors of municipalities. The next section goes into greater depth to present an analysis of respondents who hold a professional qualification.

### **5.2.2 Professional Qualifications**

The second contribution is that of the level of professionalism. Professionals are people educated with a set of skills which are important in carrying out designated tasks required in that profession. They maintain a strict observance of codes of conduct and ethical obligations. These skilled standards are usually approved and maintained by professional groups such as the South African Institute of Chartered Accountants (SAICA), South African Institute of Professional Accountants (SAIPA), Independent Regulatory Board for Auditors (IRBA), while the individual's "level of professionalism is horned through membership of these professional bodies. Professionalism lies at the foundation of every profession" (Clayton, Staden & Lynch, 2010). It is a core value of people who possessed a combination of financial skills learnt over time, highly committed to their

professional freedom, to act in accordance with professional judgment (Clayton et.al, 2010). Therefore, the professional qualification (of each of the respondents) of the four sample groups is presented in the following table:

**Table 5.2: Analysis Depicting the Professional Qualification of Respondents**

		Current position held				Total
		Municipal Manager	Audit Committee Chair person	CFO (Finance Head)	Internal Auditor	
SAICA	Count	0	8	1	0	9
	% within Current position held	0.0%	22.9%	4.8%	0.0%	11.3%
SAIPA	Count	0	0	4	3	7
	% within Current position held	0.0%	0.0%	19.0%	25.0%	8.8%
IRBA	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
IIASA	Count	0	0	0	9	9
	% within Current position held	0.0%	0.0%	0.0%	75.0%	11.3%
Others	Count	12	24	16	0	52
	% within Current position held	100.0%	68.6%	76.2%	0.0%	65.0%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

The South African Institute of Chartered Accountants (SAICA) is South Africa's accountancy body, and is widely recognised as one of the world's leading accounting institutes. The Institute provides a wide range of support services to more than 37,000 members who are Chartered Accountants, and hold positions as CEOs, MDs, CFOs, board directors, business owners, auditors, and leaders in their spheres of business operation. It is no surprise that all respondents who are SAICA registered are Audit Committee Chairpersons and CFOs, with 22.9% and 4.8%, respectively. There is no Municipal Manager or Internal Auditor amongst the respondents, who is a member of SAICA, and this is also of no surprise, as their line of duty does not recommend that they take on the CA route.

On the other hand, SAIPA represents qualified Professional Accountants (South Africa) in practice, commerce and industry, academia, and the public sector. It was no surprise to find that the majority of respondents holding this professional qualification are CFOs and Internal Auditors, with 19% and 25%, respectively and having an overall response rate of 8.8% when compared with other professional qualifications.

The duty of the Independent Regulatory Board for Auditors (IRBA) is to protect the financial interests of the South African public and international investors in South Africa through the effective regulation of audits conducted by registered auditors, in accordance with internationally recognised standards and processes. The results indicate that the only respondents (8.6%) that belong to this body are Audit Committee Chairpersons. This is no surprise as it is a body of registered auditors, and it is expected that Audit Committee members should be registered (professional) auditors.

The Institute of Internal Auditors South Africa (IIA SA) is part of an international network representing the interests of Internal Auditors worldwide. As a part of this international network, the IIA SA upholds and supports the fundamental tenets of the profession - the Code of Ethics and the International Standards for the Professional Practice of Internal Auditing. The results show that the only respondents (75%) who are Internal Auditors belong to this body. This is also expected as it is a body of registered Internal Auditors of South Africa.

Lastly, all the respondents who are Municipal Managers possess "other" professional qualifications, with 68.6% of Audit Committee Chairpersons, 76.2% CFOs, and none of the Internal Auditors possess "other" professional qualifications.

### 5.2.3 Experience

Work experience of respondents is observed as a total number of years that they spent working in the related field or job. Years of working experience in the current municipality or related field have been taken into account, but not of the previous ones. Work experience is crucial for the respondents in understanding the questions and responding to them properly. The experience of the respondents participating in the questionnaire survey is presented in the following two tables:

**Table 5.3: Analysis Depicting the Work Experience of Respondents**

Work experience		Current position held				Total
		Municipal Manager	Audit Committee Chair person	CFO (Finance Head)	Internal Auditor	
Less than 5 years	Count	0	4	0	0	4
	% within Current position held	0.0%	11.4%	0.0%	0.0%	5.0%
Less than 10 years	Count	3	8	5	0	16
	% within Current position held	25.0%	22.9%	23.8%	0.0%	20.0%
Over 10 years	Count	9	23	16	12	60
	% within Current position held	75.0%	65.7%	76.2%	100.0%	75.0%
<b>Total</b>	<b>Count</b>	<b>12</b>	<b>35</b>	<b>21</b>	<b>12</b>	<b>80</b>
	<b>% within Current position held</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

The majority of all groups of respondents had an enormous amount of experience, with all Internal Auditors having had over 10 years of experience, 76.2% for CFOs, 65.7% for Audit Committee

Chairpersons and 75% for Municipal Managers. Following those of over 10 years of experience are those with less than 10 years of experience. The percentages are steady across all four respondent groups and those with less than 5 years are Audit Committee Chairpersons (at 11.4%). The distribution reflects that the respondents had many years of experience. The researcher believes that opinions of these experienced participants have significantly contributed to achieving the objectives of the study. Echoed by Jeffrey Cohen et al. (2017) in their study, concluded that the experience of Audit Committee, CFOs and External Auditors have the importance of impacting the quality of the financial reporting process, internal controls, and external auditing.

### **5.3 Descriptive Statistics**

Data description is typically the first step in analysing any set of information. There are three major types of descriptive statistics: Measures of frequency (frequency, percent), measures of central tendency (mean, median and mode), and measures of dispersion or variation (variance, SD, standard error, quartile, interquartile range, percentile, range, and coefficient of variation [CV]) provide simple summaries about the sample and the measures. A measure of frequency is usually used for the categorical data while others are used for quantitative data (Mishra et al., 2019).

Descriptive statistics are used to describe and summarise the basic features of the data in a study. It includes mainly graphical presentation, frequency table, mean, media, mode, ranking, skewness, kurtosis, and standard deviation of data. In the current study, the questionnaire survey data have been presented using some descriptive statistical tools including frequency table, mean, standard deviation, and ranking. The following subsections present and analyse the descriptive statistics results of the questionnaire survey data.

#### **5.3.1 Analysis of Frequency Distribution of Responses towards the Statements on Audit Committee Practices in KwaZulu-Natal Local Government**

The following subsections present the frequency of responses (in percentages) towards the statements included in the questionnaire. It should be noted that to facilitate the reporting and analysis, the “strongly disagree” and the “disagree” columns have been merged to “disagree” and similarly, the “strongly agree” and the “agree” columns have been merged to “agree” in the table. The following statements relate to the composition of the Audit Committee:

**The Audit Committee members are appointed in consultation with the Audit Committee Chairperson**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	26	0	3	29
	% within Current position held	0.0%	74.3%	0.0%	25.0%	36.3%
Neutral	Count	0	4	2	0	6
	% within Current position held	0.0%	11.4%	9.5%	0.0%	7.5%
Agree	Count	12	5	19	9	45
	% within Current position held	100.0%	14.3%	90.5%	75.0%	56.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee members have sufficient knowledge of the municipality's environment**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	7	0	0	7
	% within Current position held	0.0%	20.0%	0.0%	0.0%	8.8%
Agree	Count	12	25	21	12	70
	% within Current position held	100.0%	71.4%	100.0%	100.0%	87.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%



**The Audit Committee members have sufficient knowledge of Accounting and/or Auditing practices**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO(Finance Head)	Internal Auditor	
Disagree	Count	0	6	0	0	6
	% within Current position held	0.0%	17.1%	0.0%	0.0%	7.5%
Neutral	Count	0	3	3	6	12
	% within Current position held	0.0%	8.6%	14.3%	50.0%	15.0%
Agree	Count	12	26	18	6	62
	% within Current position held	100.0%	74.3%	85.7%	50.0%	77.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee members have sufficient experience in Accounting and/or Auditing**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	6	0	0	6
	% within Current position held	0.0%	17.1%	0.0%	0.0%	7.5%
Neutral	Count	3	4	4	6	17
	% within Current position held	25.0%	11.4%	19.0%	50.0%	21.3%
Agree	Count	9	25	17	6	57
	% within Current position held	75.0%	71.4%	81.0%	50.0%	71.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee members are capable of mediating problems in performing their duties**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	4	0	0	4
	% within Current position held	0.0%	11.4%	0.0%	0.0%	5.0%
Neutral	Count	0	2	1	6	9
	% within Current position held	0.0%	5.7%	4.8%	50.0%	11.3%
Agree	Count	12	29	20	6	67
	% within Current position held	100.0%	82.9%	95.2%	50.0%	83.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The majority of Audit Committee members are independent/external members**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	4	0	0	4
	% within Current position held	0.0%	11.4%	0.0%	0.0%	5.0%
Neutral	Count	0	1	0	6	7
	% within Current position held	0.0%	2.9%	0.0%	50.0%	8.8%
Agree	Count	12	30	21	6	69
	% within Current position held	100.0%	85.7%	100.0%	50.0%	86.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The chairperson of the Audit Committee is an independent/external member**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	5	0	0	5
	% within Current position held	0.0%	14.3%	0.0%	0.0%	6.3%
Neutral	Count	0	0	0	0	7
	% within Current position held	0.0%	0.0%	0.0%	0.0%	0.0%
Agree	Count	12	30	21	12	75
	% within Current position held	100.0%	85.7%	100.0%	100.0%	93.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The size of the Audit Committee is appropriate for carrying out its duties properly**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	6	0	0	6
	% within Current position held	0.0%	17.1%	0.0%	0.0%	7.5%
Neutral	Count	0	8	1	0	9
	% within Current position held	0.0%	22.9%	4.8%	0.0%	11.3%
Agree	Count	12	21	20	12	65
	% within Current position held	100.0%	60.0%	95.2%	100.0%	81.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

### 5.3.1.1 Composition

The existing body of literature has, over the decades, stressed the importance of the appropriate composition of an Audit Committee. The thesis has acknowledged the composition of Audit Committee as one of the input factors for an effective Audit Committee. There is a general consensus on the composition of Audit Committees in KZN local government. All respondent groups (93.8%) seem to have agreed that the chairperson of the Audit Committee is an independent/external member. It is noted that this was the highest number regarding the composition of Audit Committees. Also, 86.3% of respondents agreed that the majority of Audit Committee members are independent/external members, who are not in the employ of the municipality. This was in line with Section 166 (of the MFMA) which states that the Audit Committee should be independent and safeguarded from undue influence in exercising its responsibilities in an objective manner. To enhance the independence of the Audit Committee, the

term of office for members must be adhered to strictly. The chairperson should be appointed for a minimum of three years to ensure that he/she contributes most effectively and provides stability to the Audit Committee and Audit Committee members should serve at least a minimum of three years with an option to renew for another three years, based on performance. There are 5% and 6.3% of Audit Committee Chairpersons who indicated that the majority of Audit Committee members and Audit Committee Chairpersons (respectively) are not independent. A competent, committed, and independent Audit Committee has been described as one of the most reliable guardians of public interest (Levitt, 2000; Beasley et al., 2009).

Furthermore, 56.3% of respondents agreed that Audit Committee Chairpersons are appointed with due consultations with the Audit Committee Chairpersons. It is noted that 74.3% of Audit Committee Chairpersons disagreed with this notion that is shared by Municipal Managers, CFOs, and Internal Auditors. However, all respondents' groups agreed, unanimously, on the following three points: that Audit Committee had sufficient knowledge of the municipality's environment; the members have knowledge and experience on accounting and auditing practices (77.5% and 71.3%, respectively); and that Audit Committee members were capable of mediating problems in performing their duties (at 83.8%).

Overall, the statement regarding the appropriateness of Audit Committee size was agreed with by 81.3% (or 65 out of 80) of the respondents, which was the fifth-highest number. Section 166 (of the MFMA) provides for a minimum requirement for the composition of an Audit Committee. The Audit Committee must comprise of at least three persons who are not in the employ of the municipality or a municipal entity. The responses are consistent with the findings of Pincus et al. (1989); Felo et al. (2003); and Pucheta-Martinez and Fuentes (2007) who highlighted that the appropriate Audit Committee size is a crucial component for Audit Committee effectiveness. However, a few studies (such as Kalbers and Fogarty, 1996; Yermack, 1996; Scarbrough et al., 1998; Lin et al., 2008) have documented that a large sized Audit Committee may sometimes hinder its effectiveness. Nevertheless, the BRC (1999) and the ICEW (2001) have suggested that there should be a minimum of three members in an Audit Committee. In the context of the U.K. and the U.S.A., the Audit Committees generally consist of between three to five members (Carcello and Neal, 2000; Raghunandan et al., 2001; Spira, 2002; Davidson et al., 2004). The combined response

of all four sample groups suggests that size of the Audit Committees as practiced in KZN local government is appropriate for them to function effectively.

Regarding the statements on **authority of and resources** provided to the Audit Committees in KZN local government, the following subsections are presented:

**The Audit Committee has adequate authority in order to carry out its responsibilities**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	6	1	0	7
	% within Current position held	0.0%	17.1%	4.8%	0.0%	8.8%
Neutral	Count	0	5	0	9	14
	% within Current position held	0.0%	14.3%	0.0%	75.0%	17.5%
Agree	Count	12	24	20	3	59
	% within Current position held	100.0%	68.6%	95.2%	25.0%	73.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%



**The Audit Committee has ready access to relevant information if required**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	6	0	0	6
	% within Current position held	0.0%	17.1%	0.0%	0.0%	7.5%
Neutral	Count	0	8	1	0	9
	% within Current position held	0.0%	22.9%	4.8%	0.0%	11.3%
Agree	Count	12	21	20	12	65
	% within Current position held	100.0%	60.0%	95.2%	100.0%	81.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee receives prompt responses from the management in carrying out its duties**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	12	0	0	12
	% within Current position held	0.0%	34.3%	0.0%	0.0%	15.0%
Neutral	Count	0	6	2	6	14
	% within Current position held	0.0%	17.1%	9.5%	50.0%	17.5%
Agree	Count	12	17	19	6	54
	% within Current position held	100.0%	48.6%	90.5%	50.0%	67.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee is provided with sufficient resources including secretarial support to carry out its duties**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	8	0	0	8
	% within Current position held	0.0%	22.9%	0.0%	0.0%	10.0%
Neutral	Count	0	4	1	0	5
	% within Current position held	0.0%	11.4%	4.8%	0.0%	6.3%
Agree	Count	12	23	20	12	67
	% within Current position held	100.0%	65.7%	95.2%	100.0%	83.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The non-executive Audit Committee members are adequately paid for their time and efforts**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	5	1	3	9
	% within Current position held	0.0%	14.3%	4.8%	25.0%	11.3%
Neutral	Count	0	9	1	0	10
	% within Current position held	0.0%	25.7%	4.8%	0.0%	12.5%
Agree	Count	12	21	19	9	61
	% within Current position held	100.0%	60.0%	90.5%	75.0%	76.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

### 5.3.1.2 Authority and resources

In terms of the MFMA section 166(3)(a) - In performing its functions, the Audit Committee has access to the financial records and other relevant information of the municipality or municipal entity. The Audit Committee should have the authority to obtain any information, advice, and appropriate resources from within or outside the municipality or entity, in order to perform its functions as legislated.

Some of the legislated functions of Audit Committee in local government include the following:

- communicate with the Council, Municipal Manager or the Internal and External Auditors of the municipality or municipal entity;
- have access to municipal records containing information that is needed to perform its duties or exercise its powers;
- request any relevant person to attend any of its meetings, and, if necessary, to provide
- information requested by the committee; and

- conduct investigations into the financial affairs of the municipality or municipal entity, as may be requested by the Council of the municipality or in the case of a municipal entity,
- the Council of the parent municipality or the BoD of the entity.

The aggregated responses of all 80 respondents in relation to the statements on authority of and resources of the Audit Committees in KZN local government imply that the Audit Committees are provided with adequate resources and authority in order to carry out their responsibilities. Contessotto and Moroney (2014) in their study found the authority of Audit Committees to be closely associated with their effectiveness.

Appropriate resources are made available to the Audit Committee to perform their functions as agreed in their charter. Sufficient secretariat support is provided to Audit Committees, as evident from the highest number (83.8%) of respondents who agreed with this. Audit Committees also seem to have ready access to relevant information if they require it. DeZoort, et al. (2002) posited that sufficient resources are needed by Audit Committees to achieve Audit Committee Effectiveness.

Circular 65 of the MFMA states that the members of the Audit Committee shall be remunerated for time spent in attendance of Audit Committee meetings. The municipality may utilise the rates provided by the National Treasury, from time to time, and should the Accounting Officer deem it necessary, he or she can, in consultation with the Municipal Council, determine other remuneration, provided that the charter properly defines time and cost. While compensation should be enough to recognise the time commitment required and the liabilities accepted in order to attract good and responsible Audit Committee members, the amount should not be excessive such that independence may be perceived to be impaired. 76.3% of respondents agreed that non-executive Audit Committee members are paid an adequate fee for their time and effort spent within the municipality.

The above functions, in most instances, may only be carried out effectively if Audit Committee receives prompt responses from management in carrying out its duties and there is some consensus regarding this, as Municipal Managers and CFOs agreed, unanimously, that the Audit Committee is provided with responses promptly (100% and 90.5%, respectively), while Internal Auditors were split 50%/50% between agreeing and being neutral to this response. A noted 34.3% seem to disagreed with this. It may be due to differences from one municipality to the next. Properly and/or

effectively functioning municipalities, with good leadership, should not experience issues of Audit Committee having to not receive prompt responses from management, whereas those that are not run adequately may experience these issues. The disparity was noted here.

The following subsections present responses towards the diligence of Audit Committee members within the KZN local government.

**The Audit Committee has a charter which outlines its objectives, duties, and responsibilities.**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Agree	Count	12	32	21	12	77
	% within Current position held	100.0%	91.4%	100.0%	100.0%	96.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee has a charter which is reviewed annually**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	1	3	0	4
	% within Current position held	0.0%	2.9%	14.3%	0.0%	5.0%
Agree	Count	12	31	18	12	73
	% within Current position held	100.0%	88.6%	85.7%	100.0%	91.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee members have a clear understanding of their responsibilities**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Agree	Count	12	32	21	12	77
	% within Current position held	100.0%	91.4%	100.0%	100.0%	96.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%



**Members of the Audit Committee assume their responsibilities readily**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	1	1	0	2
	% within Current position held	0.0%	2.9%	4.8%	0.0%	2.5%
Agree	Count	12	31	20	12	75
	% within Current position held	100.0%	88.6%	95.2%	100.0%	93.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

### The Audit Committee members devote sufficient time to the affairs of the committee

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	4	0	0	4
	% within Current position held	0.0%	11.4%	0.0%	0.0%	5.0%
Neutral	Count	0	2	1	3	6
	% within Current position held	0.0%	5.7%	4.8%	25.0%	7.5%
Agree	Count	12	29	20	9	70
	% within Current position held	100.0%	82.9%	95.2%	75.0%	87.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

#### 5.3.1.3 Diligence

The majority of Audit Committee Chairpersons agreed to all five statements on the diligence of Audit Committees in KZN local government. The highest two (96.3%) being that the Audit Committee has a charter which outlines its objectives, duties, and responsibilities, and that Audit Committee members have a clear understanding of their responsibilities. The charter is reviewed annually and members assume their responsibilities readily (91.3% agreed). However, 8.6% of Audit Committee Chairpersons disagreed with both these notions. This may be a small fraction of poorly run municipalities that may not be doing this.

Notably, under this section are the responses regarding Audit Committee members having to devote sufficient time to the affairs of the committee. A total of 87.5% of respondents, being the highest in this section, agreed with this. Rupley et al. (2011) using survey methodology, their study examined the extent to which public company Audit Committee were approaching Audit

Committee Effectiveness post SOX and found the diligence of Audit Committee members to be an important determinant. However, 11.4% of Audit Committee Chairpersons disagreed totally, while 25% of Internal Auditors, 5.7% of Audit Committee Chairpersons, and only 4.8% of CFOs remained neutral. One of the main ingredients of a diligent Audit Committee is that all members must be prepared to invest the time necessary to evaluate all municipal processes critically, under their remit and advice Council accordingly. Audit Committee members normally attend all scheduled meetings of the committee, including special meetings called on an ad-hoc basis. The researcher noted that this disagreement from Audit Committee Chairpersons stems from members who are sometimes unable to attend all scheduled Audit Committee meetings.

On the note of meetings, the following subsections present the respondent's perception towards Audit Committee meetings:

**The agendas of the Audit Committee meetings are finalised by the chairperson**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	6	0	6	12
	% within Current position held	0.0%	17.1%	0.0%	50.0%	15.0%
Neutral	Count	0	6	0	0	6
	% within Current position held	0.0%	17.1%	0.0%	0.0%	7.5%
Agree	Count	12	23	21	6	62
	% within Current position held	100.0%	65.7%	100.0%	50.0%	77.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The chairperson cooperates with other committee members before finalising the agenda of the meetings**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	10	1	6	17
	% within Current position held	0.0%	28.6%	4.8%	50.0%	21.3%
Neutral	Count	0	1	1	3	5
	% within Current position held	0.0%	2.9%	4.8%	25.0%	6.3%
Agree	Count	12	24	19	3	58
	% within Current position held	100.0%	68.6%	90.5%	25.0%	72.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The agenda and related materials are provided to members fairly ahead of the meetings**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	15	1	0	16
	% within Current position held	0.0%	42.9%	4.8%	0.0%	20.0%
Neutral	Count	0	10	0	6	16
	% within Current position held	0.0%	28.6%	0.0%	50.0%	20.0%
Agree	Count	12	10	20	6	48
	% within Current position held	100.0%	28.6%	95.2%	50.0%	60.0%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**All members can express their views freely and independently at the meetings**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	4	0	0	4
	% within Current position held	0.0%	11.4%	0.0%	0.0%	5.0%
Neutral	Count	0	2	0	6	8
	% within Current position held	0.0%	5.7%	0.0%	50.0%	10.0%
Agree	Count	12	29	21	6	68
	% within Current position held	100.0%	82.9%	100.0%	50.0%	85.0%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The frequency of the Audit Committee meetings is sufficient to carry out its responsibilities**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	8	0	0	8
	% within Current position held	0.0%	22.9%	0.0%	0.0%	10.0%
Neutral	Count	0	8	0	0	8
	% within Current position held	0.0%	22.9%	0.0%	0.0%	10.0%
Agree	Count	12	19	21	12	64
	% within Current position held	100.0%	54.3%	100.0%	100.0%	80.0%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The duration of the Audit Committee meetings is sufficient for a full discussion of important issues**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	8	0	0	8
	% within Current position held	0.0%	22.9%	0.0%	0.0%	10.0%
Neutral	Count	0	1	0	0	1
	% within Current position held	0.0%	2.9%	0.0%	0.0%	1.3%
Agree	Count	12	26	21	12	71
	% within Current position held	100.0%	74.3%	100.0%	100.0%	88.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%



**Non-members attend the Audit Committee meetings if required or invited**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	5	0	0	5
	% within Current position held	0.0%	14.3%	0.0%	0.0%	6.3%
Neutral	Count	0	6	0	3	9
	% within Current position held	0.0%	17.1%	0.0%	25.0%	11.3%
Agree	Count	12	24	21	9	66
	% within Current position held	100.0%	68.6%	100.0%	75.0%	82.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The minutes of the Audit Committee meetings are circulated to all members of the Municipal Council**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	8	0	3	11
	% within Current position held	0.0%	22.9%	0.0%	25.0%	13.8%
Neutral	Count	0	8	0	3	11
	% within Current position held	0.0%	22.9%	0.0%	25.0%	13.8%
Agree	Count	12	19	21	6	58
	% within Current position held	100.0%	54.3%	100.0%	50.0%	72.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

#### 5.3.1.4 Meeting

The Audit Committee should meet as often as its role and responsibilities require. The Audit Committee should hold sufficient scheduled meetings per annum to discharge all aspects of the terms of reference fully. In South Africa, King IV and MFMA recommend at least four meetings per year. This is in line with international best standards (i.e. the ACF recommends four meetings per year for the Audit Committee to be able to discharge its responsibilities effectively). The following persons must have a standing invitation to the Audit Committee and attend all meetings:

- Municipal Manager,
- Accounting Officer of the Entity,
- Head of Internal Audit of the municipality,
- Chief Financial Officer,
- External Auditor,

- Provincial Treasury,
- National Treasury, and
- Any other person on invitation by the chairperson of the Audit Committee.

The Municipal Managers, CFOs and Internal Auditors all agreed (100%) that the frequency and duration of meetings is sufficient in discussing and carrying on of all Audit Committee roles. However, the Audit Committee Chairpersons did not agree with this notion fully, as 74.3% agreed that the duration of Audit Committee meetings is sufficient and a mere 54.3% agreed on the sufficiency of the frequency of meetings.

Timing meetings to coincide with key dates within the financial reporting and audit cycle enables the Audit Committee to make timely and influential decisions. Equally, having sufficient time available at each meeting is critical. The committee must be able to cover all agenda items, hold as full a discussion as is required, and enable all parties to ask questions or to provide input (Greco, 2011).

Sufficient time should be set aside for Audit Committee members to discuss issues, without invitees being present (in a private session), at each meeting, as the majority (82.5%) of respondents agreed that non-members attend the Audit Committee meetings if required or invited. Both Municipal Managers and CFOs (who are usual invitees) agreed 100% with this and 75% of Internal Auditors and 68.8% of Audit Committee Chairpersons agreed.

An appropriate interval should be allowed between Audit Committee meetings and other related meetings (such as main board meetings) to allow any work arising from the Audit Committee meeting to be carried out and reported on as appropriate. Municipal Managers, CFOs (100%) and Audit Committee chairpersons (82.9%) agreed that all members in an Audit Committee meeting can express their views freely and independently. It is imperative that members hold effective meetings, as well as prioritisation of issues to help drive the effectiveness and efficiency of Audit Committee meetings. These are findings echoed by Dellaportas, Leung, Cooper, Yin, et al. (2012) found that the frequency and time allowable for Audit Committee meetings is closely associated to Audit Committee Effectiveness.

The quality and timely issuing of pre-meeting materials, an appropriate balance between discussion/debate and listening to presentations is also expressed by respondents as being appropriate, as the majority feel agendas (at 60%) and minutes (at 72.5%) of meetings are adequately circulated to all parties concerned.

As stated in chapter 1 of this thesis, one of the functions of an Audit Committee is the evaluation of the adequacy and efficiency of the internal control systems, accounting practices, information systems, and auditing processes applied within the municipality. In a nutshell, financial reporting remains one of the paramount functions that an Audit Committee has to provide. The following subsection presents respondents' perceptions towards statements on the role that is played by Audit Committees in financial reporting:

**The Audit Committee reviews the integrity of the Municipality's financial statements**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	2	0	6	8
	% within Current position held	0.0%	5.7%	0.0%	50.0%	10.0%
Agree	Count	12	30	21	6	69
	% within Current position held	100.0%	85.7%	100.0%	50.0%	86.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee reviews accounting policies and any changes made therein**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	6	0	6	12
	% within Current position held	0.0%	17.1%	0.0%	50.0%	15.0%
Agree	Count	12	26	21	6	65
	% within Current position held	100.0%	74.3%	100.0%	50.0%	81.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee reviews accounting estimates and judgments done in preparing financial statements**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO(Finance Head)	Internal Auditor	
Disagree	Count	0	4	1	0	5
	% within Current position held	0.0%	11.4%	4.8%	0.0%	6.3%
Neutral	Count	0	10	0	6	16
	% within Current position held	0.0%	28.6%	0.0%	50.0%	20.0%
Agree	Count	12	21	20	6	59
	% within Current position held	100.0%	60.0%	95.2%	50.0%	73.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee reviews the compliance of the Accounting Standards (e.g. IAS, IFRS) in preparing financial statements**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	4	0	0	4
	% within Current position held	0.0%	11.4%	0.0%	0.0%	5.0%
Neutral	Count	0	5	0	6	11
	% within Current position held	0.0%	14.3%	0.0%	50.0%	13.8%
Agree	Count	12	26	21	6	65
	% within Current position held	100.0%	74.3%	100.0%	50.0%	81.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee reviews the clarity and completeness of disclosures in financial statements**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	0	0	6	6
	% within Current position held	0.0%	0.0%	0.0%	50.0%	7.5%
Agree	Count	12	32	21	6	71
	% within Current position held	100.0%	91.4%	100.0%	50.0%	88.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%



**The Audit Committee reviews other information (e.g. the Auditor General's report, financial highlights) presented in the annual report**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	3	1	0	6	10
	% within Current position held	25.0%	2.9%	0.0%	50.0%	12.5%
Agree	Count	9	31	21	6	67
	% within Current position held	75.0%	88.6%	100.0%	50.0%	83.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

### 5.3.1.5 Role in financial reporting

In addition to some of their statutory duties, Audit Committees in local government are constituted to help the Municipal Council discharge its responsibility for adequate and effective financial reporting, control, and governance. An Audit Committee fulfils this remit according to the duties and skills required by the Act (MFMA) and the committee's terms of reference. There was consensus between Municipal Managers and CFOs on many of related statements on roles of Audit Committees in financial reporting. For example, 100% of these two respondent groups agreed that the Audit Committee reviews the integrity of the Municipality's financial statements, accounting policies and any changes made therein; accounting estimates and judgments done in preparing financial statements; compliance with the Accounting Standard (i.e. IFRS); and the clarity and completeness of disclosures in financial statements.

On the other hand, Internal Auditors were split (50%/50%) between ‘neutral’ and ‘agree’ on all the statements on the roles of Audit Committee in internal auditing. This is interesting, as, in all South African local government municipalities, an internal audit function reports to an Audit Committee. The Audit Committee Chairpersons agreed (from 60% to 91.4%) with all of the statements on the Audit Committee roles in financial reporting and disagreed at 11.4% and 8.6% with these statements. The grey area (where they are neutral) being the review of accounting policies, estimates and judgments done in financial statements and compliance with Accounting Standards. Overall, Audit Committees in KZN local government are performing this function effectively and in accordance with legislation and international best practices.

The following subsections are those that relate to the statements regarding Audit Committees and their role in the external audit function:

**External Auditors are appointed and/or removed upon the recommendation of the Audit Committee**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	23	1	9	33
	% within Current position held	0.0%	65.7%	4.8%	75.0%	41.3%
Neutral	Count	0	8	4	0	12
	% within Current position held	0.0%	22.9%	19.0%	0.0%	15.0%
Agree	Count	12	4	16	3	35
	% within Current position held	100.0%	11.4%	76.2%	25.0%	43.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee assesses and reviews the expertise and resources of the External Auditors**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	15	1	6	22
	% within Current position held	0.0%	42.9%	4.8%	50.0%	27.5%
Neutral	Count	0	10	3	3	16
	% within Current position held	0.0%	28.6%	14.3%	25.0%	20.0%
Agree	Count	12	10	17	3	42
	% within Current position held	100.0%	28.6%	81.0%	25.0%	52.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee reviews and approves the terms of the Engagement Letter (EL) prepared for the External Auditors**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	16	1	3	20
	% within Current position held	0.0%	45.7%	4.8%	25.0%	25.0%
Neutral	Count	0	9	4	3	16
	% within Current position held	0.0%	25.7%	19.0%	25.0%	20.0%
Agree	Count	12	10	16	6	44
	% within Current position held	100.0%	28.6%	76.2%	50.0%	55.0%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee monitors the external audit firm's compliance with the existing ethical and regulatory requirements in South Africa**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO(Finance Head)	Internal Auditor	
Disagree	Count	0	14	1	6	21
	% within Current position held	0.0%	40.0%	4.8%	50.0%	26.3%
Neutral	Count	0	13	0	0	13
	% within Current position held	0.0%	37.1%	0.0%	0.0%	16.3%
Agree	Count	12	8	20	6	46
	% within Current position held	100.0%	22.9%	95.2%	50.0%	57.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee reviews the findings of the annual audit obtained by the Auditor General/ External Auditors**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	5	0	6	11
	% within Current position held	0.0%	14.3%	0.0%	50.0%	13.8%
Agree	Count	12	27	21	6	66
	% within Current position held	100.0%	77.1%	100.0%	50.0%	82.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee reviews the management's responsiveness to the Auditor General's findings**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	1	0	6	7
	% within Current position held	0.0%	2.9%	0.0%	50.0%	8.8%
Agree	Count	12	31	21	6	70
	% within Current position held	100.0%	88.6%	100.0%	50.0%	87.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee meets with the External Auditors without the presence of the management to discuss any issues, problems or reservations arising from the audit**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	13	0	0	13
	% within Current position held	0.0%	37.1%	0.0%	0.0%	16.3%
Neutral	Count	0	4	1	6	11
	% within Current position held	0.0%	11.4%	4.8%	50.0%	13.8%
Agree	Count	12	18	20	6	56
	% within Current position held	100.0%	51.4%	95.2%	50.0%	70.0%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%



**The Audit Committee reviews and monitors the independence and effectiveness of the external auditing process**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
	Count	0	11	1	0	12
	% within Current position held	0.0%	31.4%	4.8%	0.0%	15.0%
	Count	0	6	0	6	12
	% within Current position held	0.0%	17.1%	0.0%	50.0%	15.0%
Agree	Count	12	18	20	6	56
	% within Current position held	100.0%	51.4%	95.2%	50.0%	70.0%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

### 5.3.1.6 Role in external auditing

The function of the external audit of KZN local government's municipalities is performed (as legislated) by the Auditor-General of South Africa. Section 188 of the Constitution states that the Auditor-General is required to report on the finances of all national, provincial, and local government administrations and has the discretion to audit any institution that receives money for a public purpose. The reports of the Auditor-General must be made public. They must also be submitted to any legislature which has a direct interest in the audit, and to any other authority prescribed by national legislation. AGSA's audit reports contribute to a culture of public sector accountability that makes a difference in the lives of all South African citizens. Since 2007, they have embarked on a strong drive to promote better financial management by interacting with their auditees, even during periods when audits are not in progress. They give audit opinions,

assessments, and guidance in a simple, clear and relevant manner. AGSA's deliberately simplified audit reports now highlight factors (the so-called 'root causes') that hinder auditees' progress towards clean administration. The responses of the External Auditors in relation to the eight statements on Audit Committee's role in external auditing show that only two respondent groups agreed with the statements (namely Municipal Managers and CFOs). The majority of Municipal Managers (100%) agreed with all eight statements and CFOs ranged from 76.2% to 100%.

Mixed responses were received from Internal Auditors in the case of the statements relating to Audit Committee's role in external auditing, as they are split between being neutral and agreeing when the statement relating to the appointment and removal of External Auditors and that the Audit Committee monitors the external audit firm's compliance with existing ethical and regulatory requirements. On the other hand, they were split (50%/50%) on all of the other six statements.

The majority of Audit Committee Chairpersons disagreed with statements:

- (i) External Auditors are appointed and/or removed upon recommendations from the Audit Committee,
- (ii) The Audit Committee assesses and reviews the expertise and resources of the External Auditors,
- (iii) The Audit Committee reviews and approves the terms of Engagement Letter prepared for External Auditors, and
- (iv) The Audit Committee monitors the external audit firm's compliance with existing ethical and regulatory requirements.

However, the majority of respondents agreed that:

- (i) The Audit Committee reviews the findings of the annual audit obtained by the AGSA;
- (ii) The Audit Committee reviews the management's responsiveness to the AGSA's findings;
- (iii) The Audit Committee meets with the External Auditors without the presence of management to discuss issues arising from the audit; and
- (iv) The Audit Committee reviews and monitors the independence and effectiveness of the external auditing process.

This disparity is acknowledged and expected, as Audit Committee realise that AGSA is one of the Chapter nine institutions in South Africa and the statements where Audit Committee Chairperson

disagreed with are those statements that seem to interrogate and police the AGSA; on the other hand, the statements that they agreed with are those where the Audit Committee interrogates and provides advice to Municipal Council on matters or reports issued by AGSA and follows up on these reports from AGSA. That is indeed one the core function of any Audit Committee.

Another role of Audit Committee in KZN local government is that of supporting the internal audit function of the municipality. Responses to statements towards the role of Audit Committees in internal auditing follow:

**The Audit Committee recommends and approves the appointment or termination of the heads of the internal audit division**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	21	1	9	31
	% within Current position held	0.0%	60.0%	4.8%	75.0%	38.8%
Neutral	Count	0	8	5	0	13
	% within Current position held	0.0%	22.9%	23.8%	0.0%	16.3%
Agree	Count	12	6	15	3	36
	% within Current position held	100.0%	17.1%	71.4%	25.0%	45.0%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee approves and reviews the charter of the Internal Auditors**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	1	4	3	8
	% within Current position held	0.0%	2.9%	19.0%	25.0%	10.0%
Agree	Count	12	31	17	9	69
	% within Current position held	100.0%	88.6%	81.0%	75.0%	86.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee assesses and reviews the annual internal audit work plan**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	0	1	0	1
	% within Current position held	0.0%	0.0%	4.8%	0.0%	1.3%
Agree	Count	12	32	20	12	76
	% within Current position held	100.0%	91.4%	95.2%	100.0%	95.0%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee reviews the annual internal audit reports, budgets, and other findings**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	0	1	0	1
	% within Current position held	0.0%	0.0%	4.8%	0.0%	1.3%
Agree	Count	12	32	20	12	76
	% within Current position held	100.0%	91.4%	95.2%	100.0%	95.0%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee reviews and monitors the management's responsiveness to the internal auditor's findings and recommendations**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	0	1	0	1
	% within Current position held	0.0%	0.0%	4.8%	0.0%	1.3%
Agree	Count	12	32	20	12	76
	% within Current position held	100.0%	91.4%	95.2%	100.0%	95.0%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee meets with the head of the internal audit function without the presence of the management**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	13	0	3	16
	% within Current position held	0.0%	37.1%	0.0%	25.0%	20.0%
Neutral	Count	0	2	4	3	9
	% within Current position held	0.0%	5.7%	19.0%	25.0%	11.3%
Agree	Count	12	20	17	6	55
	% within Current position held	100.0%	57.1%	81.0%	50.0%	68.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%



**The Audit Committee enhances the independence of the Internal Auditors of the municipality**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	9	1	6	16
	% within Current position held	0.0%	25.7%	4.8%	50.0%	20.0%
Agree	Count	12	23	20	6	61
	% within Current position held	100.0%	65.7%	95.2%	50.0%	76.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**The Audit Committee monitors and evaluates the effectiveness of the internal audit function**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	6	0	0	6
	% within Current position held	0.0%	17.1%	0.0%	0.0%	7.5%
Neutral	Count	0	4	5	3	12
	% within Current position held	0.0%	11.4%	23.8%	25.0%	15.0%
Agree	Count	12	25	16	9	62
	% within Current position held	100.0%	71.4%	76.2%	75.0%	77.5%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

**5.3.1.7 Role in internal auditing**

Section 165 of the MFMA requires that each municipality and each municipal entity must have an internal audit unit. The internal audit unit of a municipality or municipal entity must:

- Prepare a risk based audit plan and an internal audit programme for each financial year;
- Advise the Accounting Officer and report to the Audit Committee on the implementation of the internal audit plan and matters relating to:
  - 1) Internal audit;
  - 2) Internal controls;
  - 3) Accounting procedures and practices;
  - 4) Risk and risk management;
  - 5) Performance management;
  - 6) Loss control;

- 7) Compliance with this Act, the annual Division of Revenue Act, and any other applicable legislation; and
- Perform any such other duties as may be assigned to it by the Accounting Officer.

As already mentioned in *Chapter One*, one of the core functions of an Audit Committee is to advise the Municipal Council, the political office bearers, the Accounting Officer and the management of the municipality or municipal entity on matters relating to:

- Internal financial control and internal audits;
- Risk management (just to name the relevant two)

All of the four respondent groups agreed on the majority of statements relating to the role of Audit Committee in internal auditing, namely:

- (i) The Audit Committee approves and reviews the charter of Internal Auditors;
- (ii) The Audit Committee assesses and reviews the annual internal audit work plan;
- (iii) The Audit Committee reviews the annual internal audit reports, budgets, and other findings;
- (iv) The Audit Committee reviews and monitors the management's responsiveness to the internal auditor's function and recommendations; and
- (v) The Audit Committee monitors and evaluates the effectiveness of the internal audit function.

The above is a clear indication that Audit Committees are able to discharge their role in internal auditing adequately. Furthermore, both Municipal Managers and CFOs agreed with all statements.

The only difference is with two statements, as both the Audit Committee Chairpersons and internal auditing (at 60% and 75%, respectively) disagreed with the statement that the Audit Committee recommends and approves the appointment or termination of the heads of internal audit division. This may be due to the fact that the appointment of internal audit personnel is normally left to municipality's management (i.e. the Accounting Officer). They are also split on if Audit Committee meets with the head of internal audit function without the presence of management. 37.1% of Audit Committee Chairpersons disagreed, while 57.1% agreed, and 50% of Internal Auditors agreed, while the other 50% is split evenly between those who were neutral and those

who disagreed with the statement. The researcher is confident that the role played by Audit Committees in the internal audit function in the KZN local government is adequate and enhances this function.

Two general statements were aimed at investigating the overall independence and effectiveness of Audit Committees in KZN local government and these are presented below:

**The Audit Committee can work independently**

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	4	0	0	4
	% within Current position held	0.0%	11.4%	0.0%	0.0%	5.0%
Neutral	Count	0	0	1	6	7
	% within Current position held	0.0%	0.0%	4.8%	50.0%	8.8%
Agree	Count	12	31	20	6	69
	% within Current position held	100.0%	88.6%	95.2%	50.0%	86.3%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

### The Audit Committee is effective

		Current position held				Total
		Municipal Manager	Audit Committee Chairperson	CFO (Finance Head)	Internal Auditor	
Disagree	Count	0	3	0	0	3
	% within Current position held	0.0%	8.6%	0.0%	0.0%	3.8%
Neutral	Count	0	8	0	6	14
	% within Current position held	0.0%	22.9%	0.0%	50.0%	17.5%
Agree	Count	12	24	21	6	63
	% within Current position held	100.0%	68.6%	100.0%	50.0%	78.8%
Total	Count	12	35	21	12	80
	% within Current position held	100.0%	100.0%	100.0%	100.0%	100.0%

#### 5.3.1.8 The overall practice

The statement that the Audit Committees can work independently was agreed to by Municipal Managers, Audit Committee Chairpersons and CFOs (100%, 88.6%, and 95.2%, respectively). Also, these three respondent groups agreed on the statement that the Audit Committee is effective (at 100%, 68.6%, and 100%, respectively). The only noted difference in respondent groups was Internal Auditors who seemed to be split (50%/50%) between being neutral and disagreeing with both these statements that seek to investigate the independence and effectiveness of Audit Committees in KZN local government. This result indicates that the Audit Committees in KZN local government are somewhat effective, but that the level of effectiveness is not up to the mark required by regulations and international best practices. There is indeed room for improvement in this regard.

### 5.3.2 Analysis of Mean and Standard Deviation (SD) of Responses towards the Statements on Audit Committee Practices in KwaZulu-Natal Local Government

The percentage of frequencies of disagree (strongly disagree and disagree), neutral, and agree (agree and strongly agree) of the four sample groups have already been presented in the previous subsection. The analysis of the responses may be more facilitated if the mean values with standard deviations of response in relation to the statements are reported. Therefore, the following table (Table 5.4) presents the mean scores and standard deviations of the responses towards the 50 statements (Mean (M), Number of respondents (N) and Standard deviation (SD)).

**Table 5.4: Analysis of Mean and Standard Deviation (SD) of Responses towards the Statements on Audit Committee Practices in KwaZulu-Natal Local Government**

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor			Total		
	M	N	SD	M	N	SD	M	N	SD	M	N	SD	M	N	SD
<b>A. Composition</b>	<b>3.97</b>	<b>12</b>	<b>0.06</b>	<b>3.73</b>	<b>35</b>	<b>1.21</b>	<b>4.01</b>	<b>21</b>	<b>0.34</b>	<b>3.88</b>	<b>12</b>	<b>0.57</b>	<b>3.86</b>	<b>80</b>	<b>0.92</b>
1. The Audit Committee members are appointed in consultation with the Audit Committee chairperson.	4.00	12	.000	1.94	35	1.37	3.90	21	.301	3.50	12	.095	3.00	80	1.36
2. The Audit Committee members have sufficient knowledge on the municipality's environment.	4.00	12	.000	3.86	35	.900	4.19	21	.402	4.25	12	.452	4.04	80	.665
3. The Audit Committee members have sufficient knowledge on Accounting and/or Auditing practices.	4.00	12	.000	3.69	35	1.16	3.86	21	.359	3.75	12	.866	3.79	80	.852
4. The Audit Committee members have sufficient experience in Accounting and/or Auditing.	3.75	12	.452	3.60	35	1.12	3.86	21	.478	3.75	12	.866	3.71	80	.860
5. The Audit Committee members are capable of mediating problems in performing their duties.	4.00	12	.000	3.91	35	1.12	3.95	21	.218	3.50	12	.522	3.88	80	.786

6. The majority of Audit Committee members are independent/external members*.	4.00	12	.000	4.43	35	1.31	4.10	21	.301	3.75	12	.866	4.18	80	.965
7. The chairperson of the Audit Committee is an independent/ external member*.	4.00	12	.000	4.49	35	1.29	4.05	21	.218	4.25	12	.452	4.26	80	.896
8. The size of the Audit Committee is appropriate for carrying out its duties properly.	4.00	12	.000	3.89	35	1.39	4.14	21	.478	4.25	12	.452	4.02	80	.968
	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>
<b>B. Authority and Resources</b>	<b>4.00</b>	<b>12</b>	<b>.000</b>	<b>3.64</b>	<b>35</b>	<b>1.24</b>	<b>3.93</b>	<b>21</b>	<b>.369</b>	<b>3.65</b>	<b>12</b>	<b>.376</b>	<b>3.77</b>	<b>80</b>	<b>2.57</b>
9. The Audit Committee has adequate authority in order to carry out its responsibilities.	4.00	12	.000	3.86	35	1.31	3.90	21	.436	3.25	12	.452	3.80	80	9.33
10. The Audit Committee has ready access to relevant information if required.	4.00	12	.000	3.57	35	1.20	4.00	21	.316	4.00	12	.000	3.81	80	.828
11. The Audit Committee receives prompt responses from the management in carrying out its duties.	4.00	12	.000	3.14	35	1.24	3.90	21	.301	3.50	12	.522	3.52	80	.927
12. The Audit Committee is provided with sufficient resources including secretarial support to carry out its duties.	4.00	12	.000	3.77	35	1.37	4.00	21	.316	4.00	12	.000	3.90	80	.922
13. The non-executive Audit Committee members are adequately paid for their time and efforts.	4.00	12	.000	3.83	35	1.10	3.86	21	.478	3.50	12	.905	3.81	80	.843
	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>
<b>C. Diligence</b>	<b>4.00</b>	<b>12</b>	<b>.000</b>	<b>4.35</b>	<b>35</b>	<b>1.17</b>	<b>4.02</b>	<b>21</b>	<b>.294</b>	<b>4.15</b>	<b>12</b>	<b>.419</b>	<b>4.18</b>	<b>80</b>	<b>.823</b>
14. The Audit Committee has a charter which outlines its objectives,															

duties and responsibilities.	4.00	12	.000	4.46	35	1.15	4.05	21	.218	4.25	12	.452	4.25	80	.803
15. The Audit Committee charter is reviewed annually.	4.00	12	.000	4.40	35	1.17	3.95	21	.498	4.00	12	.000	4.16	80	.834
16. The Audit Committee members have a clear understanding of their responsibilities.	4.00	12	.000	4.34	35	1.14	4.00	21	.000	4.25	12	.452	4.19	80	.781
17. Members of the Audit Committee assume their responsibilities readily.	4.00	12	.000	4.40	35	1.17	4.00	21	.316	4.25	12	.452	4.21	80	.822
18. The Audit Committee members devote sufficient time to the affairs of the committee.	4.00	12	.000	4.14	35	1.22	4.10	21	.436	4.00	12	.739	4.09	80	.874
	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>
<b>D. Meeting</b>	<b>4.06</b>	<b>12</b>	<b>.113</b>	<b>3.54</b>	<b>35</b>	<b>1.33</b>	<b>3.49</b>	<b>21</b>	<b>.203</b>	<b>3.63</b>	<b>12</b>	<b>.763</b>	<b>3.75</b>	<b>80</b>	<b>1.08</b>
19. The agendas of the Audit Committee meetings are finalised by the chairperson.	4.00	12	.000	3.71	35	1.45	4.00	21	.000	3.00	12	1.04	3.72	80	1.08
20. The chairperson cooperates with other committee members before finalising the agenda of the meetings.	4.00	12	.000	3.54	35	1.48	3.90	21	.539	2.75	12	.866	3.59	80	1.13
21. The agenda and related materials are provided to members fairly ahead of the meetings.	4.00	12	.000	2.77	35	1.42	3.90	21	.436	3.50	12	.522	3.36	80	1.12
22. All members can express their views freely and independently at the meetings.	4.00	12	.000	4.26	35	1.26	4.05	21	.218	3.75	12	.866	4.09	80	.903
23. The frequency of the Audit Committee meetings is sufficient to carry out its responsibilities.	4.00	12	.000	3.23	35	1.09	4.00	21	.000	4.25	12	.452	3.70	80	.848
24. The duration of the Audit Committee meetings is sufficient for															



a full discussion of important issues.	4.00	12	.000	3.77	35	1.31	4.05	21	.218	4.25	12	.452	3.95	80	.899
25. Non-members attend the Audit Committee meetings if required or invited.	4.25	12	.452	3.66	35	1.28	4.00	21	.000	4.00	12	.739	3.89	80	.928
26. The minutes of the Audit Committee meetings are circulated to all members of the Municipal Council.	4.25	12	.452	3.34	35	1.35	4.05	21	.218	3.50	12	1.17	3.69	80	1.7
	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>
<b>E. Role in Financial Reporting</b>	<b>4.63</b>	<b>12</b>	<b>.151</b>	<b>3.88</b>	<b>35</b>	<b>1.12</b>	<b>4.03</b>	<b>21</b>	<b>.190</b>	<b>3.75</b>	<b>12</b>	<b>.866</b>	<b>3.92</b>	<b>80</b>	<b>.812</b>
27. The Audit Committee reviews the integrity of Municipality's financial statements.	4.00	12	.000	4.00	35	1.09	4.19	21	.402	3.75	12	.866	4.01	80	.819
28. The Audit Committee reviews accounting policies and any changes made therein.	4.25	12	.452	3.91	35	1.15	4.10	21	.301	3.75	12	.866	3.99	80	.864
29. The Audit Committee reviews accounting estimates and judgments done in preparing financial statements.	4.00	12	.000	3.60	35	1.12	3.90	21	.436	3.75	12	.866	3.76	80	.846
30. The Audit Committee reviews the compliance of the Accounting Standards (e.g. IAS, IFRS) in preparing financial statements.	4.00	12	.000	3.77	35	1.12	4.00	21	.000	3.75	12	.866	3.86	80	.806
31. The Audit Committee reviews the clarity and completeness of disclosures in financial statements.	4.00	12	.000	3.97	35	1.15	4.00	21	.000	3.75	12	.866	3.95	80	.745
32. The Audit Committee reviews other information (e.g. the Auditor General's report, financial highlights) presented in the annual report.	3.75	12	.452	4.00	35	1.06	4.00	21	.000	3.75	12	.866	3.92	80	.792

	M	N	SD	M	N	SD	M	N	SD	M	N	SD	M	N	SD
<b>F. Role in External Auditing</b>	<b>4.00</b>	<b>12</b>	<b>0.00</b>	<b>3.10</b>	<b>25</b>	<b>1.19</b>	<b>3.49</b>	<b>21</b>	<b>0.41</b>	<b>3.19</b>	<b>12</b>	<b>.757</b>	<b>3.46</b>	<b>80</b>	<b>1.01</b>
33. External Auditors are appointed and/or removed upon the recommendation of the Audit Committee.	4.00	12	.000	2.14	35	1.00	3.71	21	.561	2.25	12	1.14	2.85	80	1.17
34. The Audit Committee assesses and reviews the expertise and resources of the External Auditors.	4.00	12	.000	2.66	35	1.11	3.81	12	.602	2.50	12	1.17	3.14	80	1.10
35. The Audit Committee reviews and approves the terms of the Engagement Letter (EL) prepared for the External Auditors.	4.00	12	.000	2.74	35	1.29	3.71	21	.561	3.25	12	.866	3.26	80	1.08
36. The Audit Committee monitors the external audit firm's compliance with the existing ethical and regulatory requirements in South Africa.	4.00	12	.000	2.74	35	1.17	3.90	21	.436	3.00	12	1.04	3.28	80	1.06
37. The Audit Committee reviews the findings of the annual audit obtained by the Auditor General/ External Auditors.	4.00	12	.000	3.97	35	1.15	4.00	21	.000	3.50	12	.522	3.91	80	.799
38. The Audit Committee reviews the management's responsiveness to the Auditor General's findings.	4.00	12	.000	4.29	35	1.15	4.10	21	.301	3.75	12	.866	4.11	80	.857
39. The Audit Committee meets with the External Auditors without the presence of the management to discuss any issues, problems or reservations arising from the audit.	4.00	12	.000	3.17	35	1.42	3.95	21	.218	3.75	12	.866	3.59	80	1.06

40. The Audit Committee reviews and monitors the independence and effectiveness of the external auditing process.	4.00	12	.000	3.06	35	1.21	4.05	21	.590	3.50	12	.522	3.52	80	.981
	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>
<b>G. Role in Internal Auditing</b>	<b>4.00</b>	<b>12</b>	<b>.000</b>	<b>3.79</b>	<b>35</b>	<b>1.21</b>	<b>3.87</b>	<b>21</b>	<b>0.36</b>	<b>3.81</b>	<b>12</b>	<b>.722</b>	<b>3.85</b>	<b>80</b>	<b>.917</b>
41. The Audit Committee recommends and approves the appointment or termination of the heads of the internal audit division.	4.00	12	.000	2.17	35	1.15	3.67	21	.577	2.50	12	.905	2.89	80	1.17
42. The Audit Committee approves and reviews the charter of the Internal Auditors.	4.00	12	.000	4.29	35	1.15	3.81	21	.402	4.00	12	.739	4.07	80	.854
43. The Audit Committee assesses and reviews the annual internal audit work plan.	4.00	12	.000	4.31	35	1.13	3.95	21	.218	4.25	12	.452	4.16	80	.787
44. The Audit Committee reviews the annual internal audit reports, budget, and other findings.	4.00	12	.000	4.31	35	1.13	3.95	21	.218	4.25	12	.452	4.16	80	.787
45. The Audit Committee reviews and monitors the management's responsiveness to the internal auditor's findings and recommendations.	4.00	12	.000	4.34	35	1.14	3.95	21	.218	4.25	12	.452	4.17	80	.792
46. The Audit Committee meets with the head of the internal audit function without the presence of the management.	4.00	12	.000	3.23	35	1.56	3.81	21	.402	3.50	12	1.17	3.54	80	1.17
47. The Audit Committee enhances the independence of the Internal Auditors of the municipality.	4.00	12	.000	3.83	35	1.17	4.00	21	.316	3.75	12	.866	3.89	80	.857

48. The Audit Committee monitors and evaluates the effectiveness of the internal audit function.	4.00	12	.000	3.83	35	1.27	3.81	21	.512	4.00	12	.739	3.88	80	.919
	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>	<b>M</b>	<b>N</b>	<b>SD</b>
<b>H. Overall Practice</b>	<b>4.00</b>	<b>12</b>	<b>0.00</b>	<b>4.12</b>	<b>35</b>	<b>1.19</b>	<b>4.07</b>	<b>21</b>	<b>0.31</b>	<b>3.75</b>	<b>12</b>	<b>.866</b>	<b>4.03</b>	<b>80</b>	<b>.886</b>
49. The Audit Committee can work independently.	4.00	12	.000	4.34	35	1.21	3.95	21	.218	3.75	12	.866	4.10	80	.894
50. The Audit Committee is effective.	4.00	12	.000	3.89	35	1.18	4.19	21	.402	3.75	12	.866	3.96	80	.878

The **composition** of Audit Committees in KZN local government in the table above (Table 5.4) shows that the mean scores of the responses to the statements are: 3.97 (Municipal Mangers); 3.73 (Audit Committee Chairpersons); 4.01 (CFOs/Finance Heads); and 3.88 (Internal Auditors); and that these result in an aggregated mean score of 3.86 for all 140 respondents. The lowest notable mean score (at 1.94) by Audit Committee Chairpersons on the statement whether the Audit Committee members are appointed in consultation with the Audit Committee Chairperson. Although this is not a requirement by any law, legislation, or code in South African local government, it does facilitate in the employment of suitable members in the Audit Committee.

The second lower aggregated mean score (which is less than 4.00) in the case of the statements on Audit Committee members' literacy and experience in Accounting/Auditing indicates that the Audit Committee members are seen to be lacking in terms of literacy and experience in related areas. However, the statement relating to the independence of the Audit Committee Chairpersons has been agreed with by the highest number of respondents in the cases of each of the four sample groups, and this implies that there is no major problem regarding the independence of Audit Committees in KZN local government. This is in line with the spirit of the formation of the Audit Committees as suggested in most of the guidelines, including: the MFMA (2003), King IV (2016), the Cadbury Report (1992), the BRC (1999), and the Sarbanes-Oxley Act (2002).

The responses indicate that Audit Committees in KZN local government include the "right people", as it indicates clearly that Audit Committee members have two main facets: independence, and competencies. The Audit Committees are composed of at least three independent members. The ultimate objective of such a requirement is to enable the Audit Committee to make judgments that are in the best interests of stakeholders (i.e., independence is

required to promote objectivity on the part of Audit Committee members). DeZoort et al., (2002) noted that an adequate number of committee members is needed to generate substantive discussion and to consider emerging issues as well as access to management, External Auditors, Internal Auditors, the full board, and legal counsel. The benefits of additional members must be weighed against the incremental costs of poorer communication, coordination, involvement, and decision-making associated with larger groups. The objective is to have an Audit Committee not so large as to become unwieldy but sufficiently large to ensure appropriate monitoring. It is also as an effort to restore public confidence in the wake of various financial reporting scandals.

Committee members in KZN local government have no relationship to the municipality that may interfere with the exercise of their independence from management and the municipality. Lastly, the Audit Committee members are financially literate, with at least one of whom having accounting or related financial-management expertise (though not all of them). Therefore, Audit Committees in KZN local government have the "right people" as members with member qualifications such as independence and expertise.

Regarding the statements on **authority and resources** provided to the Audit Committees, the mean scores of the responses of the first sample group (Municipal Managers) the highest amongst all other groups was 4.00. The rest of the sample groups are very similar at 3.64, 3.93, and 3.65 for Audit Committee Chairpersons, CFOs and Internal Auditors, respectively. Audit Committee authority is a function of the Audit Committee responsibilities and influence on management and auditors (Van Der Nest, 2008). Authority refers to formal responsibilities where Audit Committee is made accountable and endowed with the authority to intervene. These Audit Committee responsibilities are generally stated in a formal charter (the Audit Committee charter) which provide legitimate capacity to intervene (Bedard and Gendron, 2009). The Audit Committee shall have the authority to perform functions and to obtain any information and advice, from within or outside the municipality, in order to perform its functions as legislated. Appropriate resources must be made available to the Audit Committee to perform its functions as agreed in its charter (MFMA, 2003). The Audit Committee charter has become an increasingly important document for helping Audit Committee members to focus on their specific responsibilities and for helping stakeholders to assess the role and responsibilities of Audit Committees.

The lowest mean response (3.14) by Audit Committee Chairpersons whether they receive prompt responses from management in carrying out their duties is noted. The same statement also has the lowest combined average mean score of 3.52. This may be because the management of every municipality normally provides all documents or information used and/or required in Audit Committee meetings. A culture of not responding in time, especially if they are being policed (probed) may persist amongst members of municipal management. Various tactics of stalling, and, in some cases, not responding at all to Audit Committee requests may be the norm. DeZoort et al., (2002) noted that Audit Committee authority (influence) also depends on the Audit Committee's relationships with management, external and Internal Auditors, and the board as a whole. However, it is important to be realised that all mandatory responsibilities documented in Audit Committee charter always have the risk exposure of becoming ritualistic. The Audit Committee must have adequate resources to do its job (Raghunandan & Rama, 2007).

The **diligence** of Audit Committee members obtained a similar and high mean score from the responses of all four respondent groups. These are: 4.00 (Municipal Managers), 4.35 (Audit Committee Chairpersons), 4.02 (CFOs) and 4.18 (Internal Auditors). All responses from all respondent groups obtained individual mean scores of above 4.00. A clear indication that Audit Committee members in KZN local government are diligent, assume responsibilities, and devote sufficient time to the affairs of the committee. Diligence refers to the willingness of committee members to work together as needed to prepare, ask questions and pursue answers when dealing with management, External Auditors, Internal Auditors, and other relevant constituents. The Audit Committee member's determination to act is the most important component of an effort to achieve an effective Audit Committee (DeZoort et al., 2002). Expertise, independence, authority, and resources as the input components will not result in effectiveness unless the Audit Committee conducts the mechanisms by which all inputs are translated into organisational outcomes (Bedard and Gendron, 2009). Audit Committee must be diligent in working to serve the best interests of stakeholders (DeZoort et al., 2002). The Audit Committees in KZN local government have the desire to carry out their monitoring roles and include factors such as the number of committee meetings and the behavior of individuals, which include preparation before meetings, attentiveness, participation, and post-meeting follow-up. Diligence can be observed from six

proxies, i.e., agenda, meetings, questioning, relationships, power, and leadership (Bedard and Gendron, 2009).

The statements relating to Audit Committee **meetings** of Audit Committee members obtained a similar mean score from the responses of all three respondent groups. These are: 3.54 (Audit Committee Chairpersons), 3.49 (CFOs) and 3.63 (Internal Auditors) and a high mean score for Municipal Managers of 4.06. It is encouraging that the statement stating that all members can express their views and opinions freely in the Audit Committee meeting has obtained the highest overall mean value in this section of statements (4.09). Also, the fact that non-members actually do attend Audit Committee meetings if required shows an overwhelming support for Audit Committees in KZN local government, the average mean score being 3.89. The frequency (average mean of 3.70) and duration (average mean of 3.95) of Audit Committee meetings is deemed sufficient and appropriate to carry out all related responsibilities and discuss fully all pertinent matters.

The lowest mean scores, regarding Audit Committee meeting, is noted in the second statement (i.e. the Audit Committee Chairperson cooperates with other committee members before finalising the agenda of the meetings) by Internal Auditors at 2.75. Also, in the third statement (i.e. the agenda and related materials are provided to members fairly ahead of time of the meetings) by Audit Committee Chairpersons at 2.77. This result implies that the Audit Committee members do not play any significant role in choosing the agenda for the Audit Committee meetings and that Audit Committee members are not provided with all required documents by management in time for their meetings. Lary and Taylor (2012) noted the number of Audit Committee meetings as one factor that is observable publicly. The MFMA and King IV legislation/Code provides for Audit Committee meetings to at sit least four times per year, with authority to convene additional meetings, as circumstances require. All committee members are expected to attend each meeting, in person. A quorum must consist of 50% plus one member. Whenever a quorum cannot be achieved, the Audit Committee Chairperson must adjourn the meeting for up to fourteen days. The Audit Committee charter should be used as a basis for setting the agenda for meetings. The Audit Committee should hold sufficient scheduled meetings per annum to discharge all aspects of the

terms of reference fully and it is evident that KZN local government municipalities do conform with all these requirements.

Regarding the statements on the **role in financial reporting** by Audit Committees in KZN local government, the responses indicate that Audit Committees are performing that task well, as the mean scores are: 4.63 (Municipal Managers), 3.88 (Audit Committee Chairpersons), 4.03 (CFOs) and 3.75 (Internal Auditors). The combined average mean score is 3.92. The statement with the highest mean score relates to Audit Committee reviews having the integrity of municipality's financial statements. It is expected that Audit Committee will perform this function, as this is a legislated requirement as per the MFMA circular 65, which states that the Accounting Officer must prepare AFS of the municipality within two months after the end of the financial year to which those statements relate. These AFS must be submitted to the Auditor-General for auditing (This should be linked to the MFMA calendar). Primarily, the Audit Committee should have reviewed these AFS two weeks before submission to the Auditor-General. Stice and Stice (2012) state that the purpose of financial reporting is to aid interested parties in evaluating a company's past performance and in forecasting its future performance. The information about past events is intended to improve future operations and forecasts on future cash flows. According to Jonas and Blanchet (2000), there are two approaches related to financial reporting quality as described: Users need approach: This approach tends to focus on valuation-related issues. Also, shareholders/investors protection approach: This approach tends to focus more on Corporate Governance and stewardship-related issues.

However, the lowest mean value (overall 3.76) is noted in the case of the third statement (i.e. the Audit Committee reviews accounting estimates and judgements done in preparing financial statements. This may be because Audit Committee members may not necessarily have the required expertise required to review and interrogate the accounting estimates used. Normally, an Accounting Officer in preparation of AFS will make use of an expert (i.e. a qualified chartered accountant). In addition, the necessary information required to interrogate the accounting estimates used may not be available to Audit Committee members. One form of Audit Committee effectiveness is a high quality of financial reporting. The Audit Committee has a significant impact



in reducing the likelihood of fraud and restatements, so that there must be frequent communication between the AG, the Audit Committee, and the Council.

As already mentioned, the AGSA, which has a constitutional mandate and, as the Supreme Audit Institution (Hussain & Mallin) of South Africa does the external audit function of municipalities in KZN local government exists to strengthen our country's democracy by enabling oversight, accountability, and governance in the public sector through auditing, thereby building public confidence. The statements relating to the **role of Audit Committee members in external auditing** obtained mean scores of 4.00 (Municipal Managers), 3.10 (Audit Committee Chairpersons), 3.49 (CFOs) and 3.19 (Internal Auditors). The noted low mean scores from Audit Committee Chairpersons are in relation to the first to forth statement (i.e. External Auditors are appointed and/or removed upon the recommendation of the Audit Committee, the Audit Committee assesses and reviews the expertise and resources of the External Auditors, the Audit Committee reviews and approves the terms of the Engagement Letter (EL) prepared for the External Auditors, and the Audit Committee monitors the external audit firm's compliance with the existing ethical and regulatory requirements). These noted low scores are warranted, as mentioned that in South Africa, the audit of all municipalities rests with the AG-SA as a chapter nine institution. There is limited scope for Audit Committees to amend the functions of the external audit, as the AG-SA is the sole institution entrusted with auditing municipalities in South Africa, in a bid to safeguard democracy.

In the case of the statements on Audit Committee's **role relating to internal auditing**, the mean score obtained from the responses of the Audit Committee Chairpersons (4.00) is higher than that of the other three sample groups which obtained similar mean scores of 3.79 (Audit Committee Chairpersons), 3.87 (CFOs) and 3.85 (Internal Auditors). The lowest mean value has been assigned in the case of the first statement (i.e. that the Audit Committees recommend and approve the appointment or termination of the heads of internal audit division). This indicates that the Audit Committees play insignificant role in appointing or terminating the head of internal audit functions. On the other hand, the highest mean value (overall 4.17) is observed in the case of the statement that the Audit Committee reviews and monitors the management's responsiveness to the internal auditor's findings and recommendations. This result reflects the view that the Audit

Committees in KZN local government do play an important role in ensuring effective and efficient responsiveness by municipal management on internal audit findings. This result is consistent with guidelines on Audit Committee by the Financial Reporting Council that highlighted the role of Audit Committees in closely monitoring the responsiveness of management on matters raised by the internal audit function.

Davidson and Ebersole (2002) pointed out that independence from management is widely recognised as an important characteristic of an effective Audit Committee. The last two statements that aimed to measure the general scenario of the Audit Committee's independence and effectiveness obtained different mean values. The mean score of the statement regarding Audit Committee independence is 4.10, while the statement on the overall effectiveness of the Audit Committees obtained a lower mean value of 3.96. The difference in mean scores in the case of these two statements can be interpreted by the fact that the respondents have evaluated the Audit Committees as independent, but they still think that the Audit Committees are not yet able to fulfil their duties effectively.

### 5.3.3 Analysis of Mean, Standard Deviation and Ranking of Responses towards the Factors Affecting the Audit Committee Practices in KwaZulu-Natal Local Government

**Table 5.5: Analysis of Mean and Standard Deviation (SD) of Responses towards the Factors Affecting Audit Committee Effectiveness in KwaZulu-Natal Local Government**

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor			Total		
	M	SD	R	M	SD	R	M	SD	R	M	SD	R	M	SD	R
<b>A. Composition</b>															
1. Lack of Audit Committee member's qualification in relevant field.	2.25	.456	4	2.17	1.34	6	2.81	.873	8	1.25	.452	8	2.21	1.12	7
2. Lack of Audit Committee member's experience and expertise in the relevant field.	2.75	.866	1	2.20	1.30	5	2.86	.964	7	1.25	.452	8	2.31	1.18	6

3. Non-inclusion of majority independent/external members in the Audit Committees.	2.25	.452	4	1.89	1.02	8	3.00	.894	4	3.00	.000	1	2.40	.976	5
4. Non-appointment of Audit Committee chairperson from external/independent members.	2.25	.452	4	1.91	1.07	7	2.81	.750	8	2.00	.000	4	2.21	.896	7
5. Low frequency of Audit Committee meetings.	2.00	.000	8	2.37	1.22	4	2.95	1.02	5	2.00	.000	4	2.41	1.02	4
6. Lack of diligence in Audit Committee members.	2.00	.000	8	1.77	.808	9	2.95	1.12	5	2.00	.000	4	2.15	.915	9
7. Inadequate authority delegated to the Audit Committees.	2.25	.452	4	2.57	1.30	3	3.19	.981	3	2.50	.905	2	2.68	1.10	3
<b>Statements</b>	<b>Municipal Manager</b>			<b>Audit Committee Chairperson</b>			<b>CFO (Finance Head)</b>			<b>Internal Auditor</b>			<b>Total</b>		
<b>A. Composition</b>	<b>M</b>	<b>SD</b>	<b>R</b>	<b>M</b>	<b>SD</b>	<b>R</b>	<b>M</b>	<b>SD</b>	<b>R</b>	<b>M</b>	<b>SD</b>	<b>R</b>	<b>M</b>	<b>SD</b>	<b>R</b>
8. Inadequate resources provided to the Audit Committee.	2.75	.866	1	2.83	1.15	2	3.90	.539	1	2.25	.452	3	3.01	1.05	1
9. Lack of support from top management.	2.50	.522	3	2.89	1.26	1	3.57	.676	2	2.00	.000	4	2.87	1.15	2

As discussed in *Chapter Four*, the respondents were requested to share their views on the factors that affect the Audit Committee practices in KZN local government. A total of nine factors were listed in the questionnaire. It should be mentioned that the factors were chosen on the basis of the literature as reviewed in *Chapter Three*, and were also the participant's opinions obtained from the pre-testing of the questionnaire. Table 5.6 (above) presents the mean values along with the standard deviations of the responses towards these factors. Furthermore, the factors have also been ranked on the basis of the mean scores as obtained from the responses.

It is noted that mean scores are generally low, across all four respondent groups, which gives a general perception that the Audit Committees in KZN local government are somehow effective in

their duties. The lowest mean scores relate to Internal Auditors, where they regard Audit Committees in KZN local government as having relevant qualifications. This is indicative of their mean score of 1.25 for the first statement (lack of Audit Committee member's qualification in relevant field). Also, the Audit Committee Chairpersons on statements three, four, and six. These are: Non-inclusion of majority of independent/external members in the Audit Committees (1.89), non-appointment of Audit Committee Chairperson from external/independent members (1.91), and lack of diligence in Audit Committee members (1.77). These indicate that not only are Audit Committee members diligent, but they are also independent, with the majority of external members and the Audit Committee Chairperson externally appointed. This is in line with the provisions of the MFMA Act and the King IV Code on Corporate Governance.

The CFOs and Internal Auditors presume that the inclusion of majority of independent or external members in the Audit Committees may be the cause of the poor performance of Audit Committee in KZN local government. A mean score of 3.00 is noted in both these respondent groups. Furthermore, the CFOs presume that there may be inadequate authority delegated to the Audit Committees (3.19) and inadequate resources provided to the Audit Committee (3.90). The CFOs play an imperative and integral role in ensuring that Audit Committees are provided with adequate resources and is noted, with dismay, that they in turn presume that Audit Committees in KZN local government are not provided with adequate resources, which invariably leads to reduced performance in their duties.

The average highest mean score (3.01) on factors affecting the Audit Committee practices is statement eight (inadequate resources provided to Audit Committee). Of all factors affecting the Audit Committee practices listed in the questionnaire, the provision of adequate resources to Audit Committee appears a prominent factor that affects the effective and efficient functioning of Audit Committees in KZN local government.

### 5.3.4 Analysis of Mean Standard Deviation and Ranking of Responses on the Suggestions for Improving Audit Committee Effectiveness in KwaZulu-Natal Local Government

**Table 5.6: Analysis of Mean and Standard Deviation (SD) of Responses on the Suggestions for Improving Audit Committee Effectiveness in KwaZulu-Natal Local Government**

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor			Total		
	M	SD	R	M	SD	R	M	SD	R	M	SD	R	M	SD	R
<b>A. Composition</b>															
1. Voluntary and self-regulation by the Municipalities.	2.75	.866	6	2.83	1.15	10	2.81	.680	10	3.00	.000	9	2.84	.892	10
2. Increased pressure from National Government.	4.00	.000	1	3.60	1.12	6	4.00	.000	2	3.25	.452	1	3.71	.799	2
3. Increased monitoring of existing rules and guidelines.	4.00	.000	1	3.69	1.08	5	3.95	.218	3	3.25	.452	1	3.74	.775	1
4. Introducing some new rules and guidelines.	4.00	.000	1	3.29	1.34	9	4.14	.359	1	3.00	.000	9	3.58	1.00	4
5. Compulsory inclusion of Audit Committee report in the Annual Corporate Report.	2.75	.452	6	3.77	1.14	3	3.62	.740	6	3.25	.452	1	3.50	.941	5

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor			Total		
	M	SD	R	M	SD	R	M	SD	R	M	SD	R	M	SD	R
<b>A. Composition</b>															
6. Mandating the appointment of Audit Committee Chairperson from independent/external individuals.	2.50	.522	8	3.91	1.29	1	3.52	.750	7	3.25	.452	1	3.50	1.08	5
7. Mandating inclusion of majority independent /external members in the Audit Committees.	2.25	.452	9	3.89	1.28	2	3.43	.507	8	3.25	.452	1	3.43	1.07	7

8. Including Audit Committee practices in the requirements of the Municipal Finance Management Act.	2.25	.452	9	3.51	1.3	7	3.71	.717	5	3.25	.452	1	3.34	1.04	9
9. Offering some incentives to the municipalities that comply with the King Code (King IV).	4.00	.000	1	3.51	1.30	7	3.81	.402	4	3.25	.452	1	3.62	.919	3
10. Compulsory compliance of King Code regarding the guidelines of Audit Committee practices.	3.00	.000	5	3.71	1.18	4	3.29	.463	9	3.25	.452	1	3.42	.868	7

The last section of the questionnaire consisted of ten possible ways of improving Audit Committee effectiveness in KZN local government. Table 5.7 presents the responses towards this section in terms of mean standard deviation and ranking of the responses.

It is seen in Table 5.7 that the Municipal Managers emphasised some possible improvements for effectiveness of the Audit Committees in KZN local government. The four most recommended improvements, as viewed by the Municipal Managers, are:

- (i) Increased pressure from National Government,
- (ii) Increased monitoring of existing rules and guidelines,
- (iii)Introducing some new rules and guidelines, and
- (iv)Offering some incentives to the municipalities that comply with the King Code (King IV).

All the above statements from Municipal Managers received 4.00 as mean scores. The CFOs shared the Municipal Manager's sentiments on two statements:

- (i) Increased monitoring of existing rules and guidelines (mean score of 4.00); and
- (ii) Introducing some new rules and guidelines (highest mean score of 4.14).

It is interesting that both Municipal Managers and CFOs will see the need for reform as far as rules and guidelines are concerned. It could be that they see that KZN local government municipalities operate in a very distinct space. It is unlike the private sector, where the idea of Audit Committees emanated. The views of Audit Committee Chairpersons and Internal Auditors, regarding the

introduction of new rules and guidelines, is similar at mean scores of 3.29 and 3.00, respectively. The CFOs further see the need for: inclusion of Audit Committee practices in the requirements of the MFMA Act (3.71 mean score) and offering some incentives to the municipalities that comply with the King Code (King IV) (3.81 mean score). On the other hand, Audit Committee Chairpersons seem to emphasise the need for:

- (i) Mandating inclusion of majority of independent /external members in the Audit Committees (3.91); and
- (ii) Mandating inclusion of majority of independent /external members in the Audit Committees (3.89).

The average mean scores emphasise the following:

- (i) Increased monitoring of existing rules and guidelines as the first and foremost exercise,
- (ii) Increased pressure from National Government as the second, and
- (iii) Offering some incentives to the municipalities that comply with the King Code (King IV), being the third.

Normally, in South Africa, whenever a municipality collapses or is on the verge of collapse, Section 139 of the South African Constitution allows provincial intervention in local government when that municipality fails to fulfil its executive obligations in terms of the constitution or legislation. One of these interventions may include putting a municipality under administration. This will mean that there will be no executive positions and that an administrator will be appointed to manage and oversee the day-to-day running of the municipality. However, more often than not, this provincial intervention is always regarded as “being too late”. Hence, it is interesting to note that respondent groups regard the strict monitoring of existing rules and guidelines and the increased pressure from National and Provincial Government as being paramount in ensuring improved Audit Committee effectiveness.

This section has discussed descriptive statistics in order to describe the nature of the data collected from the field survey. These descriptive results need confirmation by some inferential statistics. Therefore, some non-parametric statistics (namely, the Wilcoxon Signed Rank Test, the Kruskal Wallis Test and the Mann Whitney U Test) have been run, and the results obtained in these tests are discussed in the following section (section 5.4).

## 5.4 Statistical Testing

The previous section focused on the descriptive characteristics of the questionnaire survey responses. This section continues with the analysis of the responses and a discussion of the test results of the hypotheses in this study. Firstly, the Wilcoxon Signed Rank Test has examined the significance of the responses; and secondly, the hypotheses have been tested using the Kruskal Wallis Test and the Mann Whitney U Test, as applicable.

### 5.4.1 Wilcoxon Signed Rank Test of the Significance of Responses towards the Statements

Table 5.8 to 5.15 depicts the mean values and SDs of responses to the 50 statements on Audit Committee practices in KZN local government. The researcher feels that it is worth comparing the mean responses with 3 (the mid score of a 5 point scale) to examine the significance of agreement/disagreement using the Wilcoxon Signed Rank Test. This test is used as non-parametric statistics, as opposed to one sample “t” test in parametric statistics. Table 5.8 presents the mean scores of the responses to the statements as compared with “3” (the midpoint of a 5 point scale) to examine whether the agreement or disagreement of the responses to the statements is statistically significant or not.

**Table 5.7: Wilcoxon Signed Rank Test of the Significance of Responses towards the Composition of Audit Committee in KZN local government**

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>A. Composition</b>												
1. The Audit Committee members are appointed in consultation with the Audit Committee Chairperson.	4.00	3.464	0.001	1.94	3.454	0.001	3.90	4.359	.000	3.50	1.732	0.083



Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>A. Composition</b>												
2. The Audit Committee members have sufficient knowledge of the municipality's environment.	4.00	3.464	0.001	3.86	4.111	0.000	4.19	4.359	.000	4.25	3.217	0.001
3. The Audit Committee members have sufficient knowledge of Accounting and/or Auditing practices.	4.00	3.464	0.001	3.69	2.873	0.004	3.86	4.243	0.000	3.75	2.251	0.024
4. The Audit Committee members have sufficient experience in Accounting and/or Auditing.	3.75	3.000	0.003	3.60	2.677	0.007	3.86	4.025	0.000	3.75	2.251	0.024
5. The Audit Committee members are capable of mediating problems in performing their duties.	4.00	3.464	0.001	3.91	3.497	0.000	3.95	4.472	0.000	3.50	2.449	0.014
6. The majority of Audit Committee members are independent/external members	4.00	3.464	0.001	4.43	4.270	0.000	4.10	4.413	0.000	3.75	2.251	0.024
7. The chairperson of the Audit Committee is independent/ external members.	4.00	3.464	0.001	4.49	4.672	0.000	4.05	4.491	0.000	4.25	3.217	0.001
8. The size of the Audit Committee is appropriate for carrying out its duties properly.	4.00	3.464	0.001	3.89	3.360	0.001	4.14	4.179	0.000	4.25	3.217	0.001

A Wilcoxon Signed Rank Test, on the above table (Table 5.8), showed that there was a significant difference ( $p < 0.005$ ) between scores given by three respondent groups (namely: Municipal Managers, Audit Committee Chairpersons and CFOs) on all eight statements on Audit Committee composition. The insignificant difference, between these groups, is only noted with Audit Committee Chairpersons on statement 4: The Audit Committee members have sufficient

experience in accounting and/or Auditing. This translates that some Audit Committee Chairpersons regard some Audit Committee members as not having the relevant experience in the related field. Unlike the other three respondent groups, the Internal Auditors neither disagreed significantly nor agreed significantly at the 5% level of significance regarding statements one, three, four, five and six. However, all four sample groups significantly agreed with two particular statements, which are: firstly, the Audit Committee members have sufficient knowledge on the municipality's environment; secondly, the chairperson of the Audit Committee is an independent/ external members; and lastly, the size of the Audit Committee is appropriate for carrying out its duties properly. This finding is inconsistent with Davidson and Ebersole (2000) who noted that there is a strong relationship between Audit Committee independence and Audit Committee effectiveness. Verschoor (1993) also pointed out that Audit Committee independent is widely recognised as an important characteristic of an effective Audit Committee.

Moreover, the size of Audit Committees in KZN local government has been regarded as appropriate for them to carry out their responsibilities. This result is consistent with the studies of Pincus et al. (1989) and Pucheta-Martinez and Fuentes (2007) who emphasised the importance of appropriate Audit Committee size. Lastly, it is notable that the Audit Committee members have sufficient knowledge of the municipality's environment.

**Table 5.8: Wilcoxon Signed Rank Test of the Significance of Responses towards the Authority and Resources of Audit Committee in KZN local government**

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>B. Authority and Resources</b>												
9. The Audit Committee has adequate authority in order to carry out its responsibilities.	4.00	3.464	0.001	3.86	3.161	0.002	3.90	4.146	0.000	3.25	1.732	0.083
10. The Audit Committee has ready access to relevant information if required.	4.00	3.464	0.001	3.57	2.422	0.015	4.00	4.379	0.000	4.00	3.464	0.001

11. The Audit Committee receives prompt responses from the management in carrying out its duties.	4.00	3.464	0.001	3.14	.625	0.532	3.90	4.359	0.000	3.50	2.449	0.014
12. The Audit Committee is provided with sufficient resources including secretarial support to carry out its duties.	4.00	3.464	0.001	3.77	2.947	0.003	4.00	4.379	0.000	4.00	3.464	0.001

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>B. Authority and Resources</b>												
13. The non-executive Audit Committee members are adequately paid for their time and efforts.	4.00	3.464	.001	3.83	3.678	0.000	3.86	4.025	0.000	3.50	1.732	0.083

Regarding the statements on authority and resources provided to the Audit Committees, the three sample groups (namely: Municipal Managers, Audit Committee Chairpersons, and CFOs) agreed significantly on all statements, with the exceptions of Audit Committee Chairpersons having disagreed significantly with two statements: the Audit Committee has ready access to relevant information if required; and the Audit Committee receives prompt responses from the management in carrying out its duties. The result is consistent with prior descriptive statistics (section 5.3) which also revealed that Audit Committee in KZN local government may not be provided with ready access to information required to discharge their duties; and also may not be receiving prompt responses from management. This is NOT consistent with the recommendation of Bull and Sharp (1989) and Rittenberg and Nair (1994) who recommended the importance of management's support and open lines of communication with the Audit Committee members. The Internal Auditors echoed the responses of Audit Committee Chairpersons that the Audit Committees in KZN local government may not be receiving prompt responses from the management in carrying

out its duties. The Internal Auditors' agreement was further insignificant ( $p > 0.005$ ) on statements nine and thirteen, which respectively say that Audit Committees have adequate authority in order to carry out their responsibilities and that the non-executive Audit Committee members are paid adequately for their time and efforts. However, the Internal Auditors significantly agreed adequately on one statement, alongside all other respondent groups, that Audit Committees are provided with sufficient resources, including secretarial support, to carry out their duties.

**Table 5.9 Wilcoxon Signed Rank Test of the Significance of Responses towards the Diligence of Audit Committee in KZN local government**

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>C. Diligence</b>												
14. The Audit Committee has a charter which outlines its objectives, duties and responsibilities.	4.00	3.464	0.001	4.46	4.385	0.000	4.05	4.491	0.000	4.25	3.217	0.001
15. The Audit Committee charter is reviewed annually.	4.00	3.464	0.001	4.40	4.185	0.000	3.95	4.077	0.000	4.00	3.464	0.001
16. The Audit Committee members have a clear understanding of their responsibilities.	4.00	3.464	0.001	4.34	4.278	0.000	4.00	4.583	0.000	4.25	3.217	0.001
17. Members of the Audit Committee readily assume their responsibilities.	4.00	3.464	0.001	4.40	3.804	0.000	4.00	4.379	0.000	4.25	3.217	0.001
18. The Audit Committee members devote sufficient time to the affairs of the committee.	4.00	3.464	0.001	4.14	2.272	0.023	4.10	4.234	0.000	4.00	2.762	0.006

Regarding the five statements on the diligence of the Audit Committees, all four sample groups agreed significantly with all statements ( $p < 0.005$ ). The only noted exception is in regards to the last statement, (namely, the Audit Committee members devote sufficient time to the affairs of the

committee), where both the Audit Committee Chairpersons and Internal Auditors disagreed with the statements. F Todd DeZoort, Hermanson, Archambeault, et al. (2002) noted that composition, authority, and resources represent the three primary inputs to the Determinants of Audit Committee Effectiveness (ACE), while diligence is the process factor that is needed to achieve ACE. Similarly, Kalbers and Fogarty (1993) highlighted that the Audit Committee member's will to act is arguably the most important

ACE attribute. Audit Committees must be diligent in working to serve the best interests of stakeholders. The Wilcoxon Signed Rank Test scores given by all four sample groups show that Audit Committees in KZN local government are diligence. However, the only noted insignificant agreement relates to the last statement (the Audit Committee members devote sufficient time to the affairs of the committee). This indicates room for improvement.

The accounting literature includes numerous calls for Audit Committee diligence (e.g., Beasley et al., 1999; BRC, 1999; Horton et al., 2000; Sommer, 1991). For example, the BRC (1999) recommended that Audit Committees meet at least quarterly, discuss financial reporting quality with the external auditor, and provide up-to-date charters detailing committee responsibilities. Similarly, the NACD (2000) emphasised the importance of diligence when it suggested that Audit Committees have four half-day meetings each year. There is an evident connection between the diligence of Audit Committees and the meeting held by these Audit Committees. Therefore the following table (Table 5.11) presents the Wilcoxon Signed Rank Test results of statements relating to Audit Committees meetings.

**Table 5.9 Wilcoxon Signed Rank Test of the Significance of Responses towards the Meetings of Audit Committee in KZN local government**

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>D. Meeting</b>												
19. The agendas of the Audit Committee meetings are finalised by the chairperson.	4.00	3.464	0.001	3.71	1.860	0.063	4.00	4.583	0.000	3.00	0.000	1.000

20. The chairperson cooperates with other committee members before finalising the agenda of the meetings.	4.00	3.464	0.001	3.54	0.905	0.366	3.90	3.962	0.000	2.75	1.000	0.317
21. The agenda and related materials are provided to members fairly ahead of the meetings.	4.00	3.464	0.001	2.77	4.028	0.000	3.90	4.146	0.000	3.50	2.449	0.014
22. All members can express their views freely and independently in the meetings.	4.00	3.464	0.001	4.26	1.107	0.268	4.05	4.491	0.000	3.75	2.251	0.024

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>D. Meeting</b>												
23. The frequency of the Audit Committee meetings is sufficient to carry out its responsibilities.	4.00	3.464	0.001	3.23	2.939	0.003	4.00	4.583	0.000	4.25	3.217	0.001
24. The duration of the Audit Committee meetings is sufficient for a full discussion of important issues.	4.00	3.464	0.001	3.77	2.341	0.019	4.05	4.491	0.000	4.25	3.217	0.001
25. Non-members attend the Audit Committee meetings if required or invited.	4.25	3.217	0.001	3.66	1.189	0.234	4.00	4.583	0.000	4.00	2.762	0.006
26. The minutes of the Audit Committee meetings are circulated to all members of the Municipal Council.	4.25	3.217	0.001	3.34	3.711	0.000	4.05	4.491	0.000	3.50	1.473	0.141



The above table shows that both Municipal Managers and CFOs significantly agreed (at most, 1% level of significance) with all eight statements. It should be borne in mind that all three sample groups (Municipal Managers, CFOs, and Internal Auditors) are standing invitees to Audit Committee meetings. There is inherently, limited insight that may be offered by these groups as far as Audit Committee meetings are concerned.

On the contrary, both the Audit Committee Chairpersons' and the internal auditor's agreement was insignificant in relation to four of the eight statements:

- (i) The agendas of the Audit Committee meetings are finalised by the chairperson,
- (ii) The chairperson cooperates with other committee members before finalising the agenda of the meetings,
- (iii) All members can express their views freely and independently at the meetings, and
- (iv) Non-members attend the Audit Committee meetings if required or invited.

Futhermore, Audit Committee Chairperson's agreement was insignificant to one more statement (i.e. the duration of the Audit Committee meetings is sufficient for a full discussion of important issues) and internal auditor's on statement relating to the minutes of the Audit Committee meetings being circulated to all members of the Municipal Council. The responses from these two sample groups are NOT consistent with the recommendations and results of Raghunandan et al. (1998); the BRC (1999); Gendron and Bedard (2006); Beasley et al. (2009) who emphasised the importance of various issues of effective Audit Committee meetings. These responses reflect that there are major shortcomings in relation to meetings of the Audit Committees in KZN local government. There is only one statement that was significantly agreed by all four sample groups, with the significance level below 3% (i.e. the frequency of the Audit Committee meetings is sufficient to carry out its responsibilities). This may well be as a result of the fact that the frequency of meetings is legislated under the MFMA, King IV, and by many other international best practices, regulations, rules, and codes.

**Table 5.10 Wilcoxon Signed Rank Test of the Significance of Responses towards the Role in Financial Reporting of Audit Committee in KZN local government**

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>E. Role in Financial Reporting</b>												
27. The Audit Committee reviews the integrity of Municipality's financial statements.	4.00	3.464	0.001	4.00	3.378	0.001	4.19	4.291	0.000	3.75	2.251	0.024
28. The Audit Committee reviews accounting policies and any changes made therein.	4.25	3.217	0.001	3.91	2.589	0.010	4.10	4.413	0.000	3.75	2.251	0.024
29. The Audit Committee reviews accounting estimates and judgments done in preparing financial statements.	4.00	3.464	0.001	3.60	3.149	0.002	3.90	4.146	0.000	3.75	2.251	0.024
30. The Audit Committee reviews the compliance of the Accounting Standards (e.g. IAS, IFRS) in preparing financial statements.	4.00	3.464	0.001	3.77	3.852	0.000	4.00	4.583	0.000	3.75	2.251	0.024

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>E. Role in Financial Reporting</b>												
31. The Audit Committee reviews the clarity and completeness of disclosures in financial statements.	4.00	3.464	0.001	3.97	3.851	0.000	4.00	4.583	0.000	3.75	2.251	0.024



32. The Audit Committee reviews other information (e.g. the Auditor General's report, financial highlights) presented in the annual report.	3.75	3.000	0.003	4.00	3.784	0.000	4.00	4.583	0.000	3.75	2.251	0.024
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In relation to the statements on Audit Committee's role in financial reporting, three groups of respondents (i.e. Municipal managers, Audit Committee Chairpersons, CFOs) agreed significantly with all six statements. This is reflected in the view of these three sample groups, that the Audit Committees in KZN local government are performing a satisfactory role in relation to the municipality's financial reporting. However, the Internal Auditors significantly disagreed with all six statements relating to the role of Audit Committees in financial reporting. Therefore, it is clear that the Internal Auditors do not deduce that Audit Committees are performing satisfactory work in financial reporting.

It is indeed the primary purpose of Audit Committees to provide oversight of the financial reporting process, the audit process, the municipality's system of internal controls, and compliance with laws and regulations. The Audit Committee can expect to review significant accounting and reporting issues and recent professional and regulatory pronouncements to understand the potential impact on financial statements. An understanding of how management develops internal interim financial information is necessary to assess whether reports are complete and accurate and it would seem that is the case in KZN local government.

**Table 5.11 Wilcoxon Signed Rank Test of the Significance of Responses towards the Role in External Auditing of Audit Committee in KZN local government**

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>F. Role in External Auditing</b>												
33. External auditors are appointed and/or removed upon the recommendation of the Audit Committee.	4.00	3.464	0.001	2.14	3.851	0.000	3.71	3.638	0.000	2.25	1.979	0.048
34. The Audit Committee assesses and reviews the expertise and resources of the External Auditors.	4.00	3.464	0.001	2.66	1.907	0.057	3.81	2.673	0.008	2.50	1.473	0.141
35. The Audit Committee reviews and approves the terms of the Engagement Letter (EL) prepared for the External Auditors.	4.00	3.464	0.001	2.74	1.141	0.254	3.71	3.638	0.000	3.25	1.000	0.317
36. The Audit Committee monitors the external audit firm's compliance with the existing ethical and regulatory requirements in South Africa.	4.00	3.464	0.001	2.74	1.258	0.208	3.90	2.887	0.004	3.00	0.000	1.000
37. The Audit Committee reviews the findings of the annual audit obtained by the Auditor General/external auditors.	4.00	3.464	0.001	3.97	3.500	0.523	4.00	4.583	0.000	3.50	2.449	0.024
38. The Audit Committee reviews the management's responsiveness to the Auditor General's findings.	4.00	3.464	0.001	4.29	4.077	0.927	4.10	3.357	0.005	3.75	2.251	0.014

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>F. Role in External Auditing</b>												
39. The Audit Committee meets with the External Auditors without the presence of the management to discuss any issues, problems, or reservations arising from the audit.	4.00	3.464	0.001	3.17	0.638	0.523	3.95	4.472	0.000	3.75	2.251	0.024
40. The Audit Committee reviews and monitors the independence and effectiveness of the external auditing process.	4.00	3.464	0.001	3.06	0.092	0.927	4.05	2.840	0.005	3.50	2.449	0.014

There were eight statements related to Audit Committee's role in external auditing and the significance test produced mixed results. The Municipal Managers significantly agreed significantly with all eight statements while CFOs agreed significantly with seven of these statements, with the exception of one, namely: that the Audit Committee assesses and reviews the expertise and resources of the External Auditors.

In contrast, the Internal Auditors disagreed significantly with all eight statements related to Audit Committee's role in external auditing, while Audit Committee Chairpersons significantly disagreed with seven of these statements. The exception being that External Auditors are appointed and/or removed upon the recommendation of the Audit Committee.

The role of the Audit Committee is to assist the Council and the Accounting Officer in fulfilling its oversight responsibilities with regard to the integrity of internal control and accounting function, internal auditing, and **external auditing**. Furthermore, the Audit Committees review the

annual financial statements and the non financial information contained therein (integrated report to provide the Council of the municipality with an authoritative and credible view of the financial position of the municipality or municipal entity, its efficiency and effectiveness, and its overall level of compliance with the MFMA, the annual Division of Revenue Act, and any other applicable legislation.

The results indicate that there are some differences in opinion within the four respondent groups, and in attempting to examine whether these differences are significant statistically, some other statistical techniques (e.g. Kruskal Wallis Test and Mann Whitney U Test) have been applied (as will be detailed in the impending section 5.4.2).

**Table 5.12: Wilcoxon Signed Rank Test of the Significance of Responses towards the Role in Internal Auditing of Audit Committee in KZN local government**

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>G. Role in Internal Auditing</b>												
41. The Audit Committee recommends and approves the appointment or termination of the heads of the internal audit division.	4.00	3.464	0.001	2.17	3.641	0.000	3.67	3.500	0.000	2.50	1.732	0.083
42. The Audit Committee approves and reviews the charter of the Internal Auditors.	4.00	3.464	0.001	4.29	4.077	0.000	3.81	3.162	0.002	4.00	2.762	0.006
43. The Audit Committee assesses and reviews the annual internal audit work plan.	4.00	3.464	0.001	4.31	4.144	0.000	3.95	4.472	0.000	4.25	3.217	0.001
44. The Audit Committee reviews the annual internal audit reports, budget and other findings.	4.00	3.464	0.001	4.31	4.144	0.000	3.95	3.317	0.001	4.25	3.217	0.001

45. The Audit Committee reviews and monitors the management's responsiveness to the internal auditor's findings and recommendations.	4.00	3.464	0.001	4.34	4.185	0.000	3.95	4.472	0.000	4.25	3.217	0.001
46. The Audit Committee meets with the head of the internal audit function without the presence of the management.	4.00	3.464	0.001	3.23	.700	0.484	3.81	3.162	0.002	3.50	1.473	0.141

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>G. Role in Internal Auditing</b>												
47. The Audit Committee enhances the independence of the Internal Auditors of the municipality.	4.00	3.464	0.001	3.83	3.109	0.002	4.00	4.379	0.000	3.75	2.251	0.024
48. The Audit Committee monitors and evaluates the effectiveness of the internal audit function.	4.00	3.464	0.001	3.83	3.102	0.002	3.81	2.887	0.004	4.00	2.762	0.006

In relation to Audit Committee's role in internal auditing, the three respondent groups (i.e. Municipal Managers, Audit Committee Chairpersons, and CFOs) all significantly agreed with the statements. The only exception is with Audit Committee Chairpersons on one statement, namely: that the Audit Committee meets with the head of the internal audit function without the presence of the management. It would appear that not all municipalities in KZN local government are privileged to meet with the head of internal auditing, in the absence of the said municipality's management.

In the case of responses from Internal Auditors, they agreed significantly with three out of the eight statements, namely: that the Audit Committee assesses and reviews the annual internal audit work plan, that the Audit Committee reviews the annual internal audit reports, budget, and other findings and that the Audit Committee reviews and monitors the management's responsiveness to the Internal auditor's findings and recommendations. The Internal Auditors significantly disagreed with the Audit Committee Chairpersons on the fact that Audit Committee Chairpersons meet with Internal Auditors in the absence of municipality's management.

The Internal Auditors further indicate the inability of Audit Committees to enhance the independence and effectiveness of Internal Auditors. This is over and above that they indicated that Audit Committees do not approve the appointment or termination of heads of internal audit nor do they review and approve the charter of Internal Auditors.

Internal audit is an independent, objective, assurance and consulting activity designed to add value and improve the organisation's operations. It helps a municipality to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. The overall results of the significance test reflect the view that the Audit Committees in KZN local government do play an important role in internal auditing, which is consistent with the Audit Committee duties that were suggested by Wolnizer (1995), Woodlock and Claypool (2001), and Porter and Gendrall (1998).

**Table 5.13 Wilcoxon Signed Rank Test of the Significance of Responses towards the Overall Practices of Audit Committee in KZN local government**

Statements	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor		
	M	Z value	P value	M	Z value	P value	M	Z value	P value	M	Z value	P value
<b>H. Overall Practice</b>												
49. The Audit Committee can work independently.	4.00	3.464	0.001	4.34	4.192	0.000	3.95	4.472	0.000	3.75	2.251	0.024
50. The Audit Committee is effective.	4.00	3.464	0.001	3.89	3.242	0.001	4.19	3.276	0.001	3.75	2.251	0.024

In relation to the last two statements concerning the overall Audit Committee practices in KZN local government, to three sample groups (i.e. Municipal Managers, Audit Committee

Chairpersons and CFOs) significantly agreed that the Audit Committees can work independently. This result is consistent with the studies of McHugh and Raghunandan (1994), Yeo (2001); Scarborough et al. (1998) and Christopher et al., (2009) who noted the importance of Audit Committee independence for its effectiveness. A great deal of studies (for example, Campbell, 1990; Vicknair et al., 1993; Chen and Zhou, 2007; Chan and Li, 2008) noted the importance of an effective Audit Committee for sound governance of the company. Hence, the last statement was about the overall effectiveness of the Audit Committees in KZN local government, and the agreement with this statement was found statistically to be significant also in the case of three of the samples (namely, the Municipal Managers, Audit Committee Chairpersons, and CFOs) although the Internal auditor's agreement on both these statements was statistically insignificant at a 5% level of significance.

Tables 5.8 to 5.15 indicates that most of the statements were agreed upon by the four sample groups, which were also found statistically significant using the Wilcoxon Signed Rank Test. However, it is clear that the significance of agreement in the case of the internal auditor groups is much lower than that of the rest of the three groups. This implies that there are some differences in the responses of the four sample groups. In attempting to examine whether there is any significant difference in terms of the mean scores of the responses in the four sample groups regarding the different aspects of the Audit Committees, the next section (section 5.4.2) presents and discusses the Kruskal Wallis Test results.

#### **5.4.2 Analyses of Hypothesis Testing Results**

The main objective of hypothesis testing in this study is to examine whether there is a significant difference in responses of sample groups. Theses eight hypotheses were developed on eight broad aspects of Audit Committees with a view to compare the mean scores of responses obtained from the four sample groups. The test results will also assist in concluding whether different groups of respondents and the samples have been chosen from the same or an identical population. These test results from these hypotheses have been presented in Tables 5.16 and 5.17.



**Table 5.14 Analysis of Hypothesis Testing Results**

Audit Committee Aspects	Municipal Manager			Audit Committee Chairperson			CFO (Finance Head)			Internal Auditor			Total		
	M	N	SD	M	N	SD	M	N	SD	M	N	SD	M	N	SD
1. Composition	3.00	12	.000	2.80	35	.584	3.00	21	.000	3.00	12	.000	2.91	80	.396
2. Authority and resources	3.00	12	.000	2.66	35	.639	2.95	21	.218	3.00	12	.000	2.84	80	.462
3. Diligence	3.00	12	.000	2.83	35	.568	3.00	21	.000	3.00	12	.000	2.93	80	.382
4. Meeting	3.00	12	.000	2.77	35	.598	3.00	21	.000	2.75	12	.452	2.86	80	.443
5. Role in Financial Reporting	3.00	12	.000	2.83	35	.568	3.00	21	.000	2.50	12	.522	2.85	80	.453
6. Role in External Auditing	3.00	12	.000	2.40	35	.736	2.95	21	.218	2.50	12	.522	2.65	80	.597
7. Role in Internal Auditing	3.00	12	.000	2.74	35	.611	3.00	21	.000	3.00	12	.000	2.89	80	.421
8. Overall Independence and Effectiveness	3.00	12	.000	2.80	35	.584	3.00	21	.000	3.00	12	.522	2.91	80	.396

**Table 5.15 Analysis of Hypothesis Testing Results**

Audit Committee Aspects	Kruskal-Wallis $H$ test ( $\chi^2(2)$ )	Degree of freedom (DF)	Asymp. Sig. (P Value)
1. Composition	5.343	3	0.148
2. Authority and resources	5.144	3	0.171
3. Diligence	3.957	3	0.266
4. Meeting	7.021	3	0.071
5. Role in Financial Reporting	5.348	3	0.145
6. Role in External Auditing	5.897	3	0.162
7. Role in Internal Auditing	8.223	3	0.042
8. Overall Independence and Effectiveness	5.343	3	0.148

*Hypothesis 1[Ho (1)]: Differences observed in the mean scales of the four sample groups (Municipal Managers, Audit Committee Chairperson, CFO/Finance Head, and Internal Auditor) with respect to composition of the Audit Committees are statistically insignificant.*

Table 5.17 depicts the results of a Kruskal-Wallis H test that, as at a 5% significance level, no statistically significant difference was found in the opinions of the four sample groups on Audit Committee composition in the KZN local government municipalities ( $\chi^2(2) = 5.343$ ,  $p = 0.148$ ),



with the mean rank score of 3.00 for Municipal Managers, 2.80 for Audit Committee Chairpersons, 3.00 for CFOs, and 2.91 for Internal Auditors.

The associated p-value of the Kruskal-Wallis H test (i.e. 0.148) shows that it is very likely to find such a value if a null hypothesis is true, and, hence, the null hypothesis is accepted at a 5% significance level. Therefore, the test results suggest that no significant difference exists in the responses of the four different groups of respondents and, therefore, it can be inferred that the samples for the study have been taken from an identical population. This also reflects the fact that similar views on Audit Committee composition have been obtained from all samples, which is an indication of the robustness and validity of the findings.

***Hypothesis 2[Ho (2)]: Differences observed in the mean scales of the four sample groups with respect to the authority and resources provided to the Audit Committees are statistically insignificant.***

It can be seen that, at a 5% level, there is no significant difference in the views of the four responding groups in respect of authority and resources provided with the Audit Committees in the KZN local government municipalities ( $\chi^2(2) = 5.144$ ,  $p = 0.171$ ), with the mean rank score of 3.00 for Municipal Managers, 2.66 for Audit Committee Chairpersons, 2.95 for CFOs, and 3.00 for Internal Auditors. The associated p-value of the Kruskal-Wallis Test (i.e. 0.171) indicates that the null hypothesis is likely to be true and it is accepted at a 5% significance level. Therefore, it can be inferred from the test results that the differences observed in the response of the four responding groups are not statistically significant.

***Hypothesis 3[Ho (3)]: Differences observed in the mean scales of the four sample groups with respect to the diligence of the Audit Committees are statistically insignificant.***

It can be seen that, at a 5% level, there is no significant difference in the views of the four responding groups in respect of the diligence of Audit Committees in the KZN local government municipalities ( $\chi^2(2) = 3.957$ ,  $p = 0.266$ ), with the mean rank score of 3.00 for Municipal Managers, 2.83 for Audit Committee Chairpersons, 3.00 for CFOs, and 3.00 for Internal Auditors. The associated p-value of the Kruskal-Wallis Test (i.e. 0.266) indicates that the null hypothesis is likely to be true and it is accepted at a 5% significance level. Therefore, it can be inferred from the

test results that the differences observed in the response of the four responding groups are not statistically significant.

***Hypothesis 4[Ho (4)]: Differences observed in the mean scales of the four sample groups with respect to the meetings of the Audit Committees are statistically insignificant.***

It can be seen that, at a 5% level, there is no significant difference in the views of the four responding groups in respect of the meetings of Audit Committees in the KZN local government municipalities ( $\chi^2(2) = 7.021$ ,  $p = 0.071$ ), with the mean rank score of 3.00 for Municipal Managers, 2.77 for Audit Committee Chairpersons, 3.00 for CFOs, and 2.75 for Internal Auditors. The associated p-value of the Kruskal-Wallis Test (i.e. 0.071) indicates that the null hypothesis is likely to be true and it is accepted at a 5% significance level. Therefore, it can be inferred from the test results that the differences observed in the response of the four responding groups are not statistically significant.

***Hypothesis 5[Ho (5)]: Differences observed in the mean scales of the four sample groups with respect to the role in financial reporting of Audit Committees are statistically insignificant.***

It can be seen that, at a 5% level, there is no significant difference in the views of the four responding groups in respect of the role in financial reporting of Audit Committees in the KZN local government municipalities ( $\chi^2(2) = 5.348$ ,  $p = 0.145$ ), with the mean rank score of 3.00 for Municipal Managers, 2.83 for Audit Committee Chairpersons, 3.00 for CFOs, and 2.50 for Internal Auditors. The associated p-value of the Kruskal-Wallis Test (i.e. 0.145) indicates that the null hypothesis is likely to be true and it is accepted at a 5% significance level. Therefore, it can be inferred from the test results that the differences observed in the response of the four responding groups are not statistically significant.

***Hypothesis 6[Ho (6)]: Differences observed in the mean scales of the four sample groups with respect to the role in external auditing of Audit Committees are statistically insignificant.***

It can be seen that, at a 5% level, there is no significant difference in the views of the four responding groups in respect of the role in external auditing of Audit Committees in the KZN local government municipalities ( $\chi^2(2) = 5.897$ ,  $p = 0.162$ ), with the mean rank score of 3.00 for Municipal Managers, 2.40 for Audit Committee Chairpersons, 2.95 for CFOs, and 2.50 for Internal

Auditors. The associated p-value of the Kruskal-Wallis Test (i.e. 0.162) indicates that the null hypothesis is likely to be true and it is accepted at a 5% significance level. Therefore, it can be inferred from the test results that the differences observed in the response of the four responding groups are not statistically significant.

***Hypothesis 7[Ho (7)]: Differences observed in the mean scales of the four sample groups with respect to the role in internal auditing of Audit Committees are statistically insignificant.***

It can be seen that, at a 5% level, there is no significant difference in the views of the four responding groups in respect of the role in internal auditing of Audit Committees in the KZN local government municipalities ( $\chi^2(2) = 8.223$ ,  $p = 0.042$ ), with the mean rank score of 3.00 for Municipal Managers, 2.74 for Audit Committee Chairpersons, 3.00 for CFOs, and 3.00 for Internal Auditors. The associated p-value of the Kruskal-Wallis Test (i.e. 0.042) indicates that the null hypothesis is likely to be true and it is accepted at a 5% significance level. Therefore, it can be inferred from the test results that the differences observed in the response of the four responding groups are not statistically significant.

***Hypothesis 8[Ho (8)]: Differences observed in the mean scales of the four sample groups with respect to the overall perception on the independence and effectiveness of Audit Committees are statistically insignificant.***

Table 5.16 and 5.17 lastly indicate that, at a 5% level, there is no significant difference in the views of the four responding groups in respect of the independence and effectiveness of Audit Committees in the KZN local government municipalities ( $\chi^2(2) = 5.343$ ,  $p = 0.148$ ), with the mean rank score of 3.00 for Municipal Managers, 2.80 for Audit Committee Chairpersons, 3.00 for CFOs, and 2.50 for Internal Auditors. The associated p-value of the Kruskal-Wallis Test (i.e. 0.148) indicates that the null hypothesis is likely to be true and it is accepted at a 5% significance level. Therefore, it can be inferred from the test results that the differences observed in the response of the four responding groups are not statistically significant.

## **5.5 Conclusion**

Several observations can be made from the results presented in this chapter. Firstly, it reflects the fact that the Audit Committee Chairpersons in KZN local government municipalities are appointed from independent external members of the committee. This factor relating to independent members in the Audit Committee was also viewed as the key factor that affect Audit Committee effectiveness in KZN local government municipalities. Secondly, it appears that the Audit Committee in KZN local government municipalities discharge their duties accordingly, and all checks and balances for a fully functional Audit Committee are present. Lastly, the results of hypothesis testing suggest that there is no significant difference in opinions of the four groups in relation to all aspects of Audit Committee practices (such as: composition, authority and resources, diligence, meetings, role in financial reporting, role in external auditing, role in internal auditing and the overall independence and effectiveness)

## **CHAPTER SIX**

### **ANALYSIS AND DISCUSSION OF THE INTERVIEW SURVEY FINDINGS**

#### **6.1 Introduction**

The aim of this chapter is to analyse and discuss the findings of the interview survey which was undertaken during the second phase of the data collection for the current study. This phase aims to supplement questionnaire surveys, as outlined in *Chapter Four* of the research methodology, in order to make the study more robust. As discussed in *Chapter Five*, the responses of the questionnaire survey describe various aspects of the Audit Committee practices prevailing in KZN local government municipalities. The outline of the interview checklist (appendix 7) covers broadly the same issues as are covered in the survey questionnaire (appendix 5). Therefore, the structure of this chapter is similar to that of the previous chapter.

Section 6.2 discusses the interview results concerning several different aspects of the Audit Committees in KZN local government municipalities, namely, the attributes of the Audit Committees, the different roles being played by the Audit Committees, the scenario of the overall effectiveness of the Audit Committees, the factors that affect the Audit Committee effectiveness, and finally, some suggestions on how Audit Committee effectiveness can be improved. A summary of the interview findings is presented at the end of this section. Finally, Section 6.3 concludes the chapter.

#### **6.2 Interview Findings**

At the outset of the interview, the interviewees were asked to express their views on the importance of establishing an Audit Committee as a Corporate Governance mechanism in the company, together with the community awareness of Audit Committee. As outlined in the interview checklist, the interviewees were gradually asked to talk on different aspects of Audit Committees, namely,

- (i) The various attributes of the Audit Committees, including composition, size, authorities, diligence, and meetings,
- (ii) The role and function of the Audit Committees,
- (iii) The overall effectiveness of the Audit Committees in KZN local government,
- (iv) The major factors that have an impact on Audit Committee practices, and,

The findings obtained from the interview responses are discussed in the following sub-sections:

Key	Question	Number of Respondents
Importance of Audit Committee	Would you please share your opinions about the importance of an Audit Committee in improving the overall governance quality of the municipality and protecting the interest of the community it serves?	12
Negative perception	■	1
Positive perception	■ ■ ■ ■ ■ ■ ■ ■ ■ ■	11

*"I don't think it's given too much support to make an impact within other municipalities."*  
(Mkhize)

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Highlighting the importance of Audit Committees in KZN local government, the Municipal Manager of a district noted that:

*“Since the Audit Committee is independent of the respective municipality, their evaluation of a municipality in terms of the internal controls, and other functions delegated to the Audit Committee promotes effective and efficient leadership. This, in turn, assists the respective municipality in mitigating risks of corruption by improving certain areas and thus protecting the interests of the community.” (Khumalo)*

The sentiment is echoed by the CFO of a local municipality, who remarked that:

*“Corporate Governance is an important concept that incorporates sustainability. Thus, it is the exercise of ethical and effective leadership for effective control and legitimacy. An effective Audit Committee is essential for the effective functioning of a governance system, which generates opportunities for increased productivity while minimising agency costs which are prevalent within municipalities as municipality individuals often do not act in favor of the principles, namely citizens.” (Ntuli)*

However, a vast majority (9) of respondents suggested that the role of an Audit Committee is more visible and important in financial reporting, particularly in reducing the likelihood of the misrepresentation of financial statements and in ensuring adequate disclosure. Respondents further highlighted the fact that a positive relationship exists between the establishment of an Audit Committee and the quality of financial reporting. Prior research studies support these findings, as Hasan (2020) stated in his paper: *“Audit Committee Effectiveness Towards Financial Reporting Quality in Malaysia”*, aimed to fill the gap in Corporate Governance literature and report the importance of the Audit Committee in ensuring the quality of financial reporting in an emerging economy such as Malaysia.

One of the CFOs from a local municipality indicated that:

*“The Audit Committee serves to provide the highest level of assurance on the fair presentation of the financial statements thus strengthening credibility with the stakeholders about the reliability of the presented financial statements.” (Mngadi)*

The implication is that the ultimate beneficiaries of Audit Committees are the stakeholders of that municipality, and the most visible role of an Audit Committee is regarded to be that of financial reporting. Illustrating this further, yet another CFO of a local municipality remarked that:

*“It is important to establish Audit Committees as they oversee the financial practice and reporting, contribute to the integrity of internal audit function and strengthen the credibility of the financial statement of municipalities.” (Maharaj)*

This remark is consistent with the results of Sarens et al. (2009); Bédard and Gendron (2010) and Cohen et al., (2014) who observed that Audit Committees have a significant role in financial reporting. A similar opinion was given by the Municipal Manager of a local municipality:

*“The Audit Committee provides independent oversight of the effectiveness of the municipal’s assurance function and the integrity of the annual financial statements, including external reports issued by the municipality to improve the governance quality.” (Sotoba)*

This indicates that the establishment of Audit Committee enhances the stakeholders’ confidence in the company’s governance mechanism through its rigorous oversight role in internal control and financial reporting. This view is consistent with the studies of Akinpelu (2012); Adam, Mukhtaruddin, Soraya, and Yusrianti (2015) and , who highlighted the necessity of the Audit Committee in carrying out different oversight responsibilities for the entity.

Section 53 of the Constitution of the Republic of South Africa, 1996, states that:

*“...a municipality must structure and manage its administration, budgeting and planning processes to give priority to the basic needs of the community, and to promote the social and economic development of the community, and participate in national and provincial development programmes.”*



The section directly translates the aim of any municipality is to provide a service to its community. It is imperative that the community concerned is aware of the legislative duties of its municipality and the said community should know of any other legislative oversight committee of a municipality. Hence the following question (under the same section) which seeks to discover if communities are aware of Audit Committees in KZN local government.

Key	Question	Number of Respondents
Community awareness of Audit Committee	Do you think all communities in KwaZulu-Natal are properly aware of Audit Committee importance?	12
Negative	■■■■■■■■■■■■■■■■■■■■	11
Neutral	■	1
Positive	-	0

The results are quite worrisome, as they indicated that the majority of respondents (11) do not surmise that communities in KZN local government are aware of Audit Committees, nor of their importance. One respondent was neutral. One Audit Committee Chairperson of a local municipality was neutral to that she remarked that:

*“I think some of the more active communities are aware. The Audit Committee reports to Council. It is limited in terms of them having access to the community, but they're able to attend some open municipal meetings. However, I don't think that people do think that Audit Committee is a way to influence the workings of the Council. I think that they see it as Corporate Governance.” (Zuma)*

All of the other respondents were quite clear to the fact that communities in KZN local government are not aware of Audit Committees, nor of their importance. One of the Audit Committee Chairpersons of a district municipality and Audit Committee member of another local municipality reported that:

*“I don't think so. Even Councillors themselves, some of them don't understand it. Even political parties. We (as Audit Committee members) also seem not to have a better and broader understanding of the role of Audit Committees.” (Khumalo)*

The following is a sentiment echoed by the Audit Committee Chairperson of a local municipality, who said:

*“Not at all. I doubt it because you get a situation where even Municipal Councillors misunderstand the role played by municipal Audit Committees.” (Mabaso)*

The above two statements indicate a clear overlap of duties or duplication of labour between Municipal Public Accounts Committees and Audit Committees as these two oversight committees perform similar roles within a municipality, often with limited resources and capacity constraints, particularly in smaller municipalities.

An internal auditor of a local municipality said that:

*“No, Audit Committees by law normally attend a minimum of four meetings in a year and they don't interact with the community of that municipality concerned. Hence the communities are not aware of the importance and functions of the Audit Committee.” (Naidoo)*

This is a clear indication that there is no mechanism in place for the community, that is being provided the service by the municipality, to interrogate and peruse any of the burning issues being looked at by the Audit Committees in KZN local government.

Therefore, it can be inferred from the above discussion that the practice of Audit Committees is very important to ensure good governance within the municipalities. However, the state of the current practices of Audit Committees in KZN local government is not ideal and municipalities do not benefit fully from them as their contribution remains an illusion to communities. Méndez and García (2007) and Bédard and Gendron (2010) also highlighted that only the presence of an Audit

Committee does not guarantee stronger financial reporting systems; the Audit Committee should perform more effectively in order for this to take place. Lastly, the Audit Committees in KZN local government need to be strengthened in terms of their composition and independence in order to function effectively. Sommer Jr (1991) noted that a corporation having an Audit Committee as part of its governance structure and having an effective Audit Committee are, of course, different matters. Hence the following sub-section outlines the interview results about the composition of Audit Committees in KZN local government.

### **6.2.2 Composition of Audit Committees**

Section 166 (5) of the MFMA requires that the Council of the municipality must appoint the members of an Audit Committee. Its structural independence is statutorily protected, at least in part, by ensuring that (i) the majority of its committee members and the Chairperson are external appointments, not employed by the municipality in any capacity; (ii) at least three members have the appropriate experience; and (iii) no Councillor occupies a seat as a member of the committee. The independence of Audit Committee members should be subject to review at least annually and more often as necessary. Councillors are not allowed to be members of an Audit Committee. When selecting members of Audit Committee, the Council should take into account personal qualities, skills, experience, as well as independence – all of which are critical (Van der Nest, 2008). However, deficiencies exist. First, while the committee is composed largely of external members, it is not entirely clear what constitutes the “appropriate experience” required to qualify for selection. This ambiguity leaves it to the discretion of the Council to determine the level of expertise necessary for an appointment to the Audit Committee.

Prior literature (for example, Scarborough et al., 1998; Abbott and Parker, 2000; Raghunandan et al., 2001 and Lee, 2008 ) has documented that appropriate composition is one of the pre-requisites for Audit Committee effectiveness. Bedard and Gendron (2010) noted that most previous studies had found a positive association between a member’s independence and competence, and Audit Committee effectiveness. They also highlighted the fact that contemporary best practices and regulations recommend that the Audit Committee members should possess certain personal characteristics in terms of qualification and experience. An overwhelming majority (all 12) of interviewees agreed that Audit Committee Chairpersons are independent (not in the employ of the

municipality), but, the majority (9) of interviewees in this study reported that the Audit Committee members do not have sufficient qualifications and experience. Hence the MFMA legislation is also not clear. The appointment process of Audit Committee Chairpersons appears to be very blurred. But, the respondents regarded that the size of Audit Committees in KZN local government is appropriate in order to carry out their responsibilities, and this response confirms the findings acquired through the earlier questionnaire survey (as stated in *Chapter Five*). The researcher started by probing on how Audit Committees are composed and also the relevant procedures to appoint Audit Committee members/chairpersons in KZN local government.

<b>Key</b>	<b>Question</b>	<b>Number of Respondents</b>
Audit Committee in your Municipality	Would you please tell me something about the Audit Committee in your municipality in terms of size, composition?	12
Appointment procedures	Please tell us/me about the procedure(s) to appoint Audit Committee members/chairpersons in KZN local government.	11

All respondents agreed that a minimum of three (external members) should constitute a municipality. This is legislated as per the MFMA Circular 65. One Audit Committee Chairperson of a local municipality said:

*“If you look at the recommendation of Circular 65 and also depending on the size and services the municipality offers, you will need the engineers. In most cases, municipalities just load Audit Committees with accountants and lawyers. A person will only comment on what he/she knows. A lawyer will comment on legal matters, accountants will deal with accounting but when it comes to service delivery matters, which is a is the core business of municipalities, they do not touch.”*  
(Khumalo)

A CFO of a local municipality added that:

*“The size of our Audit Committee is four external members. It exceeds the set minimum requirement by one member because of the size of our municipality. The Audit Committee has one chartered accountant, therefore the Audit Committee has some necessary financial literacy skills and experience to exercise their duties effectively.” (Naidoo)*

These remarks are consistent with the results of Gendron et al. (2004); Pomeroy (2010) and Annuar and Rashid (2015), who noted that if majority of the committee are independent members, then the Audit Committee is associated with having a probing attitude. Most guidelines for Audit Committee best practices (for example, the Treadway Commission, 1987; the Cadbury Report, 1992; the American Law Institute, 1994; and the BRC, 1999) also recommend that independent directors should sit on the Audit Committee for it to function effectively. The size of Audit Committee is also assessed and aligned with the requirements of the MFMA Circular 65.

A Municipal Manager of a local municipality clearly outlined the composition of the Audit Committee from size, independence, and experience by saying:

*“Our Audit Committee comprises of a minimum of three external members. For example, individuals that are not officials of the municipality and a maximum of five external members. Each Committee member is both independent and financially literate as defined by applicable regulation and by the Municipal Council. At least one member must have expertise in performance management. The independence of Audit Committees members shall mean having no relationships with the municipality that may interfere with the exercising of their duties objectively and independently. Such relationships include Financial arrangements and family relationships with management; significant direct or indirect arrangements with the municipality; compensation from Audit Committee involvement that is a major source of a committee member’s income or net worth.” (Mkhize)*

A follow-up question, on the composition of Audit Committees, was the appointment of Audit Committee members and chairpersons. At inception, the appointment of Audit Committee members (including the chairperson) was cited as being the cornerstone for an independent committee. Numerous studies of companies listed on stock markets in the private sector, found a

correlation on how stock markets react to the appointment of Audit Committee chairperson/members Davidson III, Xie, and Xu (2004); Raghunandan and Rama (2007); Jagan Krishnan and Lee (2009) and Singhvi, Raghunandan, and Mishra (2013). Consistently, the appointment of Audit Committee members/chairperson in the public sector remains imperative. An internal auditor at a local municipality said:

*“To appoint the Audit Committee members, the municipality issued an advert to the newspapers them after the closing date shortlisting is done and invite shortlisted candidates to the interview. The Municipal Council appoints the chairperson from the employed/ recommended members.”*  
(Jones)

The above is agreed with by the Audit Committee Chairperson of a district municipality:

*“In some places they adequate, but they do the whole advertising and then the go through the process of shortlisting and interviews.”* (Mhlongo)

Furthermore, an Audit Committee Chairperson at local municipality added that:

*“You find in most places that they just only advertising, and then you just see with the appointment letter sent to you, if chosen to be a member”* (Ngobese)

The blurred lines in the legislation regarding the recruitment process of Audit Committee members/chairpersons may leave room for inadequate members being employed, thus jeopardising the independence of the Audit Committee as a whole.

Lastly, the adequacy of the qualifications and experience of Audit Committees in KZN local government was probed by the researcher. It was previously discussed in *Chapter Three* that researchers (such as: Beasley and Salterio, 2001; DeZoort and Salterio, 2001; McDaniels et al., 2002; Bedard et al., 2004) documented that knowledge, expertise, and experience of the Audit Committee members are directly associated with the effective functioning of the Audit Committees.

Key	Question	Number of Respondents
Characteristics of Audit Committees	How do you evaluate the necessity of the following characteristics of Audit Committee members for its effective functioning?	<i>refer to each sub-heading</i>
<b>(i) Qualifications of Audit Committee members</b>		<b>10</b>
Average	-	0
High	■■■■■■■■■■	10
Low	-	0
<b>(ii) Experience of Audit Committee members</b>		<b>9</b>
Average	-	0
High	■■■■■■■■■■	9
Low	-	0
<b>(iii) Independence of Audit Committee members</b>		<b>12</b>
Average	-	0
High	■■■■■■■■■■■■■■■■■■■■	12
Low	-	0
<b>(iv) Size of Audit Committee</b>		<b>12</b>
Average	■■■■■	4
High	■■■■■■■■■■■■■■■■■■■■	8
Low	-	0

There is a consensus amongst the respondents that Audit Committees in KZN local government municipalities possess adequate qualifications, knowledge, and experience, are independent and that committees are appropriate in size. One Audit Committee Chairperson of a local municipality remarked:

*“I think it is very important is to have relevant qualification or experience in areas such as risk in particular, financial management as these are key fundamentals in running efficient municipalities.” (Khan)*

A Municipal Manager of a local municipality echoed this and said:

*“Experience is a key factor. It enables members to understand the operations of a municipality and can provide relevant and appropriate improvements to ensure that members are able to successfully discharge their duties towards the municipality.” (Ntuli)*

Independence and size of the Audit Committee was covered extensively in the first question, on the composition of Audit Committee. A Municipal Manager of a local municipality remarked:

*“Since members of the Audit Committee are non-executive members, they are not full-time salaried employees of the municipality. This ensures that their judgements on operations within a municipality would not be biased or induced by the incentive of earnings. This component allows for them to be independent and go about their duties without fear or favour” (Mntambo)*

In relation to the size of the Audit Committee, the MFMA legislation suggests a minimum of three, and a maximum of five members. Audit Committees in KZN local government seem to follow the requirements of the legislation, as they are able to employ a minimum of three members to the committee, and depending on the size, complexity, and nature of the business of that municipality, the number will vary to a maximum of five. The internal auditor of a metropolitan municipality shared the sentiment and said:

*“It all depends on the size of the municipality. It varies from one municipality to the next. This would then guide the Municipal Council as to how many members should they have. A minimum of three, with a maximum of five Audit Committee members for a municipality is a standard requirement.” (Van Der Merwe)*



The opinion, on the number of members an Audit Committee should have, is also consistent with the results of the questionnaire survey and also with the recommendations of the best practice suggested by the Cadbury Committee (1992), the Combined Code (1999), the Hampel Report (1998), KPMG (1999), and the BRC (1999), that the Audit Committee should include at least three members to provide the necessary expertise for the oversight function.

Many studies, including Kalbers and Fogarty (1996), Yermack (1996), Scarbrough et al. (1998) and Lin et al. (2008), have argued that a large Audit Committee may not necessarily result in more effective functioning as more members in an Audit Committee may lead to unnecessary debates and delay the decisions, although Pucheta-Martinez and Fuentes (2007) and Felo et al. (2003) found a positive relationship between the size of Audit Committee and the quality of financial reporting.

### **6.2.3 Authority and Resources of Audit Committees**

Because of the wide scope of responsibilities, an Audit Committee requires adequate resources to perform effectively (PricewaterhouseCoopers, 2005). Most Audit Committee guidelines, including the Treadway Report (1987), the Cadbury Committee (1992), the Hampel Report (1998), the BRC (1999) and the Sarbanes-Oxley Act (2002), recommend that an Audit Committee should be provided with sufficient authority and resources for its effective functioning. The Circular 65 of the MFMA indicates that the authority for the committee to conduct inquiries and to access municipality should be spelled out in the Audit Committee charter.

In terms of the MFMA section 166(3)(a) - In performing its functions, the Audit Committee has access to the financial records and other relevant information of the municipality or municipal entity. Audit Committees should have the authority to obtain any information, advice, and appropriate resources from within or outside the municipality, in order to perform their functions as legislated.

Respondents were asked to share their knowledge on various aspects of the authority and resources of Audit Committee in KZN local government. The majority (12 respondents) agreed that Audit Committee in KZN local government work independently, nine respondents agreed that external independent members are remunerated adequately and have ready access to information they require, while eight of the respondents said that Audit Committees are delegated adequate

authority and seven of them agreed that the secretarial support offered to Audit Committees is adequate.

Key	Question	Number of Respondents
Audit Committee's authority	Do you think the Audit Committees in KwaZulu-Natal municipalities are delegated adequate authority required to perform its duties properly?	12
Maybe	■ ■ ■ ■	4
No	-	0
Yes	■ ■ ■ ■ ■ ■ ■ ■	8
Audit Committee's performance	Can the Audit Committees perform their duties independently? Please explain.	12
Maybe	-	0
No	-	0
Yes	■ ■ ■ ■ ■ ■ ■ ■ ■ ■ ■ ■	12
Audit Committee's information access	Do the Audit Committees get ready access to the information required for performing their job?	
Maybe	■ ■	2
No	■	1
Yes	■ ■ ■ ■ ■ ■ ■ ■ ■ ■	9
Audit Committee's secretarial support	Do the Audit Committees get adequate secretarial supports for carrying out their duties?	12
Maybe	■ ■ ■ ■ ■	5
No	-	0
Yes	■ ■ ■ ■ ■ ■ ■ ■	7

Audit Committee's remuneration / benefits	Are the external independent members of the Audit Committees paid enough remuneration and benefits for their time and efforts deployed for the municipality?	12
Maybe	-	0
No	■ ■ ■	3
Yes	■ ■ ■ ■ ■ ■ ■ ■	9

The majority (8) of respondents agreed that Audit Committees are delegated enough authority to perform their duties adequately. International codes, rules, and best practices (such as the UK Combined Code, Treadway Report and Sarbanes Oxley) all spell out specifically the importance of delegating enough authority to Audit Committees in order to discharge their duties. The South African King Report and MFMA outline the importance of spelling out the authority of Audit Committees in their Audit Committee charter, a sentiment shared by the UK Combined Code. It would appear that not all municipalities (as indicative of four respondents) in KZN local government are able to outline this authority.

An internal auditor of a local municipality remarked:

*“Yes, but this depend to the support and experience of the committee members. Experienced members are able to have adequate authority included in the Audit Committee charter to ensure that they duties are not hindered by any party” (Naidoo)*

This was echoed by an Audit Committee Chairperson of a local municipality who said:

*“The authority is not something that you could just simple get, you need to have a good Audit Committee charter, which will spell out everything. You will need to table this charter Municipal Council. Normally, Council doesn't have a problem in accepting it as sometimes they don't even read the charter, they just adopt it. It's up to individual Audit Committee memebtrs, if they are dedicated, to do their work in accordance to the charter and according to the legislation.” (Mabaso)*

The remarks are indicative that management may not be completely supporting that committee or the committee itself is not fully aware of its own duties or takes on duties outside of its own remit. However, all respondents (12) agreed vehemently that all Audit Committees in KZN local government are able to work independently. This is consistent with the findings of McMullen; Raghunandan (1996) Gendron et al. (2004); Fiolleau, Hoang, Jamal, and Sunder (2013) and Alzeban (2015) that an independent Audit Committee is able to have a probing attitude in assessing management decisions. Arthur Anderson (1994) noted that it is deemed extremely important that the Audit Committees have unrestricted access to all relevant internal and external information to fulfill their oversight responsibilities.

Furthermore, providing the Audit Committee with all resources is another vital factor for an effective Audit Committee (subsequent to their authority). The researcher noted in Chapter Three that in the South African public sector, the Audit Committee is appointed by the Municipal Council, and report to Municipal Council; however it the duty of the municipal management (Municipal Managers, CFOs) to ensure that Audit Committees receive all relevant documents and support deemed fit to carry out their functions. Nine respondents agreed that this is the case in KZN local government.

The CFO of a district municipality reported that:

*“Yes, they do request information from us, and we always scramble to get all requested information to the committee.” (Maharaj)*

These remarks are consistent with the results of the questionnaire survey which showed that the majority of Audit Committees have access to information required by them. Another local municipality CFO’s comment was that:

*“Yes, the Audit Committee must be given access to the required information for it to give advice and to make recommendations on various functions over the matters of the municipality.” (Maharaj)*

It however noted that one respondent disagreed, while two were somehow indecisive about Audit Committees having ready access to information they need. An Audit Committee Chairperson of a local municipality remarked that:

*“They will give you the information, although it will come dribs and drabs. You have to follow up and management will say you are troublesome. That's why some of us get fired. So if you are seen to be working according to book, they are not happy but they would give you information.”*  
(Ntuli)

The remark is indicative that some municipal management may view Audit Committees as another tedious oversight committee and invariably be reluctant in giving their full support. PricewaterhouseCoopers (2005) reported that an Audit Committee requires significant resources to perform effectively because of the wide scope of responsibilities. This information needs to come in time for the members to peruse the information, ahead of their legislated four meetings per annum. Seven respondents indicated that Audit Committees receive adequate secretarial support, as an internal auditor of a local municipality reported that:

*“Yes, Audit Committees are supported as they are not in the employ of the municipality, so any secretariat needs are provided to them, for example the distribution of meetings, setting of meetings, exetera.”* (Van Der Merwe)

The remark is echoed by the CFO of a local municipality, who said:

*“Yes, the municipality does provide enough or adequate secretariat support to them.”* (Bhengu)

However, there is room for improvement in this area also, as five of the respondents were indecisive or not completely satisfied with the secretariat support given to Audit Committees in KZN local government. An Audit Committee Chairperson of a local municipality emphasised that:

*“It varies from a municipality to municipality. You may find one where you've got dedicated secretaries.”* (Cele)

A sentiment echoed by another Audit Committee Chairperson of a different local municipality, who added that:

*“I think that it could be possibly made a little better in terms of the minutes of meetings that come out of these meetings. They are usually somewhat not great. In some instances, you receive information from municipal management just a few days before the scheduled Audit Committee meeting.” (Ntuli)*

Lastly, Circular 65 of the MFMA provides that the members of the Audit Committee shall be remunerated for time spent in attendance of Audit Committee meetings. Consistent with the results of the questionnaire survey (76.3%), the majority (9) respondents agreed that external Audit Committee members are remunerated adequately. A CFO of a local municipality remarked:

*“Yes, independent members of the Audit Committee are paid enough remuneration to not only perform their duties but also and attract skilled members.” (Zuma)*

Because member’s remuneration is legislated, there are no deviations or no major deviations to it, as emphasised by the Municipal Manager of a local municipality:

*“We follow recommendations as per circular 65 of the Department of National Treasury” (Mkhize)*

A view shared by the CFO of a district municipality, who said:

*“Yes, in accordance to the published Treasury circular. We follow that.” (Maharaj)*

The municipality may utilise the rates provided by the National Treasury, from time to time, and should the Accounting Officer deem it necessary, he or she can, in consultation with the Municipal Council, determine other remuneration, provided that the charter defines time and cost properly.

Three of the respondents disagreed that Audit Committees are adequately remunerated. One Audit Committee Chairperson of a local municipality explained that:

*“I would rather sit in the office and try to make my three thousand rands (R3 000.00) on a daily basis rather than to spend the whole day at a municipality and make two thousand rands (R2 000.00). I wake up at five (5:00 am) drive to eMzinyathi, only to be back at home at eight (20:00 pm). It may not really be reasonable in that sense” (Mngadi)*

While compensation should be enough to recognise the time commitment required and the liabilities accepted in order to attract good and responsible Audit Committee members, the amount should not be excessive such that independence may be perceived to be impaired.

#### **6.2.4 Diligence and Meetings of Audit Committees**

The results of the questionnaire survey showed significant agreement amongst all respondents that Audit Committee in KZN local government are diligent, devote enough time to discuss pertinent issues in meetings, and follow the MFMA legislation with regards to holding a minimum of four meetings each year. Contemporary literature reviewed (in *Chapter Three*) outlined that the member’s diligence is very important in performing the responsibilities of an Audit Committee effectively and with integrity (V. Sharma, Naiker, & Lee, 2009). Earlier studies by Kalbers and Fogarty (1993) also reported that the Audit Committee member’s diligence is one of the main components of its effectiveness. Moreover, researchers such as Spira (2002) and Anderson et al. (2004) recognised the frequency of Audit Committee meetings as being imperative. Braiotta Jr, Gazzaway, Colson, and Ramamoorti (2010) noted that Audit Committee meetings must be meaningful and substantive.

The survey findings further confirm that Audit Committees in KZN local government are properly aware of their duties, assume those duties willfully, meet regularly, devote ample time to discuss pertinent issues, and members talk freely in meetings.

Key	Question	Number of Respondents
Awareness of Audit Committee's roles and responsibilities	Are the Audit Committee members properly aware of their roles and responsibilities?	12
Maybe	-	0
No	-	0
Yes	■■■■■■■■■■■■■■■■■■■■	12
Audit Committee's responsibilities	Do the Audit Committee members wilfully assume their responsibilities?	12
Maybe	■	1
No	-	0
Yes	■■■■■■■■■■■■■■■■■■■■	11
Audit Committee's time and effort	Do the Audit Committee members devote adequate time and effort for performing their duties?	12
Maybe	■	1
No	■	1
Yes	■■■■■■■■■■■■■■■■■■■■	10
Audit Committee's meeting and regularity	Does the Audit Committee meet regularly? How often?	12
Maybe	■	1
No	-	0
Yes	■■■■■■■■■■■■■■■■■■■■	11
Audit Committee's freedom of speech	Can all members talk freely in the Audit Committee meetings?	12
Maybe	-	0



No	-	0
Yes	■■■■■■■■■■■■■■■■■■■■	12
Audit Committee standing invitees	Does anybody else (other than Audit Committee members) attend the Audit Committee meetings regularly?	12
Maybe	-	0
No	-	0
Yes	■■■■■■■■■■■■■■■■■■■■	12

The overwhelming majority (12) of respondents agreed that Audit Committees in KZN local government are properly aware of their roles, willfully assume their responsibilities, talk freely in meetings and all standing invitees do attend Audit Committee meetings if/when requested to by the committee. A CFO of a local municipality answered that:

*“Yes, as per their charter. They normally ask information as and when they want to, without being told what and how to do their duties.” (Naidoo)*

A feeling shared by the Internal auditor of a metro municipality, who remarked that:

*“Yes, Every member of the Audit Committee should be aware of his or her role and responsibilities with the committee to carry out duties with due diligence and faithfully. When members are appointed, evaluation of knowledge of their roles and responsibilities forms part of the selection process.” (Khan)*

Moreover, freedom of speech is central to the strength of an Audit Committee. It needs to be probing and to be able to follow up on any pertinent matters as deemed fit. An internal auditor of a metro municipality explained that:

*“Every member of the Audit Committee has the right to express his/her opinion with regards to the municipality and is not restricted to make any suggestions, recommendations.” (Jones)*

Following is a sentiment shared by the CFO of a district municipality who answered that:

*“Yes, that is one strength of a fully functional Audit Committee. They need to be probing, inquisitive in their work. So speaking without any fear or favour is important.” (Bolt)*

Overall, the respondents gave an unwavering indication that Audit Committees in KZN local government are diligent. The diligence of Audit Committees works to serve the best interests of stakeholders. Diligence refers to the willingness of committee members to work together as needed to prepare, ask questions, and pursue answers when dealing with management, External Auditors, Internal Auditors, and other relevant constituents (Rupley et al., 2011).

Lastly, in his sample of 254 firms from the S&P SmallCap 600, Thiruvadi (2012) found consistent evidence to show that Audit Committee meetings lead to good outcomes. In theory, an Audit Committee can have fewer meetings but be more diligent, ask more informed questions, and have more productive meetings. Hence the MFMA legislation requires all Audit Committees in KZN local government to meet at least four times in any given year. An Audit Committee of a local municipality explained that:

*“The regulations suggest we have a minimum of four meetings for the Audit Committee and a minimum of two meetings for performance Audit Committee.” (Lovemore)*

The sentiment is shared by both CFO and the internal auditor of a local municipality, who respectively said that:

*“The Audit Committees members in KwaZulu-Natal municipalities meet at least four times per financial year.” (Nathaniel)*

*“The Audit Committees normally have to meet four times within a year, but they also meet more than that if required or if they have to deal with matters as deemed necessary.” (Van Der Merwe)*

The interviewees unanimously agreed that the diligence of the Audit Committee members is a vital factor for the effective functioning of the committee's affairs, which is consistent with the findings of Kalbers and Fogarty (1993); Sharma et al. (2009); Wu (2012) and Eyenubo et al. (2017) in this regard. The member's understanding of the responsibilities and willingness to undertake these responsibilities are important indicators of Audit Committee diligence. A well-designed Audit Committee charter is essential for defining the responsibilities of Audit Committee members. The charter should be used to guide the functioning of the Audit Committees so that the key roles delegated by the Municipal Council are properly performed. The charter should clearly define the role, responsibilities, and the authority of the committee.

#### **6.2.5 Role of Audit Committees**

The primary purpose of any Audit Committee is to provide oversight of the financial reporting process, the audit process, the entity's system of internal controls, and compliance with laws and regulations. The role of Audit Committees in improving the credibility of financial reporting remains the same regardless of country or sector of the industry. Venables & Impey (1991); Bédard and Gendron (2010) and Woidtke and Yeh (2013) noted that Audit Committees are developed in order to increase confidence in the credibility of the financial statements; and strengthen the independence of the External Auditors. This indicates the point that an Audit Committee has to undertake multiple roles for the entity, which are related to different functional areas. Wolnizer (1995) summarised the Audit Committee recommendations of the Corporate Governance commissions and committees in the U.S.A., the U.K., Canada, and Australia. The author demonstrated that Audit Committees are expected to perform almost exclusively in the technical areas of financial reporting, auditing, and internal control. Sharma et al. (2009) noted that Audit Committees play an important role in overseeing and monitoring financial reporting, external auditing, and internal auditing.

Similarly, the KZN Provincial Treasury outlines the roles of Audit Committees as that to provide a review and assess the qualitative aspects of financial reporting, the municipality's processes to manage the business and financial risk, governance processes and compliance with applicable legal, and ethical and regulatory requirements. Correspondingly, the role to be played by the Audit Committees have been legislated in the MFMA and is critical to provide a mechanism for the rendering of impartial advice and recommendations to the Municipal Manager and Municipal

Council on financial and non-financial matters, to improve accountability and governance over the activities of municipalities.

#### ***6.2.5.1 Role in Financial Reporting***

Information about the company's operations is made publicly available through different statements, namely, the board of director's report, the auditor's report, the balance sheet, the income statement, the statement of retained earnings, cash flow statements, and the notes to the financial statements included in the annual corporate report (Fraser, Ormiston, & Fraser, 2010). Similarly, Section 121(1) of the local government: Municipal Finance Management Act 56 of 2003 (MFMA) stipulates that: "Every municipality and the municipal entity must for each financial year prepare an annual report in accordance with its guidelines". According to the MFMA, this Report should include:

- (a) The annual financial statements of the Municipality, and consolidated annual financial statements, submitted to the Auditor-General for audit in terms of section 126 (1) of the MFMA;
- (b) The Auditor-General's audit report in terms of section 126 (3) of the MFMA and in accordance with section 45 (b) of the Municipal Systems Act (MSA) on the financial statements in (a) above;
- (c) The annual performance report of the Municipality as prepared by the municipality in terms of section 45(b) of the local government: Municipal Systems Act 32 of 2000 (MSA);
- (d) An assessment of the arrears on municipal taxes and service charges;
- (e) An assessment of the Municipality's performance against the measurable performance objectives referred to in Section 17 (3)(b) of the MFMA for revenue collection from each revenue source and for each vote in the municipality's approved budget for the financial year;
- (f) Corrective action that was taken in response to issues raised in the audit reports referred to in paragraphs (b) and (d); and
- (g) Recommendations of the municipality's Audit Committee.

The majority of participants interviewed felt that most Audit Committees rarely review the accounting policies, compliance of accounting standards, and account estimates done by accountants. A Municipal Manager of a local municipality explained that:

*“The Committee will examine and review the annual financial statements, prior to submission to the Auditor General of Southern Africa and all other accompanying reports to stakeholders, and any other announcements regarding the municipality’s results or other financial information to be made public, prior to submission to and approval by the Council.” (Khawula)*

A sentiment echoed by the CFO of a district municipality who said that:

*“The primary role of the municipality’s Audit Committee is to provide oversight of the financial reporting process ensuring that it is sound within the KwaZulu-Natal Municipality. Also, to ensure that financial reports produced fairly represent the financial performance and position of the municipality.” (Magalela)*

An Audit Committee is moreover (generally) responsible for reviewing the compliance of accounting standards, principles, and conventions. However, the majority (85%) of interview participants noted that the Audit Committees in KZN local government municipalities rarely review these standards (including the ***going concern assumption of the municipality***) and principles. For example, the internal auditor of a local municipality said:

*“The Audit Committee does not properly review whether the going concern assumption has been properly reflected in the financial statements. Instead, they simply rely on the external auditor’s opinion on the going concern status of the municipality” (Norton)*

This might happen because most Audit Committee members in KZN local government municipalities are not competent enough to review such technical matters and/or to disagree with the external auditor’s opinion.

#### **6.2.5.2 Role in External Auditing**

One of the main responsibilities of Audit Committees is to oversee the external audit functions including the selection, compensation, work, and independence of the external auditor (Bédard & Gendron, 2010). Their study further noted that Audit Committees are directly responsible for the appointment and oversight of their work, including the regulation of the disagreement with the auditor. The ultimate focus of the audit process is to arrive at an opinion on fair presentation of the financial statements and, thus, to convey an independent opinion to the users of the financial statements as to whether these statements as a whole, represent a true and fair view of the company's profits or losses, and its state of affairs at balance sheet date. However, in South African local government, the AGSA, a Chapter 9 institution of the Constitution of the Republic of South Africa is accountable to the National Assembly in terms of section 181(5) of the Constitution and section 3(d) of the Public Auditing Act (PAA) and has to report on its activities and performance of its functions in terms of section 10 of the PAA. It produces audit reports on all government departments, public entities, municipalities, and public institutions annually. Over and above these entity-specific reports, the audit outcomes are analysed in general reports that cover both the PFMA and MFMA cycles. In addition, reports on discretionary audits, performance audits, and other special audits are also produced. The AGSA tables these reports to the legislature with a direct interest in the audit, namely Parliament, provincial legislatures, or Municipal Councils. These reports are then used in accordance with their own rules and procedures for oversight. Lastly, South Africa adopted a combined assurance model, the King IV Code on Corporate Governance which recommends that the Audit Committee should provide independent oversight of the effectiveness of the organization's combined assurance arrangements, including external assurance service providers, internal audit, and the finance function. It also recommends that the Audit Committee discloses its views on the effectiveness of the CFO and finance function. One Municipal Manager of a local municipality clarified that:

*“The Committee will attend to the following matters in conjunction with duly authorised representatives from the Auditor General of South Africa: Discuss and review, with the External Auditors before the audit commences, the nature and scope of the audit function, procedures and to ensure coordination between internal and external audit to avoid duplication of effort; Negotiate procedures, subject to agreement, beyond minimum statutory and professional duties*



- (a) Ensuring that significant findings and recommendations by the AGSA are received and discussed on a timely basis; and
- (b) Ensuring that management responds to recommendations by the AGSA on a timely basis.

### **6.2.5.3 Role in Internal Auditing**

Laux and Laux (2009); Dobija (2015); Sulaiman (2017) also argued that one of the key responsibilities of the Audit Committee is to oversee the internal auditing function. The Audit Committee must make effective use of the internal audit function in giving assurance on risk management, governance, and internal control systems. The literature depicts internal audit as a contemporary Corporate Governance mechanism (Eulerich, Theis, Velte & Stiglbauer 2013; Soh & Martinov-Bennie 2011; Holt & De Zoort 2009; Zain & Subramaniam 2007; Sarens & De Beelde 2006; Carcello, Hermanson & Raghunandan 2005; Gramling, Maletta, Schneider & Church 2004). Certain scholars (e.g. Mihret, James & Mula 2010) hold that without demonstrating effectiveness, an internal audit function (IAF) cannot become a trusted Corporate Governance mechanism. This study investigates internal audit effectiveness in local government to acquire a clearer comprehension perception of whether what is fact or fiction at municipalities in the Vhembe district in Limpopo, a province in South Africa. It is clear that the Audit Committee has to work very closely with the municipality's Internal audit function on various aspects of the municipality's internal control function, governance, risk management. One CFO of a local municipality outlined that:

*“The Audit Committee corresponds with the internal audit function providing them with information to analyse the effectiveness of financial controls and other financial risks which the municipalities face. They will, in return, make recommendations to the municipality's internal audit function to improve systems and process and curb any risks that the municipality may be exposed to.” (Khusi)*

The Internal Auditors report to Audit Committee, a committee tasked with advising Municipal Council and municipality's management (including the Accounting Officer – Municipal Manager) on various aspects. The Audit Committee is further tasked with probing and following up on any



of the recommendations made. Another CFO of a local municipality further confirmed the function, importance, and role of internal audit function as integral and remarked:

*“The Audit Committee will monitor the responses of the Council to internal control recommendations made by the internal and External Auditors, with a view to enhancing appropriate accountability.” (Noah)*

The responsibility for the prevention and detection of fraud does not rest with external auditing (against popular belief) but is one of the core functions of the internal audit. Any Audit Committee has to ensure that this function is properly executed, especially in South African local government where allegations of fraud, looting, and financial mismanagement are rampant. Respondents agreed that one of the checks and balances performed by Audit Committee in KZN local government is to ensure that the internal audit function does proper fraud prevention and detection function. One Municipal Manager of a local municipality explained that:

*“The Audit Committee will also ensure that the Internal Auditors review the municipality’s policies for preventing or detecting fraud, the municipality’s policies for ensuring that it complies with relevant regulatory and legal requirements and the operational effectiveness of the policies and procedures.” (Sibisi)*

The researchers, in their case study of three JSE listed mining companies operating in the South African gold, platinum, coal, and energy sectors, to understand whether communication processes between their Audit Committees and boards of directors were effective. Very little research had been performed on communication between Audit Committees and boards of directors and no studies have been performed on Audit Committees’ communication of internal audit information to boards of directors (Barac & Williams, 2016). In closing the gap the article examined the effectiveness of the process of communicating internal audit information between the Audit Committee and the board and this was useful as previous Audit Committee studies focused predominantly on the diligence, resources, authority, and composition of the Audit Committee, and not on the actual process of communication. The MFMA regulations require all Audit

Committees to act as a forum for communication between management, and Internal and external auditing.

Audit Committee's communication with Internal Auditors	Does the Audit Committee sit with the head of the internal audit section to discuss their role in the absence of management?	12
Maybe	-	0
No	-	0
Yes	■■■■■■■■■■■■■■■■■■■	12

The majority (12) of respondents agreed, when asked “does the Audit Committee sit with the head of the internal audit section to discuss their role in the absence of management?”, as that it is the case. The Audit Committee Chairperson of a local municipality answered that:

*“Yes, that is expected of us, any the Audit Committee has to have such meetings. Especially in the absence of the municipality’s management as it ensures that the Internal Auditors can completely and transparently outline their internal audit findings to us. We also assess any indication of auditors not being independent of management, for example, any indication of Internal Auditors being held at ransom by the municipality’s administration.” (Mthembu)*

The CFO and internal auditor of a local municipality share the above sentiment. They both, respectively, responded by saying:

*“Yes, that does happen as it ensures that the internal audit function may speak freely within being held to task for whatever they say, as they would be saying it in the absence of management, who appointed them.” (Naidoo)*

*“Yes, the Audit Committee must meet with the head of the internal audit section in the absence of management; this also reflects that the internal audit is not under the influence of management given that they report directly to the Audit Committee.”*

There were, however, conflicting views with responses given by sampled respondents regarding whether or not the Audit Committees have any role in appointing an internal auditor for the municipality.

Audit Committee's role in appointing the internal auditor	Does the Audit Committee have any role in appointing an internal auditor for the municipality? Please explain.	10
Maybe	■ ■ ■	3
No	■ ■ ■ ■	4
Yes	■ ■ ■	3

The King Code of Governance Principles for South Africa (King IV Report) requires the Audit Committee to be responsible for appointing, assessing the performance of, and terminating the Heads of internal audit, or chief audit executives (CAEs) (IoDSA 2009:16-46). However, the MFMA regulations only require the Audit Committee to “provide advice” to the Accounting Officer on the appointment and dismissal of the CAE. The former is recommended practice (Code) for all entities in South Africa (including municipalities), and the latter is a local government finance legislation that focussed on compliance with rules and procedures and one that local government municipalities must comply with. The slight distinction in the two pieces of legislation (on the involvement of Audit Committees in heads of internal audit appointments) live room are confusing, as to whether or not Audit Committees can enforce the appointment and dismissal or just merely provide advice to the Accounting Officer.

#### **6.2.6 Overall Effectiveness of Audit Committees**

Kalbers and Fogarty (1993) proposed that Audit Committee effectiveness is perceived as a function of the types and extent of Audit Committee power. Furthermore, in their paper to examine the effectiveness of UK Audit Committees, using a logit regression approach to benchmark corporate financial reporting quality against financial reporting standards in the period from 1991 to 2000, Song and Windram (2004) results showed that an “active” Audit Committee may contribute to Audit Committee effectiveness. However, Van der Nest (2008) concluded (in his

study to investigate the status and function of Audit Committees in South African national government departments) that the majority of Audit Committees in the South African public service are not perceived as ineffective in the performance of the required functions of committees, but can still improve their effectiveness in their performance of certain key functions in the areas of oversight over risk management, governance, financial reporting, internal control, and support for the external audit function. Although effectiveness is an elusive concept that can be approached through several models, none of which is appropriate in all circumstances (Cameron, 1981), it is commonly believed that an effective Audit Committee enhances the protection of the interests of stakeholders.

Audit Committee independence	What do you think about the independence of Audit Committees in KwaZulu-Natal municipalities?	12
Negative perception	-	0
Positive perception	■ ■ ■ ■ ■ ■ ■ ■ ■ ■ ■ ■ ■ ■ ■ ■	12

*“Based on the Audit Committee charter which is formulated in adherence to the applicable rules and regulations and the fact that Audit Committee members have to comply with the various codes, such as MFMA, I can confidently say that Audit Committees in KZN local government are independent.” (Mkhize)*

The remark confirms that the independence of Audit Committees is not only practised but is also enshrined in the Audit Committee charter. In so doing, it becomes very hard for the process to be circumvented, and Municipal Council, together with municipal administration/management may find it very hard to influence this independence of Audit Committees. However, one internal auditor said:

*“The Audit Committees in KZN municipalities are independent. On rare occasions will management influence Council to make decisions that may be to their advantage regarding an Audit Committee. Again, this happens on rare occasions in the normal reporting duties of the Audit Committee to Council as per legislation. In this case, you find Audit Committee suggestions not supported or take forward by Council and is evident by high cases of fraud and corruption of tenders and government money being stolen with no one being held accountable for any of this wrongdoing.” (Davis)*

It is a reality (per legislation) that Audit Committees may only advise the Municipal Council and are, however, unable to enforce any of their recommendations. It is upon each Municipal Council to enforce these recommendations made by each respective Audit Committee. This creates a limitation, one that is created by our legislation. In the light of this, respondents were further asked to explain if they thought that Audit Committees, in KZN local government, can achieve their objectives.

Audit Committee achieving objectives	Do you think that Audit Committees in KwaZulu-Natal municipalities can achieve their objectives? Explain.	12
Maybe	-	
No	-	0
Yes	■■■■■■■■■■■	12

All (12) of respondents strongly believe that Audit Committees can meet their objectives. A Municipal Manager of a local municipality commented:

*“The independence of Audit Committees in KwaZulu-Natal municipalities, size, resources, competence are all the characteristics that channel any Audit Committee to achieving its objectives. There have been gradual improvements in the effectiveness of Audit Committees and in general, are meeting their objectives.” (Tembe)*

One Municipal Manager of a district municipality answered that:

*“Yes, if the Audit Committee has adequate support from the Council to effect improvements and recommendations decided upon by the Audit Committee.” (Shandu)*

A sentiment shared by the internal auditor of the metropolitan municipality, who said:

*“If the municipalities could promote ethical leadership within the KZN province, this would help to reduce corruption and fraud that have been taking place. The appointment of personnel with high standards of integrity, ethics and sound moral discipline into the positions of leadership could help with this regard.” (Lance)*

These responses indicated that, for Audit Committees to be effective and also to achieve their goals, a collective effort is needed. They provide a crucial oversight role and provide advice accordingly. However, if they are not supported, nor their recommendations enforced, the entire oversight role becomes a futile exercise.

The last question in this section was somewhat open-ended as it required respondents to comment on the overall effectiveness of Audit Committees in KZN local government municipalities.

Comment on the overall effectiveness of Audit Committees	Please comment on the overall effectiveness of Audit Committees in KwaZulu-Natal municipalities.	12
Negative perception	■ ■ ■ ■	4
Positive perception	■ ■ ■ ■ ■ ■ ■ ■	8

Mixed views are observed in the interview responses on the overall effectiveness of Audit Committees in KZN local government. However, the majority (8) of these are positive and only four considered the effectiveness of Audit Committees as being unsatisfactory. The majority (8) overwhelmingly agreed that there is room for improvements, one CFO of a local municipality remarked:

*“The Audit Committees in KZN municipalities have been effective in overseeing financial reporting, internal audit functions; however, there is room for improvement in external audit due to a large number of qualified reports.” (Maharaj)*

A sentiment echoed by another CFO of a local municipality, who said that:

*“They are effective, though there is room for improvement. They need to be supported heavily by leadership in order for them to succeed.” (Cele)*

It would appear that various reasons lead to respondents viewing Audit Committees in KZN local government as not “fully” effective when discharging their duties. The internal auditor of a metropolitan municipality remarked that:

*“I would personally say that the Audit Committees of KZN municipalities are operating effectively towards promoting strong internal control measures to reduce corruption within municipalities. Though there is some room for improvement in other municipalities, especially those with rampant cases of financial mismanagement and looting of public funds.” (Jones)*

In his remark, one Municipal Manager offered a solution for improvement, not only for Audit Committee effectiveness but also for municipalities in managing their affairs better in KZN local government, by saying:

*“The effectiveness of Audit Committees is in question due to the reported 9.6% of corruption in KZN municipalities in 2018, and note that KZN is in second place when compared to national statistics. So, one may ask if they are really effective? However, I do think they are. It just that,*

*for the results to show, an all-inclusive approach needs to be adopted, where not only Audit Committees are effective, but municipal management, Municipal Council and all other stakeholders are involved in making any municipality a success.” (Mhlongo)*

### **6.2.7 Factors Affective the Audit Committee Effectiveness**

The questionnaire survey results revealed that both diligence and member’s qualifications are factors that obstruct the effectiveness of Audit Committees in KZN local government. When supplementing the questionnaire surveys, semi-structured interviews were employed. Semi-structured interviews do not strictly follow a formalised list of questions. They ask more open-ended questions, allowing for a discussion with the interviewee rather than a straightforward question and answer format. It was quite surprising that a completely different reason surfaced. The majority (11) of respondents, except for one, noted political influence/interference as a major contributing factor. One Audit Committee Chairperson of a local municipality shared that:

*“I think the key one would be the support from political leaders. They need to understand the role of Audit Committees, so that when Audit Committees escalate matters to Council, Council will be able to make decisions on those without any political interference.” (Dlamini)*

A CFO of a local municipality also explained that:

*“It is a politically charged environment they operate in, and this entails that all Audit Committees must resist the influence, pressure and so forth.” (Gumbi)*

Two Internal Auditors share the above sentiments, one from a metropolitan municipality and the other from a local municipality respectively said:

*“Fraud, corruption, lack of integrity and ethics by municipal employees with no accountability nor remedial actions by powers may be of that municipality. This is evident in the fact that even though Audit Committees raise issues, no remedial action or strict punishment is taken. It is seldom that perpetrators of fraud are held to account in the fullest extent of the law” (Mabuza)*





*“They are adequate. I wouldn't recommend more regulations. In fact, too much regulations and policies may become constraints in themselves.” (Ntuli)*

A CFO of a local municipality shared the same sentiment and added that:

*“Yes, they need to be no more regulations, but to make the existing one work to the best of how they are intended to.” (Maharaj)*

As a result of the comment above, one may view some Audit Committees or municipalities as using the regulation to “tick the box” (for compliance purposes only) and not for what it is intended. This is evident when one internal auditor of a local municipality was asked the same question and responded:

*“Yes, given that they are being properly applied and not a “tick the box” exercise.” (Van Der Merwe)*

Prior research indicates that Audit Committee independence is positively related to effective oversight of the financial reporting process (Madi, Ishak, & Manaf, 2014). Unfortunately, prior research has not provided an answer as to how much independence in the Audit Committee is enough. This is an important unanswered question. The MFMA regulations require the majority (including the Audit Committee Chairperson) to be independent, not in the employ of the municipality, and no Councilor may be a member of the Audit Committee. All respondents agreed (unanimously) that Audit Committees, in KZN local government are independent. The responses confirm the questionnaire survey results (see 5.3.1, in *Chapter Five*) where the inclusion of a majority of independent members has been regarded as one of the top-ranked suggestions for improving the effectiveness of Audit Committees in KZN local government. This is also consistent with the results of Chan and Li (2008) who focused on the importance of including independent directors in Audit Committees. Furthermore, (Zgarni, Hlioui, & Zehri, 2016) revealed that the inclusion of independent members in the Audit Committee has a positive impact on improving the reporting quality (both externally and internally). The establishment of an Audit Committee aims to delegate the responsibilities to hire External Auditors and to facilitate and supervise their work

and, therefore, the Audit Committee should be composed of a majority of independent members (Ghafran & O'Sullivan, 2013).

Lastly, respondents were asked to make recommendations on various subjects (i.e. chairmanship of Audit Committees, size, qualifications) that they believe can enhance the Audit Committee effectiveness in KZN local government. The interview respondents re-emphasised the necessity of an Audit Committee member's knowledge and experience in the field of accounting and/or auditing. One CFO of a local municipality suggested:

*“The majority of members should have sufficient accounting knowledge and experience but some members have qualifications in political science or public relations. Also, knowledge of the local government sphere is crucial, as members who have in the private sector all their lives will have a hard time adapting to the different environment that municipalities operate under” (Masinga)*

In relation to composition, another Audit Committee Chairperson thought that the Audit Committee should be comprised of a wide variety of members (such as chartered accountants, auditors, academics, and businessmen). Another CFO of a local municipality noted:

*“I highly recommend that an expert in accounting and auditing who is financially literate should be one of the members of the Audit Committee.” (Mbhele)*

These responses indicate that there should be a minimum level of qualification and experience for Audit Committee members. The opinion of an Audit Committee Chairperson of a bank was that:

*“Since the primary task of an Audit Committee is to oversee corporate financial reporting and the auditing processes, I think all of its members should have sufficient knowledge and exposure in this area.” (Ndlovu)*

The response of the internal auditor of a local municipality seems worth citing regarding this issue:

*“The three main factors that are needed in order to improve the effectiveness of the Audit Committee regarding the membership of the Audit Committee are: (i) a minimum of three members is necessary for the Audit Committee to be effective; (ii) all members of the Audit Committee are to be independent for the; and, (iii) the independent members with qualification and experience in accounting/finance /auditing or similar jobs are considered necessary for the effectiveness of the committee.” (Nkosi)*

In addition, respondents also cited a strong Audit Committee Chairperson as being a pillar of the entire Audit Committee. One Municipal Manager of a local municipality remarked:

*“In order to be more effective, the Chair of the Audit Committee needs to develop and be given room to develop stronger relationships with the head of internal audit and lead external auditor as this can make him more effective in carrying out his duties and assisting the Audit Committee to carry out their duties.” (Shabane)*

This sentiment was echoed by the CFO of a local municipality who said:

*“The chairmanship of any Audit Committee should be the most qualified and most experienced person within that Audit Committee concerned.”(Maharaj)*

The responses are clear indications of a mammoth task that lies ahead, one that requires a tone to be set the top (by the Audit Committee Chairperson).

The frequency of meetings was also confirmed as appropriate (as per questionnaire surveys). The MFMA legislation suggests a minimum of four (4) meetings per year, and all respondents (12) agreed that Audit Committees in KZN local government do sit for a minimum of four meetings per year, with additional meetings if deemed necessary. One Audit Committee Chairperson of a local municipality indicated that:

*“Quarterly meetings are fine and the standing items should be agreed upon the first seating.” (Ntuli)*

Perhaps the area of improvement is with regards to the resources and Audit Committee having unrestricted access to information. Though none of the respondents indicated any instances of “restriction to information”, however, it was noted that not all information required by Audit Committees is provided in time.

In most cases, information is provided to Audit Committees with limited time to peruse and ponder over the information for effective discussion in meetings. One Audit Committee Chairperson explained that:

*“The Audit Committees should be provided with the necessary resources that they require in order to perform their duties. All the required information and resources should be provided and provided on time.” (Khumalo)*

### **6.3 Conclusion**

The aim of the interview survey was to complement the questionnaire survey findings through gaining a greater insight into the Audit Committee practices in KZN local government. Several observations on the current scenario of Audit Committee practices in KZN local government as obtained from the interview responses have been discussed in this chapter. There is a consensus between the respondents that the Audit Committees have some success in achieving their objectives, though there is room for improvement. The survey also noted some key factors that were considered to be favorable in ensuring that Audit Committees are effective. Furthermore, the respondents also gave some suggestions on how Audit Committee effectiveness can be enhanced in KZN local government.

This chapter has briefly discussed the findings obtained from the interview responses. The next chapter concludes the thesis by presenting a chapter by chapter overview of the thesis, some policy implications of the research, the major limitations of the study, and the potential scope for future researchers.

## CHAPTER SEVEN

### CONCLUSION AND RECOMMENDATION

#### 7.1 Introduction

This research aimed to investigate the current state of Audit Committee practices in KwaZulu-Natal (KZN) local government municipalities. The thesis is motivated by the deficiency of academic studies (particularly those in the public sector sphere) focusing specifically on Audit Committee practice; however, it has been recognised commonly as a very efficient mechanism for ensuring sound Corporate Governance.

Based on the primary quantitative and supplementary qualitative analysis (mixed-method approach) of the practices of Audit Committees in KZN local government, it can be concluded that Audit Committees in KZN local government are effective in the execution of its oversight role. However, minor areas of concern are noted in this thesis. The results further indicate the potential for policy reform and or “*superior*” application of existing policies.

The structure of this final chapter is set out as follows: Section 7.2 provides a summary of each chapter of this thesis; Section 7.3 states some policy implications of this research on local government municipalities; Section 7.4 provides some limitations of the study; Section 8.5 indicates some potential areas for future researchers; and, finally, Section 7.6 ends the thesis with some concluding notes.

#### 7.2 Summary and Overview

This thesis has presented the route of the entire research study, which emanated from the background of the study, a two-fold literature review (Corporate Governance and Audit Committee), methodological issues, the results or findings, and the implications of the study. The following chapter-by-chapter summary is presented:

##### 7.2.1 Chapter One – Introduction

This chapter laid the foundation of the research by introducing the focus of the study (i.e., KwaZulu-Natal Local Government) and the related pieces of legislation regulating this sphere of government. The noted problem statement was that Audit Committees in KZN local government

are not deemed to be an effective instrument (governance structure) of the governing body. Furthermore, compelling motivations for the study were presented (i.e., the lack of scholarly studies on Audit Committees geared for the public sector sphere, the dwindling financial performance of KZN municipalities, and the widespread poor (lack of) service delivery by KZN local government municipalities). A mixed approach research methodology was deemed appropriate for this study, as presented in Chapter One. The semi-structured interviews supplemented the primary data collection (i.e., questionnaire surveys) to four distinct but essential groups of respondents (Audit Committee Chairpersons, Municipal Managers, CFOs, and Internal Auditors), and finally, a structure of the entire thesis was presented.

### ***7.2.2 Chapter Two – Theoretical Literature Review***

This chapter reviewed the literature on Corporate Governance in general. The study hinges on the theoretical framework that was presented in this chapter. Theories were formulated to explain, predict, and understand phenomena and, to challenge and extend existing knowledge within the limits of critical bounding assumptions. The theoretical framework holds or supports a theory of the research study. Moreover, the theoretical framework introduced and described the theory that explained why the research problem under study existed. These discussed theories have underpinned the development of Corporate Governance. Lastly, the chapter presented the prevailing Corporate Governance models prevalent from international best practices (guidelines). A Corporate Governance model is much like the foundation of a building. A well-built Corporate Governance structure that is strong and solid weathers the test of time and the elements.

### ***7.2.3 Chapter Three – Empirical Literature Review***

This chapter focused on the review of literature relating to various aspects of an Audit Committee commencing with international and national Audit Committee guidelines. The composition of an Audit Committee was discussed in this chapter. It was noted that the MFMA regulation is in line with international best practices in relation to the composition of Audit Committee. The chapter further reviewed literature relating to the purposes, roles, and attributes of an Audit Committee. The study recognised that the prominent attributes of Audit Committees are:

- a) Audit Committee independence,

- b) The committee member's knowledge and experience,
- c) The size of the Audit Committee,
- d) The authority and resources,
- e) The diligence of the committee, and
- f) Meetings of Audit Committee.

Literature noted that Audit Committees evolved as a result of corporate scandals (or corporate failures). These corporate failures also call for Audit Committees to be effective. Audit Committee effectiveness is an elusive concept that can be approached through several models, none of which is appropriate in all circumstances. The chapter outlined the determinants of Audit Committee effectiveness as follows:

(A) Input determinants:

- i. Composition,
- ii. Authority and Resources,
- iii. Diligence, and
- iv. Meeting.

(B) Output determinants:

- i. Role in Financial Reporting,
- ii. Role in Internal Reporting,
- iii. Role in External Auditing.

The literature review in this chapter emphasised the need for an effective Audit Committee. Furthermore, the concept of Corporate Governance and Corporate Governance guidelines in relation to Audit Committees was examined. Lastly, Chapter Three explored the Corporate Governance practices that are prevalent in developing countries and South Africa, together with the various roles played by Audit Committee in Corporate Governance.

This chapter has been instrumental in constructing the instruments of this study (i.e., the questionnaire and interview schedule) since it presented the best practices of the Audit Committee, which has been used to compare with the actual Audit Committee practices in KZN local government municipalities.



#### ***7.2.4 Chapter Four – Research Methodology***

The chapter focused on the adoption of the research approach. There are two main types of empirical research in Social science, namely, the quantitative approach and the qualitative approach. Many researchers have pointed out that quantitative research, while being very useful, is greatly improved when used in conjunction with other qualitative research methods (such as: case studies, interviews, and observation). Triangulation exists when qualitative and quantitative research approaches are combined. The current study has adopted a mixed method of research, comprising a questionnaire survey and an interview survey. The chapter elaborated on how the pilot study was carried out in order to develop the questionnaire, how it was conducted, and the benefits gained from respondents to the pilot study were incorporated into the primary study. In this study, the researcher chose two groups that are close to the target groups, namely academics and External Auditors. Academics possess the theoretical knowledge of Corporate Governance and Audit Committees as a whole. They are also well vested when it comes to research and methods used, together with instruments to collect data, while External Auditors have the technical knowledge of the working of Audit Committees in industry, together with the application of the relevant legislation as promulgated in the public sector. The final version of the questionnaire consisted of fifty statements divided into eight broad aspects of an Audit Committee (as informed by research questions, literature, and pilot study conducted). The questionnaire also included nine factors that generally affect Audit Committee effectiveness, and also ten suggestions for improving Audit Committee effectiveness in KZN local government municipalities. The chapter also gave details of the questionnaire administration procedures.

The second phase of data collection was semi-structured interviews. The interview participants included three (3) representatives from each of the four sample groups, namely: Audit Committee Chairpersons, Municipal Managers, CFOs (finance heads), and Internal Auditors. It had already been decided that the second method for collecting data in this research would be an examination through interviews to explore in more detail the effectiveness of the Audit Committees in KZN local government. This chapter explained the statistical tools used for analysing the data. Both descriptive and inferential statistics were used in this study to analyse the data. The descriptive

findings have been presented using frequencies, percentage, rank, mean, median, and standard deviations. The significance of responses was examined using the Wilcoxon Signed Rank Test.

### ***7.2.5 Chapter Five – Analysis and Discussion of Questionnaire Survey***

This chapter discussed the findings obtained from the questionnaire survey. The widely regarded statistical software “Statistical Package for Social Science (SPSS)” was used to present the responses with descriptive statistics in the form of frequency, mean, standard deviation, and ranking. Several observations can be made from the results presented in this chapter. Firstly, the majority of respondents indicated a wealth of experience (10 years and above) in local government. The Audit Committee Chairperson and majority of the members of the Audit Committee were independent and not in the employ of the municipality. These committees in KZN are in line with legislation and international best practices. Secondly, KZN local government municipalities provide adequate secretariat support to committees, and non-executive Audit Committee members receive adequate fees for their time spent in the municipalities. However, as there was a discrepancy when enquiring whether or not Audit Committees in KZN local government receive prompt responses from management on issues raised by them and this was further illustrated by interview surveys that a room for improvement in this area exists. Thirdly, municipalities in KZN local government make use of the Audit Committee charter to outline their roles and responsibilities. Audit Committee meetings are in line with legislation and the committees devote enough time, with the duration of these meetings appropriate to ponder over pertinent issues and coincide with key dates (audit cycle) as per the AG calendar. Lastly, Audit Committees in KZN local government are constituted in a way that the roles (both in internal and external auditing) the committee plays enables the municipality’s Accounting Officer to discharge its responsibility for effective financial reporting, control, and governance, while working independently, but there are still plenty of vacuums in these areas in which Audit Committees can play more a proactive role.

This chapter also focused on the inferential data analysis. For example, the Wilcoxon Signed Rank Test was employed to examine the significance of agreement/disagreement to fifty statements included in the questionnaire. The test results show that most of the statements were significantly agreed upon by all four sample groups, namely: the Municipal Managers, Audit Committee Chairpersons, finance heads (CFOs) and Internal Auditors. Firstly, Audit Committees in KZN

local government are independent, though the Audit Committee members are not appointed Audit Committee Chairperson nor have adequate literacy and accounting/auditing experience. Secondly, Audit Committees in KZN LH municipalities have a formal responsibility, where they are made to account for and are endowed with powers to intervene. Thirdly, Audit Committees in KZN local government municipalities are diligent, assume responsibilities, attend majority of Audit Committee meetings, devote sufficient time to the affairs of the committee and can express themselves freely in meetings, though Audit Committee members do not play a role in choosing the agenda for Audit Committee meetings and also municipality's management may not furnish all information (or documentation) required by Audit Committees in time for their scheduled meetings. Lastly, Audit Committees in KZN local government discharge their financial reporting role inadequately as far as reviewing accounting estimates and judgments are made in preparing AFS and also in appointing or terminating the head of internal auditing.

This chapter introduced eleven research hypotheses, and also explained the statistical tools used for analysing the data and for testing the hypothesis. The main objective of the hypothesis testing was to investigate whether there are any significant differences in the different responding groups. In order to test these hypotheses, a non-parametric test (namely, the Kruskal Wallis Test) was employed. Finally, the interview responses of the study have been analysed using the "Grounded Theory", which was also discussed in this chapter.

#### ***7.2.6 Chapter Six – Analysis and Discussion of Interview Survey Findings***

This chapter reported the results of the interview survey that was conducted with twelve (12) participants consisting of three Municipal Managers, three Audit Committee Chairpersons, three finance heads, (CFOs) and three Internal Auditors. The primary aim of these interviews was to complement the findings of the close-ended questionnaire survey and, therefore, this approach was adopted to gain more insight into the research issue (i.e. Corporate Governance practices of Audit Committees in KZN local government and the problems faced by these committees carrying out their responsibilities). Most of the interview survey findings were found to be consistent with that of the questionnaire survey findings and, importantly, they added more insight of the Corporate Governance practices of Audit Committees in KZN local government municipalities. For example, there was a consensus between respondents that the Audit Committees provide benefits, though

there is still room for improvements to reach a level where Audit Committees perform their tasks as they were intended when the legislation was first conceived. Some of them claimed that the Audit Committees enhance the independence of internal and External Auditors, give confidence to communities at large, reduce personal relationship and favoritism, make the internal and External Auditors more conscientious, detect problems early, and create a useful dialogue between the Audit Committee, those charged with governance, and the External Auditors. One of the interviewees mentioned that we should not be pessimistic since the Audit Committees in KZN local government are at an “infant” stage of evolution, and are still “finding their feet”, in terms of developing their role within KZN municipalities. It is noted (in *Chapter One*) that a full complement of Audit Committees, by virtue of establishing one or sharing one, was only realised by KZN local government municipalities (and the whole of South African municipalities) in the 2014 fiscal year.

Several observations can be made from the interview results presented in this chapter as summarised in the following sub-headings:

**Importance of Audit Committee:**

- (i) Respondents, overwhelmingly, agreed that Audit Committees in KZN local government are important, though typically associated with the role in financial reporting; also
- (ii) Communities in KZN local government are not aware of Audit Committees, their role, function, and mandate. Communities are not aware (or not fully aware) of the legislative oversight committees that municipalities have.

**Composition of the Audit Committee:**

- (i) Respondents agreed that Audit Committees in KZN local government are constituted in line with Section 166 of the MFMA regulation. However, there are no clear legislative guidelines on what constitute “appropriate experience” to qualify individuals for selection as Audit Committee members;
- (ii) Audit Committee Chairpersons and members are independent (not in the employ of the municipality); however some respondents indicated that some members may not possess sufficient qualifications; and

- (iii)The size of Audit Committees in KZN local government was regarded as appropriate, though there are blurred lines in the legislation regarding the recruitment process of the Audit Committee members, which exposes the municipality to the risk of employing inadequate members.

#### **Authority and resources of the Audit Committee:**

Audit Committees in KZN local government have

- (i) sufficient authority for effective functioning; and
- (ii) adequate resources to discharge their oversight roles, though the municipal administration (municipal management) of some municipalities tend to not provide all the required information or provide it late, which in turn give Audit Committees less time to consider and probe the information furnished.

#### **Diligence and Meeting of the Audit Committee:**

- (i) Interview survey findings confirmed the questionnaire survey results that Audit Committees in KZN local government are properly aware of their roles, willfully assume their responsibilities, talk freely in meetings and all standing invitees do attend Audit Committee meetings if/when requested to by the committee.

#### **Role of the Audit Committee:**

- (i) Audit Committees are typically associated with the role in **financial reporting**, though Audit Committees in KZN local government rarely review the accounting policies, compliance with accounting standards (including the “going concern” of the municipality), and account estimates;
- (ii) Audit Committees in KZN local government support the **external audit** function. However, it rarely discloses it’s views on the effectiveness of the CFO and finance function of the municipality, in line with the combined assurance model as recommended by King IV; and
- (iii)Audit Committees in KZN local government work closely with the municipality’s internal audit function on various aspects of the municipality’s internal control function,

governance, risk management. However, Audit Committees play an insignificant role in the appointment of the internal auditor of the municipality.

When assessing the **overall effectiveness of Audit Committees** in KZN local government, the respondents agreed that the Audit Committees are effective, independent, and can achieve their goals, but a collective effort (an all-inclusive approach) is needed and their recommendations need to be enforced by Municipal Councils. Furthermore, amongst others, political influence/interference is cited as one major contributing **factor affecting the effectiveness of Audit Committees** in KZN local government. Lastly, respondents noted the following as **measures that may improve Audit Committee effectiveness** in KZN local government:

- (i) Legislation is adequate, but needs to be applied as conceived and not as “tick the box” exercise;
- (ii) Measures should be put in place for a minimum level of qualifications and experience of Audit Committees; and
- (iii) Robust, ethical and decisive leadership is needed, both for Audit Committees and for municipality officials at large.

### **7.3 Policy Implications**

In this thesis, some general recommendations have been made, which may serve to advance the work of the Audit Committees in KZN local government and enhance their role to achieve the requisite effectiveness of Audit Committees at large. The study shows that the Audit Committees in KZN local government have some moderate weaknesses, resulting in many Audit Committees being seen as “rubber stamps”. Some key attributes (for example, composition, independence, authority and roles of Audit Committees) discussed in this research should be addressed for the better functioning of these committees. There is an obvious need for the specification of the minimum qualifications, background, and experience required for the members of the Audit Committees, to ensure that they are suitable and not affected (influenced) by municipal management. Furthermore, the roles of the Audit Committee, its authorities, literacy, and appointment should be defined clearly.

Additionally, to the contribution to the existing literature, the findings seem to have important policy implications from the perspective of the significance of Corporate Governance in the local government sphere. The success of Corporate Governance in the corporate companies and state-owned enterprises is recognised, prompting suggestions that local governments too should adopt Corporate Governance principles or King IV to be effective.

All companies are subject to the corporate law requirements set out in the primary sources of company law in South Africa, which are the Companies Act, 2008 (the “Companies Act”) and KING IV Report on Corporate Governance (“King IV”) – in the case of listed companies. There are no specific Corporate Governance legislations or codes for local government municipalities in KZN local government (nor South African local government as a whole). King IV is the only Corporate Governance code that has sector supplements for municipalities, even though it is not a legal requirement to abide by the principles of King IV in South African local government municipalities. The success of Corporate Governance systems in the United Kingdom and Australian local governments justifies the need for a separate corporate municipal governance system as a solution to the crisis. A specific change of legislation and Corporate Governance guidelines is necessary to address the uniqueness of local governments. Hence, corporate, municipal governance should be compulsory and based on standardised good governance principles through a code of Corporate Governance and a Corporate Governance framework responding to specific prerequisites for success.

The primary role of a municipality is to organise the inhabitants collectively, according to their area of jurisdiction and to create an environment conducive to the advancement of development. by ensuring the delivery of the expected services. The failure to deliver these services is often associated with the lack of proper **leadership** that might exist in municipalities, where both the elected office bearers, administrative officials, and oversight committees (i.e. Audit Committees and Municipal Public Accounts Committees) lack the necessary skills to perform the required tasks. (Alvesson & Spicer, 2010) acknowledges that the concept of leadership is a complex phenomenon; hence it would be almost impossible to create, develop. and utilise a universal definition. However, according to Van Wart (2017), leadership is referred to in an administrative context as the process of providing the results required by authorised processes in an efficient, effective. and legal manner. Schaubroeck et al. (2012) explained that the concept of leadership has

broad proximity and is applied to an individual, group, or organisational level and embedding ethical leadership within and across organization levels.

The government has, of late, identified improper leadership and poor governance as the prominent features in municipalities' poor performance. This, after both the former Auditor-General of Southern Africa Terence Nombembe and the current one, Kimi Mokwetu had been calling on government leaders to take urgent action to halt the trend of disappointing audit results, restore accountability, and prevent mismanagement of public funds. They have both attributed the disheartening trend to poor municipal leadership. The leadership challenges that are identified are *inter alia* political interference, lack of finance, lack of skilled human resources, lack of proper planning, and lack of commitment. For a municipality to deliver the required services effectively and efficiently, it is imperative for municipal leaders to know which skills officials should possess to enable them realise the vision of the institution. More often, political interference would exist where a Councilor encroaches on the role and responsibility of a Municipal Manager. This normally happens where the Council strives to influence the decisions of the Municipal Manager. Administratively, an organisation will not be able to function effectively without properly skilled human capital, finances, proper planning, and the commitment of the leaders. Finally, unique to KZN local government is the overwhelming phenomenon of political assassinations. This is a problem not (seldom) experienced by any of the other eight provinces in South Africa, with just over 12 450 political assassinations, 161 arrests and only six (6) convictions to date in the province of KwaZulu-Natal since the end of apartheid in 1994.

In the discipline of Public Administration, the concept of leadership is sometimes confused with that of management. The distinction between the two lies in the function and activities within which a person in a position is expected to perform. Management is the task of setting up control structures and standard operating procedures, whereas leadership involves stimulating organisational change by articulating a vision and inspiring a sense of mission. Management and leadership are distinctive and yet complementary. Hence the study suggests a combination of both **transformational** and **transactional leadership** styles as a significant contributor to improve the quality of service delivery in the local sphere of government. This calls for a comprehensive management approach with charismatic leadership, where subordinates will be inspired to attain the organisational goals in a developmental province of South Africa.



Moreover, local government is the center at which delivery takes place. **Ethics, transparency and accountability** should be the fundamental principles and cornerstones that are prevalent. However, KZN local government municipalities are often viewed as rotten to the core and virtually synonymous with corruption, looting, financial mismanagement, and sheer negligence by municipal officials. Like in any institution, corruption robs municipalities of valuable resources; looting obliterates municipalities, financial mismanagement siphons municipal funds (i.e. staggering irregular and fruitless expenditures) and negligence negates municipalities of public confidence.

The formulation of the general Code of Conduct for the South African local government (*Code of Conduct for public servants* as a Government Notice/Gazette: Regulation Gazette 5947, No. R. 825, on 10 June 1997, the *Local Government Municipal Systems Act 32 of 2000* in Schedule 1 and 2, and also in the *Local Government Municipal Structures Act 117 of 1998* in Schedule 5) indicated the commitment of the South African government to enhancing ethical conduct. The codes of conduct provide guidelines to both public officials and employers of what type of ethical behaviour is expected of them. The codes also give an indication of the spirit in which public officials should perform their duties, the action to take to avoid conflict of interest, and the terms of public official's personal conduct and private interest. It is also clear that the Codes of Conduct have been drafted so as to be as clear as possible, but a detailed standard of conduct and disciplinary measures are not provided. This is a great challenge as it poses concerns about the accountability of municipal functionaries and Councilors, and about how disciplinary measures on unethical conduct of politicians and officials should be handled. This finding is indicative that South African local government does not have an official Code of Ethics (nor a formal Code of Conduct) as a separate document for ethical conduct. Following this finding, the recommendation is therefore that a separate document (Code of ethics) should be designed, formulated, and emphasised. Ethics is a very complex area of study, but it truly is what forms the backbone of any public administration scenario. It's essentially the framework that governs what one ought to do to make KZN local government (or the entire world) either a better or worse environment for the people who live in it. When a local municipality is influenced and directed strongly by conscientious and ethical policies, the community will benefit and have a far better quality of life than those without. It is emphasised in this study that the transformation of local government in South Africa since 1994 has been nothing short of remarkable. The system of local government has been de-racialised,

municipal jurisdictions have been consolidated, a philosophy of developmental local government has been introduced, and the intergovernmental fiscal system has been overhauled to bring far more financial resources down to municipal level. However, **transparency** and **accountability** are challenges still facing developmental local government (i.e. KZN local government).

Moreover, the local government sphere, unlike the other two spheres of government (national and provincial), is the only arm that generates its own revenue to sustain its legislated mandate. **Financial sustainability** is fundamental in the provision of services within KZN local government on the basis that municipalities are financed substantially by means of their own resources. Ratings Afrika, which publishes the Municipal Financial Stability Index (MFSI) annually, defines financial stability as *“The financial ability to deliver services, develop and maintain the infrastructure required by its residents without unplanned increases in rates and taxes or a reduction in the level of services, and the capacity to absorb financial shocks caused by natural, economic and other adversities without external financial assistance.”* The MFSI is a scoring model that evaluates the operation performance, liabilities management, budget practices, and liquidity position of a municipality, and scores these components out of 100. The KZN’s average index scores have declined steadily over the past five years (58 in 2014, 62 in 2015, 56 in 2016, 55 in 2017 and 51 in 2018). Worryingly, the 2018 index found that most of the municipalities in South Africa (including those in KZN local government) are in financial distress, lacking proper budget planning and not exercising adequate fiscal discipline, with expenses exceeding income and resulting in losses. In 2016, Ratings Africa downgraded all South Africa’s municipalities to “junk status”.

Additionally, the World Health Organization (WHO) declared coronavirus disease of 2019 (COVID-19) a global pandemic. The president of South Africa, Cyril Ramaphosa decreed and declared COVID-19 as a national disaster on 15 March 2020. After that, on 27 April 2020, rating agency Moody’s cut South Africa’s sovereign credit rating to sub-investment grade. This means the country now has a junk rating from all three major international rating agencies (Moody’s and rival agencies Fitch and S&P who both downgraded South Africa to junk in 2017). These downgrades will hinder investments, especially those in local government, leading to more limitations from municipalities to raise funds, externally. The continued financial distress of municipalities, the inability of municipalities to raise their own funds will lead municipalities in

KZN local government customarily to the brink of collapse. The study, therefore, further suggests that municipalities in KZN local government should immediately:



Undoubtedly, financial stability and sustainability is crucial to service delivery and the overall good standing of municipalities, which calls for “active and collective” involvement in attempts to resuscitate both good governance as well as financial viability to our municipalities. The study suggests the following in improving the financial sustainability of KZN local government municipalities:

- Proper supply chain management (procurement) – Cut costs and save scarce resources.
- KZN local government municipalities should endeavour to leverage on modern technologies (in providing electricity and water, improving billing systems and reducing wastage.
- Improving the quality of human capital – as required by the South Africa’s 2030 National Development Plan;
- Improve financial management: Budgeting – safeguarding resources – monitoring (Financial Reporting) – accountability. Quality internal controls & Collection of revenue;
- Ensure greater sustainability of basic service delivery – through renewal of infrastructure underpinning the delivery of basic services;
- Resolve debt issues (i.e. payment of Eskom) – compliance with the 30 day payment rule should be enforced; and
- Provide support to KZN local government municipalities as prescribed in Section 154 (1) of the Constitution.

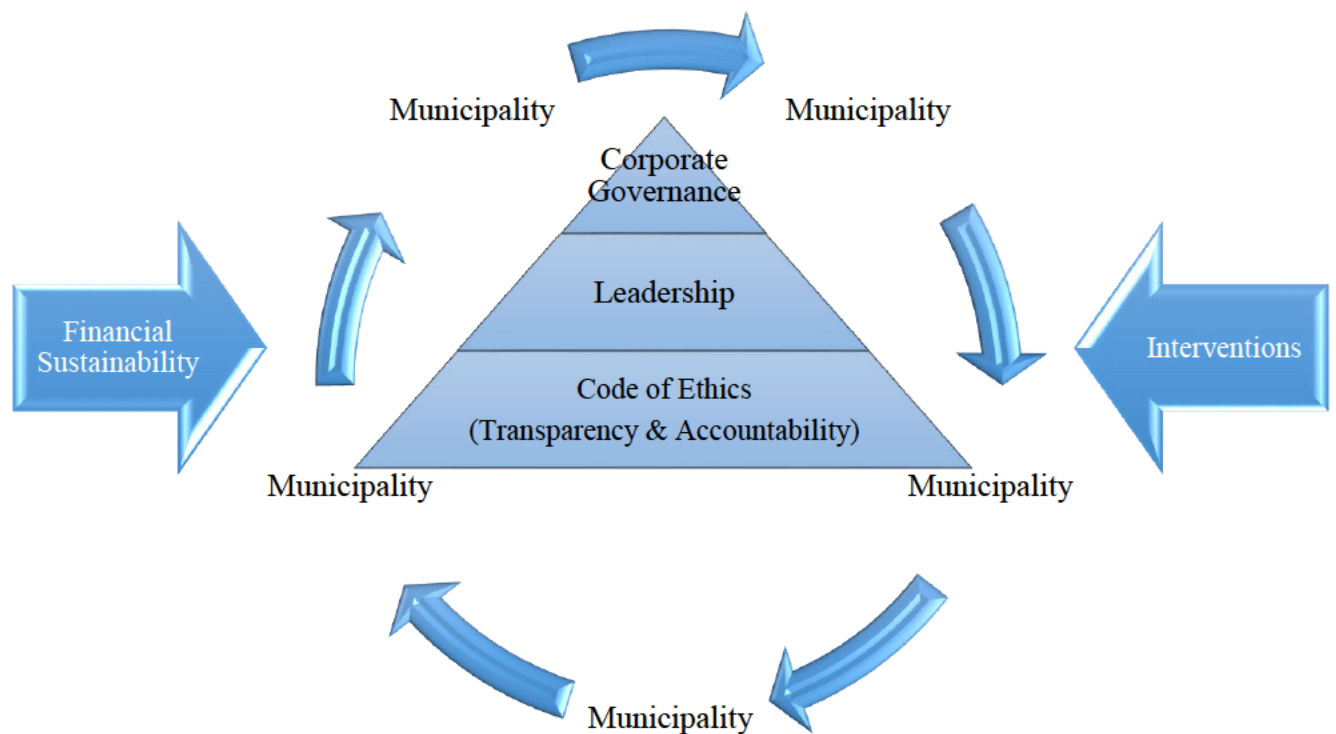
Lastly, the study findings revealed that communities in KZN local government have little or no idea of Audit Committees and the oversight duties they provide. It is, therefore, the concluding recommendation by this study that the KZN local government municipalities need to improve on local participatory governance. All municipalities must secure greater participation by residents in matters of governance. Public participation will assist in communities to have an understanding of the way local government operates. In addition, to be able to hold the municipality accountable by knowing legislations that assist them in compelling a municipality to become more transparent and holding all municipal officials (including its oversight committee) accountable.

It is also noted that one of the major innovations of the 1996 Constitution was the elevation of local government to a sphere of government, firmly establishing local government's autonomy. A municipality now appreciates the right to govern, on its own initiative, the local government affairs of its community. This means that while national and provincial governments may supervise the functioning of local government, this must be done without encroaching on the institutional integrity of local government. Despite the existing inter-governmental framework that made local government an autonomous sphere, this autonomy did not extend to any "right" to operational and financial collapse. To prevent such collapse, a mechanism was required for provincial and national government to **intervene** beforehand, hence Section 139 of the Constitution (1996). In theory, Section 139 framework intends to take place before a municipality collapses – but is often used as the last resort, when a municipality either fails to pay power utility (Eskom) or when there are service delivery protests (which tend to be violent), or both. Also, inappropriate sections are often used by oversight authorities with no collective application of mind, leading to varied reasons for intervention. Finally, National Treasury's stance that *"you got yourself into this mess, you get yourself out of it"* is flawed, as poor management (leadership) and National Treasury's ignorance share the majority of the blame. In all honesty, Section 139 legislation (intervention) is NOT implemented as conceived, nor written in the local government sphere. The study suggests the following Section 139 intervention on KZN local government municipalities:

- The spirit of Section 139 of the Constitution must be implemented as intended,
- Standardised and clear regulations of the entire Section 139 framework is required,
- Contradictory regulations must be revised and brought into line (i.e. Discretionary (139(1)(b) vs Mandatory 139(5) intervention),

- Better, standardised to & transparent approaches interventions, and
- The Provincial Executive Committee (PEC) and Cooperative Governance and Traditional Affairs (CoGTA) department should use Audit Committee reports as a mechanism for diagnosing any symptoms of municipal maladministration.

The following model, as developed by the researcher, is an effective research method that provides a logical guideline in proposing the recommendations and suggestions of the study findings:



**Figure 7.2:** Recommended Model by Researcher. Source: Self-generated

## **7.4 Limitations of the Study**

It is important for both the researcher and the users of the research to be aware of the relevant limitations as they seek to develop and interpret the results of the study or to clarify their meaning (Hancock & Algozzine, 2017). It should be acknowledged that the questionnaire survey method is not free from some of its inherent limitations. (Abowitz & Toole, 2010) noted that all surveys have some inherent weaknesses. For instance, the respondents might give answers which they think are expected of them, or which show themselves and the municipality they work for in the best light. Furthermore, it is possible that the questionnaire may have lacked in clarity, which might have caused the respondents to interpret some questions differently, even though the questionnaire underwent a rigorous pilot testing. Another limitation of the research stems from the small sample size of the interview survey. It may be argued that conducting more interviews could have obtained deeper insight into the issue. However, as discussed in *Chapter Four*, the interview survey was only one of the two data collection methods adopted in the study and the main objective of the interview survey was to complement the questionnaire survey methods by acquiring more insight so that the findings obtained from the questionnaire survey could be more reliable.

## **7.5 Potential for Future Research**

This has been one of the first academic studies on the corporate practices of Audit Committee in KZN local government. Arguably, many of the areas covered in this study warrant more specific and in-depth investigation. Further research could investigate the effectiveness of Audit Committees, including some control variables of the municipality (for example, size of the municipality, rural vs urban municipalities) in regression model. The study can also be extended to other South African provinces to ascertain and compare the effectiveness of their Audit Committees and so present a larger and more substantial analysis of economies from best performing provinces versus the worst performing by municipalities within the province. Furthermore, the adoption or promulgation of different codes of Corporate Governance and ethics could be expanded upon and researched in details. In addition, the theory vs the practices of Section 139 interventions could be relooked at, in order to bring some resolve to any inconsistencies and finally have the section put into practice as initially conceived.

## **7.6 Conclusion**

This study has been able to achieve its main objective and answer all relevant research questions posed. More specifically, the study has investigated the Corporate Governance practices of Audit Committees in KZN local government comprehensively. It has also identified the crucial factors that affect the Audit Committee effectiveness, together with measures to improve the Audit Committee effectiveness. Essentially, this study has taken a holistic view to describe the scenario of Audit Committee practices in KZN local government and proposed a model pertaining to policy implications that may be adopted in the light of the study findings. This study will contribute to the literature on Corporate Governance practices of an Audit Committee from the perspective of local government municipalities in an emerging economy. It is hoped that future researchers will be able to carry through the issues highlighted by this study and extend the avenues that the study has opened up.

Lastly, the researcher concedes that the performance of local municipalities in South Africa is the indicator of the country's heartbeat. Local municipalities are the closest institution to citizens; they reflect in great measure levels of citizen engagement – as recipients but also as contributors. In addition, local government shows, like no other indicator, the health of public institutions at the most atomised level. Local municipalities are universes, where the historic legacy of the country and the current democratic dynamics converge to give a clear picture of the status quo.

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## Appendix

### Appendix A: Language Editing Certificate

**Mrs Radhika Singh**

(F.T.C.L), FELLOWSHIP, TRINITY COLLEGE OF LONDON, (SPEECH AND DRAMA) LANGUAGE

EDITING OF PhD Thesis: Siphwe Mqadi

This is to certify that I have edited the PhD thesis titled "The Corporate Governance Practices of Audit Committees in the KwaZulu-Natal Local Government Municipalities" for language – tenses, syntax, vocabulary, spelling, sense, and all other aspects of language editing.

Corrections are marked on the thesis, and need to be corrected.

Disclaimer:

Final decisions rest with the author as to which suggestions to implement.

No review of the final document was requested before submission.



Mrs R Singh Language Editor  
02nd September 2020

## Appendix 1: Ethical Clearance Certificate



30 May 2018

Mr Siphwe Freddy Mqadi (215081811)  
School of Accounting, Economics & Finance  
Westville Campus

Dear Mr Mqadi,

Protocol reference number: HSS/0331/018D

Project Title: The practices of Audit Committees in Corporate Governance in KwaZulu-Natal Local Government Municipalities

### Approval Notification – Expedited Application

In response to your application received 10 April 2018, the Humanities & Social Sciences Research Ethics Committee has considered the abovementioned application and the protocol has been granted **FULL APPROVAL**.

Any alteration/s to the approved research protocol i.e. Questionnaire/Interview Schedule, Informed Consent Form, Title of the Project, Location of the Study, Research Approach and Methods must be reviewed and approved through the amendment /modification prior to its implementation. In case you have further queries, please quote the above reference number.

**PLEASE NOTE:** Research data should be securely stored in the discipline/department for a period of 5 years.

The ethical clearance certificate is only valid for a period of 3 years from the date of issue. Thereafter Recertification must be applied for on an annual basis.

I take this opportunity of wishing you everything of the best with your study.

Yours faithfully

Professor Shonuka Singh (Chair)

/ms

Cc Supervisor: Dr Msizi Mkhize and Mr Bomi Nomlala  
Cc Academic Leader Research: Dr Colette Muller  
Cc School Administrator: Ms Seshni Naidoo

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Humanities & Social Sciences Research Ethics Committee

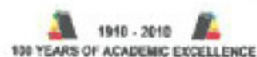
Professor Shonuka Singh (Chair)

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Website: [www.ukzn.ac.za](http://www.ukzn.ac.za)



Founding Campuses: Edgewood Howard College Medical School Pietermaritzburg Westville



3 August 2020

**Mr Siphwe Mqadi (215081811)**  
School of Acc, Economics and Finance  
Westville

Dear Mr Siphwe Mqadi

System Nr: HSS/0331/018D

Project title: The corporate governance practices of audit committees in the KwaZulu-Natal local government municipalities.

### Approval Notification – Amendment Application

This letter serves to notify you that your application and request for an amendment received on 27 July 2020 has now been approved as follows:

- Change in Title

Any alterations to the approved research protocol i.e. Questionnaire/Interview Schedule, Informed Consent Form; Title of the Project, Location of the Study must be reviewed and approved through an amendment /modification prior to its implementation. In case you have further queries, please quote the above reference number.

**PLEASE NOTE:** Research data should be securely stored in the discipline/department for a period of 5 years.

Best wishes for the successful completion of your research protocol.

Yours faithfully



Prof Josue Mbonigaba

3 August 2020

ACADEMIC LEADER RESEARCH

/

Humanities & Social Sciences Research Ethics Committee  
UKZN Research Ethics Office Westville Campus, Govan Mbeki Building  
Postal Address: Private Bag X54001, Durban 4000  
Tel: +27 31 260 8350 / 4557 / 3587  
Website: <http://research.ukzn.ac.za/Research-Ethics/>

Founding Campuses:  Edgewood  Howard College  Medical School  Pietermaritzburg  Westville

**INSPIRING GREATNESS**

## Appendix 2: Permission and Gate Keepers Approval



**cogta**

Department:  
Cooperative Governance and Traditional Affairs  
**PROVINCE OF KWAZULU-NATAL**

Tel. +27 33 395 2638 Fax. +27 33 394 5669  
Postal: Private Bag X 9078, Pietermaritzburg, 3200  
Office: Natal Building, 330 Langalibalele Street,  
Pietermaritzburg 3201

Mr. Sipiwe Mqadi  
University of KwaZulu-Natal  
College of Law and Management Studies  
School of Accounting, Economics and Finance  
Westville Campus  
E-mail: [mqadis@ukzn.ac.za](mailto:mqadis@ukzn.ac.za)

08 January 2018

Dear Mr Mqadi

### Re: PERMISSION TO CONDUCT RESEARCH

The Department is aware of your need to conduct research at Local Government Municipalities in KwaZulu-Natal, towards your Doctor of Philosophy (PhD) studies, provided Ethical clearance has been obtained. We note the title of your research project is:

***"The Practices of Audit Committees in Corporate Governance in the KwaZulu Natal Local Government Municipalities"***

It is noted that you will be constituting your sample by handing out questionnaires and conducting semi-structured interviews to municipal staff (Municipal Managers, Audit Committee Chairpersons, Chief Financial Officers and Internal Auditors).

Please ensure that the following appears on your notice/questionnaire/interview schedule:

- Ethical clearance number;
- Research title and details of the research, the researcher and the supervisor;
- Consent form is attached to the notice/questionnaire/interview schedule and signed by the user before he/she fills in the questionnaire/interview schedule;
- Noting the research to be undertaken by KwaZulu-Natal Cooperative Governance and Traditional Affairs (KZNCoGTA).

Data collected must be treated with due confidentiality and anonymity. It is trusted that municipalities approached in the context of your research, will provide you with the necessary co-operation.

You

**MR. LE PHENAAR**

**ACTING DEPUTY DIRECTOR GENERAL: LOCAL GOVERNMENT**

BACK TO BASICS: SERVING OUR COMMUNITIES BETTER **B&B**

### Appendix 3: Cover Letter from the Researcher for Questionnaire Survey

September 22, 2018

Dear Sir / Madam:

**Re: PhD Research on Audit Committee Practices in KwaZulu-Natal Local Government  
Municipalities**

---

I, Siphiwe Mqadi, a lecturer and PhD student at the School of Accounting, Economics and Finance, at the University of KwaZulu-Natal, invite you to participate in a research project entitled: ***“The practices of audit committee in corporate governance in the KwaZulu-Natal local government municipalities”***

The study findings are expected to be useful in strengthening corporate governance practices particularly audit committees in local government municipalities. This survey is an imperative part of the research and your valuable cooperation and participation in answering this questionnaire is significantly appreciated.

I would therefore, be most grateful if you could spare some of your valuable time to complete the enclosed questionnaire and return it in the enclosed envelope. **I can assure you that all responses will be used for research purpose only and will be treated with the strictest confidence and anonymity.** Results relating to individual Municipality will not be tabulated in the research report. Furthermore, your participation in this project is voluntary, you may refuse to participate or withdraw from the project at any time with no negative consequence. Lastly, please note that a summary of research findings will be dispatched to all participants in the study who wish to receive it.

If you have any questions or concerns, please do not hesitate to contact me or my supervisor(s) at the numbers listed in the informed consent form.

**This questionnaire should take about 5 to 10 minutes to complete.** I hope to use this time valuably and not disturb your normal duties. Thank you for your kind cooperation.

Yours sincerely,

.....

**Researcher's Signature**

.....

**Date**

#### Appendix 4: Cover Letter from the Supervisor for Questionnaire Survey



**UNIVERSITY OF  
KWAZULU-NATAL<sup>TM</sup>**  
**INYUVESI  
YAKWAZULU-NATALI**

**SCHOOL OF ACCOUNTING, ECONOMICS AND FINANCE**

#### **PhD Research Project**

**Researcher:** Mr. Siphwe Mqadi (031) 260 7551

**Supervisor(s):** Dr. Msizi Mkhize (031) 260 2141; and  
Mr. Bomi Nomlala (031) 260 8603

#### **RESEARCH INFORMED CONSENT**

---

#### **What is the purpose of the study?**

The study seeks to investigate the practices of Audit Committees in corporate governance on all KwaZulu-Natal local government municipalities. Your valuable participation involves having to answer questions on a 5-point Linkert scale bases.

#### **Who is asked to participate?**

Data is sort out from all local government Municipal Managers, Audit Committee Chairpersons, Chief financial officers (Finance heads) and Internal Auditors.

#### **What are potential benefits of the study?**

The findings of this study will provide valuable insights into the practices of Audit Committees and also seek to emphasise the necessity for reform in this area. Furthermore, it will also reveal insight on making Audit Committees a more effective instrument for governing bodies.

#### **What are the rights of research participants?**

Participation in this study is voluntary and anonymous. Information gathered during the research will be used solely for the purpose of this study and all efforts will be made to ensure the confidentiality of participants' personal information. All identifiable data will be stored securely on a computer with password-restricted access and only the researcher (and supervisor(s) if applicable) will have access to it. Research data will be stored for a minimum of 5 years in the School of Accounting, Economics and Finance.

**I have read this consent form. I give my consent to participate in this study.**

.....  
**Signature of Participant**

.....  
**Date**

## STRICTLY CONFIDENTIAL

### Questionnaire For:

**Municipal Managers**

**Audit Committee Chairpersons**

**Chief Financial Officers (Finance Heads)**

**Internal Auditors**

### Study

### **The Practices of Audit Committee in Corporate Governance in the KwaZulu-Natal Local Government Municipalities**

Instructions for the completion of the questionnaire:

- You are requested to answer all the questions carefully and honestly.
- Your **responses will be treated confidentially** and will be valuable to the study.
- Your name should not appear on the questionnaire.
- You are kindly requested to indicate your reply by **placing a cross, X**, in the appropriate box which best represents your view.
- You may write additional comments whenever you wish to do so and return with the questionnaire.

Kindly return the completed questionnaire to [mqadis@ukzn.ac.za](mailto:mqadis@ukzn.ac.za), post / hand deliver to: College of Law and Management Studies, 2<sup>nd</sup> Floor, J Block, Office 02-037, Westville Campus, University of KwaZulu-Natal, Private Bag 54001, Durban, 4000 or alternatively return via the **addressed postage-paid envelope enclosed**.

Thank you very much for your co-operation.

**Researcher:** Mr Sphiwe Mqadi

**Supervisor:** Dr. M. Mkhize

**Co-supervisor:** Mr. B. Nomlala

**College:** Law and Management Studies (UKZN)

**Year study conducted:** 2018/2019



**SECTION A: Biographical details** *(please circle the appropriate option)*

1. Gender

Male	1	Female	2
------	---	--------	---

2. Age (years)

18 - 21	1
22 - 30	2
31 - 40	3
41 - 50	4
51 - 60	5
Above 60	6
Prefer not to	7

3. Ethnic group

African	1
Coloured	2
Indian	3
White	4
Other	5

4. Highest qualifications

Matric	1
Diploma	2
Degree	3
Honours / CTA	4
Masters	5
Doctorate	6

5. Professional registration

SAICA	1
-------	---

SAIPA	2
IRBA	3
IIA SA	4
ACCA	5
Other, please	6

.....

6. Current position held

Municipal Manager	1
Audit Committee Chairperson	2
CFO (Finance	3
Internal Auditor	4

7. Work experience in Accounting/ Auditing/ Finance or related field

Less than 1 year	1
Less than 3 years	2
Less than 5 years	3
Less than 10 years	4
Over 10 years	5
Other, please specify	6

.....

8. Name of the Municipality

.....  
(Please write the name of the **current** Municipality you work for, **do not** include previous Municipalities)

**SECTION B: Audit Committee practices in corporate governance in the KwaZulu-Natal  
Local Government Municipalities**

**Part I: Responses about prevailing Audit Committee Practices in the municipality.**

**Instructions:** The following set of statements deal with your perception towards some issues that relate to the **Existing Practice (NOT the Ideal Practice)** of Audit Committee in your municipality. Please indicate the extent to which you agree or disagree with each of the following statements by circling only one number, where; **1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, and 5= Strongly Agree**. For example, if you strongly agree with any particular statement, please put a circle around 5.

<b>Statements</b>	<b>Strongly Disagree</b>	<b>Disagree</b>	<b>Neutral</b>	<b>Agree</b>	<b>Strongly Agree</b>
<b>A. Composition</b>					
1. The Audit Committee members are appointed in consultation with the Audit Committee Chairperson.	1	2	3	4	5
2. The Audit Committee members have sufficient knowledge on the municipality's environment.	1	2	3	4	5
3. The Audit Committee members have sufficient knowledge on Accounting and/or Auditing practices.	1	2	3	4	5
4. The Audit Committee members have sufficient experience in Accounting and/or Auditing.	1	2	3	4	5
5. The Audit Committee members are capable of mediating problems in performing their duties.	1	2	3	4	5
6. The majority of Audit Committee members are independent/external members*.	1	2	3	4	5
7. The chairperson of the Audit Committee is an independent/ external members*.	1	2	3	4	5
8. The size of the Audit Committee is appropriate for carrying out its duties properly.	1	2	3	4	5

\*An **independent/external** member of the Audit Committee is he/she who is not a member of the Municipal Council and/or Management/Executive Committee and/or any other employee of the municipality.

Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
<b>B. Authority and Resources</b>					
9. The Audit Committee has adequate authority in order to carry out its responsibilities.	1	2	3	4	5
10. The Audit Committee has ready access to relevant information if required.	1	2	3	4	5
11. The Audit Committee receives prompt responses from the management in carrying out its duties.	1	2	3	4	5
12. The Audit Committee is provided with sufficient resources including secretarial support to carry out its duties.	1	2	3	4	5
13. The non-executive Audit Committee members are adequately paid for their time and efforts.	1	2	3	4	5
<b>C. Diligence</b>					
14. The Audit Committee has a charter which outlines its objectives, duties and responsibilities.	1	2	3	4	5
15. The Audit Committee charter is reviewed annually.	1	2	3	4	5
16. The Audit Committee members have a clear understanding of their responsibilities.	1	2	3	4	5
17. Members of the Audit Committee readily assume their responsibilities.	1	2	3	4	5
18. The Audit Committee members devote sufficient time to the affairs of the committee.	1	2	3	4	5
<b>D. Meeting</b>					
19. The agendas of the Audit Committee meetings are finalized by the chairperson.	1	2	3	4	5
20. The chairperson cooperates with other committee members before finalizing the agenda of the meetings.	1	2	3	4	5
21. The agenda and related materials are provided to members fairly ahead of the meetings.	1	2	3	4	5

<b>Statements</b>	<b>Strongly Disagree</b>	<b>Disagree</b>	<b>Neutral</b>	<b>Agree</b>	<b>Strongly Agree</b>
22. All members can express their views freely and independently in the meetings.	1	2	3	4	5
23. The frequency of the Audit Committee meetings is sufficient to carry out its responsibilities.	1	2	3	4	5
24. The duration of the Audit Committee meetings is sufficient for a full discussion of important issues.	1	2	3	4	5
25. Non-members attend the Audit Committee meetings if required or invited.	1	2	3	4	5
26. The minutes of the Audit Committee meetings are circulated to all members of the Municipal Council.	1	2	3	4	5
<b>E. Role in Financial Reporting</b>					
27. The Audit Committee reviews the integrity of Municipality's financial statements.	1	2	3	4	5
28. The Audit Committee reviews accounting policies and any changes made therein.	1	2	3	4	5
29. The Audit Committee reviews accounting estimates and judgments done in preparing financial statements.	1	2	3	4	5
30. The Audit Committee reviews the compliance of the Accounting Standards (e.g. IAS, IFRS) in preparing financial statements.	1	2	3	4	5
31. The Audit Committee reviews the clarity and completeness of disclosures in financial statements.	1	2	3	4	5
32. The Audit Committee reviews other information (e.g. the Auditor General's report, financial highlights) presented in the annual report.	1	2	3	4	5

Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
<b>F. Role in External Auditing</b>					
33. External Auditors are appointed and/or removed upon the recommendation of the Audit Committee.	1	2	3	4	5
34. The Audit Committee assesses and reviews the expertise and resources of the External Auditors.	1	2	3	4	5
35. The Audit Committee reviews and approves the terms of the Engagement Letter (EL) prepared for the External Auditors.	1	2	3	4	5
36. The Audit Committee monitors the external audit firm's compliance with the existing ethical and regulatory requirements in South Africa.	1	2	3	4	5
37. The Audit Committee reviews the findings of the annual audit obtained by the Auditor General/ External Auditors.	1	2	3	4	5
38. The Audit Committee reviews the management's responsiveness to the Auditor General's findings.	1	2	3	4	5
39. The Audit Committee meets with the External Auditors without the presence of the management to discuss any issues, problems or reservations arising from the audit.	1	2	3	4	5
40. The Audit Committee reviews and monitors the independence and effectiveness of the external auditing process.	1	2	3	4	5
<b>G. Role in Internal Auditing</b>					
41. The Audit Committee recommends and approves the appointment or termination of the heads of the internal audit division.	1	2	3	4	5
42. The Audit Committee approves and reviews the charter of the Internal Auditors.	1	2	3	4	5
43. The Audit Committee assesses and reviews the annual internal audit work plan.	1	2	3	4	5

Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
44. The Audit Committee reviews the annual internal audit reports, budget and other findings.	1	2	3	4	5
45. The Audit Committee reviews and monitors the management's responsiveness to the internal auditor's findings and recommendations.	1	2	3	4	5
46. The Audit Committee meets with the head of the internal audit function without the presence of the management.	1	2	3	4	5
47. The Audit Committee enhances the independence of the Internal Auditors of the municipality.	1	2	3	4	5
48. The Audit Committee monitors and evaluates the effectiveness of the internal audit function.	1	2	3	4	5
<b>H. Overall Practice</b>					
49. The Audit Committee can work independently.	1	2	3	4	5
50. The Audit Committee is effective.	1	2	3	4	5

## Part II: Factors affecting Audit Committee Practices in KwaZulu-Natal Local Government Municipalities

**Instructions:** The following statements deal with your perception towards some **factors that affect** the existing practice of Audit Committee in the KZN Local Government municipalities.

Factors	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
1. Lack of Audit Committee member's qualification in relevant field.	1	2	3	4	5
2. Lack of Audit Committee member's experience and expertise in the relevant field.	1	2	3	4	5
3. Non-inclusion of majority independent/external members in the Audit Committees.	1	2	3	4	5
4. Non-appointment of Audit Committee chairperson from external/independent members.	1	2	3	4	5

<b>Factors</b>	<b>Strongly Disagree</b>	<b>Disagree</b>	<b>Neutral</b>	<b>Agree</b>	<b>Strongly Agree</b>
5. Low frequency of Audit Committee meetings.	1	2	3	4	5
6. Lack of diligence in Audit Committee members.	1	2	3	4	5
7. Inadequate authority delegated to the Audit Committees.	1	2	3	4	5
8. Inadequate resources provided to the Audit Committee.	1	2	3	4	5
9. Lack of support from top management.	1	2	3	4	5

### **Part III: Suggestions**

**Instructions:** The following issues deal with your perception about how **Audit Committee effectiveness** can be enhanced in KwaZulu-Natal Local Government municipalities.

<b>Possible Measures</b>	<b>Strongly Disagree</b>	<b>Disagree</b>	<b>Neutral</b>	<b>Agree</b>	<b>Strongly Agree</b>
1. Voluntary and self-regulation by the Municipalities.	1	2	3	4	5
2. Increased pressure from National Government.	1	2	3	4	5
3. Increased monitoring of existing rules and guidelines.	1	2	3	4	5
4. Introducing some new rules and guidelines.	1	2	3	4	5
5. Compulsory inclusion of Audit Committee report in the Annual Corporate Report.	1	2	3	4	5
6. Mandating the appointment of Audit Committee chairperson from independent/external individuals.	1	2	3	4	5
7. Mandating inclusion of majority independent /external members in the Audit Committees.	1	2	3	4	5
8. Including Audit Committee practices in the requirements of the Municipal Finance Management Act.	1	2	3	4	5
9. Offering some incentives to the municipalities that comply with the King Code (King IV).	1	2	3	4	5



Possible Measures	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
10. Compulsory compliance of King Code regarding the guidelines of Audit Committee practices.	1	2	3	4	5

### ***Follow Up***

Would you be willing to be contacted for any further participation (e.g. interview) in this research?

(A) Yes

(B) No

If yes, please state your contact number(s): \_\_\_\_\_

### **Study Feedback**

Would you like to receive a copy of the summary findings of this research?

(A) Yes

(B) No

If yes, please provide your contact address below:

Name	
Mailing Address	
Phone Number(s)	
E-mail Address(s)	

**Researcher's Contacts:**

College of Law and Management Studies, 2<sup>nd</sup> Floor, J Block, Room 02-037, Westville Campus,  
University of KwaZulu-Natal, Private Bag 54001, Durban, 4000

Telephone: +27 31 260 7551

Mobile: +27 78 021 7181

E-mail: [mqadis@ukzn.ac.za](mailto:mqadis@ukzn.ac.za)

## Appendix 6: Interview Consent Form

### Interview Consent Form

---

This consent form outlines my rights as a participant in the study of *“The Practices of Audit Committees in Corporate Governance in the KwaZulu-Natal Local Government Municipalities”* conducted by Siphwe Mqadi, from the University of KwaZulu-Natal.

I understand that:

- Taking part in this study is entirely voluntary;
- The purpose and nature of the interview has been clearly explained to me;
- It is my right to decline to answer any question that I am asked;
- I am free to end the interview at any time;
- I hereby consent / do not consent to have this interview recorded; and
- My name will not appear on any tapes or transcripts resulting from the interview.

I HAVE READ THIS CONSENT FORM. I HAVE HAD A CHANCE TO ASK QUESTIONS CONCERNING ANY AREAS THAT I DID NOT UNDERSTAND.

---

Signature of Interviewee

---

Date

---

Printed Name of Interviewee

---

Maintaining your anonymity is a priority and every practical precaution will be taken to disguise your identity. There will not be any identifying information on audiotapes or transcripts of this interview. I will not allow anyone other than the research supervisor(s) to hear any audiotape of your voice or review a transcript of this interview. All materials generated from your interview will remain in my direct physical possession and will be dealt with full confidentiality.

I have explained the project and the implications of being interviewed to the interviewee and I believe that the consent is informed and that he/she understands the implications of participation.

---

(Researcher's signature)

## Appendix 7: Interview Survey

### Interview Schedule

---

#### Interview:

Date: \_\_\_\_\_

Time: \_\_\_\_\_

Place: \_\_\_\_\_

#### Introduction:

Thanks for the consent and appointment.

Introduce yourself (exchange of visiting cards).

Mention nature, relevance and importance of the survey.

Assure anonymity and strictest confidentiality.

---

### Section I: Background Information

---

☐ Name of the Municipality: \_\_\_\_\_

☐ Name of the Participant: \_\_\_\_\_

☐ Current Position: \_\_\_\_\_

☐ Experience: (i) Current position: \_\_\_\_\_ years. (ii) Relevant Area: \_\_\_\_\_ years

☐ Educational Qualification: (i) Last Degree: \_\_\_\_\_ (ii) Subject: \_\_\_\_\_

☐ Professional Qualification (if any): \_\_\_\_\_

---

### Section II: Starting Question

---

☐ Would you please share your opinions about the importance of an Audit Committee (AC) in improving the overall governance quality of the municipality and protecting the interest of the community it serves?

☐ Do you think all communities in KwaZulu-Natal are properly aware of AC importance?

---

### **Section III: Composition of the AC**

---

- ☐ Would you please tell me something about the AC in your Municipality in terms of their size, composition?
- ☐ Please tell me about the procedure(s) to appoint AC members/chairpersons in KwaZulu-Natal municipalities.
- ☐ How do you evaluate the necessity of the following characteristics of AC members for its effective functioning?
  - Relevant qualification:
  - Relevant experience:
  - Independence:
  - Size:

---

### **Section IV: Authority and Resources of the AC**

---

- ☐ Do you think the ACs in KwaZulu-Natal municipalities are delegated adequate authority required to perform its duties properly?
- ☐ Can the ACs perform their duties independently? Please explain.
- ☐ Do the ACs get ready access to the information required for performing their job?
- ☐ Do the ACs get adequate secretarial supports for carrying out their duties?
- ☐ Are the external independent members of the ACs paid enough remuneration and benefits for their time and efforts deployed for the municipality?

---

### **Section V: Diligence and Meeting of the AC**

---

- ☐ Are the AC members properly aware of their roles and responsibilities?
- ☐ Do the AC members wilfully assume their responsibilities?
- ☐ Do the AC members devote adequate time and effort for performing their duties?
- ☐ Does the AC meet regularly? How often?
- ☐ Please tell me how the agenda of the AC meeting is decided.
- ☐ Can all members talk freely in the AC meetings?
- ☐ Does anybody else (other than AC members) attend the AC meetings regularly?

## **Section VI: Role of the AC**

---

- ☐ What are the main areas where the ACs in KwaZulu-Natal municipalities play role?
- ☐ What role does the AC undertake for the municipality in the following areas?
  - Financial Reporting
  - Internal Control and Auditing
  - External Auditing
- ☐ In what other areas (if any) does the AC play a role for the municipality?
- ☐ Does the AC have regular contacts with both Internal and External Auditors?
- ☐ Does the AC sit with the head of internal audit section to discuss about their role in absence of management?
- ☐ Does the AC have any role in appointing internal auditor for the municipality? Please explain.

## **Section VII: Overall Scenario and Recommendations**

---

- ☐ What do you think about independence of ACs in KwaZulu-Natal municipalities?
- ☐ Do you think that ACs in KwaZulu-Natal municipalities can achieve their objectives? Explain.
- ☐ Please comment on the overall effectiveness of ACs in KwaZulu-Natal municipalities.

## **Section VIII: Factors Affecting the AC Effectiveness**

---

- ☐ What are the main factors that affect the practices of ACs in KwaZulu-Natal municipalities and how?
- ☐ What are the main barriers of AC effectiveness in KwaZulu-Natal municipalities?

---

### **Section IX: Suggested Measures**

---

- ☐ Do you think that the existing regulations are adequate for ensuring sound AC practices in KwaZulu-Natal municipalities?
- ☐ Would you please recommend on the following issues that you believe can enhance the AC effectiveness in KwaZulu-Natal municipalities?
  - Size of AC and members' category
  - Chairmanship of AC
  - Qualification/Education of AC members
  - Experience of AC members
  - Authorities of the ACs
  - Resources of the ACs
  - Number of meetings in a year, choosing the agendas for meetings
  - Reporting and communication of ACs

---

### ***Section X: Ending Question***

---

Are there any issues relating to AC practices in KwaZulu-Natal that have not been covered in this interview and which you feel are important? Please feel free to share and elaborate as you deem appropriate.

**Thank you once again, your generous cooperation is much appreciated!**