

EXPLANATORY STATEMENT

Select Legislative Instrument 2011 No. 119

Subject - *Financial Management and Accountability Act 1997*

Financial Management and Accountability Amendment Regulations 2011
(No. 3)

The *Financial Management and Accountability Act 1997* (FMA Act) provides a framework of rules for the proper management of public money and public property by Chief Executives and officials of FMA Act Agencies.

Subsection 65(1) of the FMA Act provides that the Governor-General may make regulations prescribing matters required or permitted by the FMA Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the FMA Act.

The Regulations will update the *Financial Management and Accountability Regulations 1997* (the Principal Regulations) to improve their operation.

The Regulations will make a number of changes, including:

- strengthening the role of audit committees in FMA Act Agencies;
- adding the Australian Skills Quality Authority (ASQA) to the list of prescribed Agencies in Schedule 1 to the Principal Regulations; and
- removing Centrelink and Medicare Australia from the list of prescribed FMA Act Agencies in Schedule 1 to the Principal Regulations.

Further details on the Regulations are set out in the Attachment.

The FMA Act specifies no conditions that need to be met before the power to make the Regulations may be exercised.

The Regulations will be a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

In accordance with section 17 of the *Legislative Instruments Act 2003*, the Regulations were developed following extensive consultation with the Australian National Audit Office and all other FMA Act agencies.

The Regulations commence on 1 July 2011 and provide FMA Act Agencies with twelve months, until 30 June 2012, within which to implement the audit committee changes.

Authority: Subsection 65(1) of the
Financial Management and Accountability Act 1997

ATTACHMENT

Details of the *Financial Management and Accountability Amendment Regulations 2011* (No. 3)

Regulation 1 – Name of Regulations

This regulation provides that the title of the Regulations is the *Financial Management and Accountability Amendment Regulations 2011* (No. 3).

Regulation 2 - Commencement

This regulation provides that the Regulations commence on 1 July 2011. The changes in relation to audit committees will be phased in accordance with transitional arrangements in regulation 4.

Regulation 3 – Amendment of the *Financial Management and Accountability Regulations 1997*

This regulation provides that the *Financial Management and Accountability Regulations 1997* (the Principal Regulations) are amended as set out in Schedule 1.

Regulation 4 – Transitional

This regulation provides Chief Executives of FMA Act Agencies that already have established audit committees with 12 months from 1 July 2011 to review the membership and functions of the audit committee, and determine whether any changes are necessary to address the changes to regulation 22C of the Principal Regulations in item 1 of Schedule 1.

FMA Act Agencies that already have established audit committees will be given until 30 June 2012 to allow time for Chief Executives and Agencies to adjust audit committee terms of reference and also potentially review and adjust the internal procedures of the Agency.

Schedule 1 – Amendments

Item [1] – regulations 22C and 22D

Audit committees play an integral role in the governance framework of public sector agencies. Audit committees assist Chief Executives and Agency management to ensure that key controls are operating effectively and are appropriate, as well as ensuring the Agency's compliance with legislation.

Subsection 46(1) of the FMA Act requires a Chief Executive to establish and maintain an audit committee. Subsection 46(2) of the FMA Act requires an audit committee to be constituted in accordance with the regulations.

Regulation 22C of Principal Regulations currently prescribes membership and functions of audit committees.

Item 1 repeals and replaces former regulation 22C of the Principal Regulations, in order to strengthen the role of audit committees within FMA Act Agencies.

Until 2009, the functions and responsibilities of audit committees were prescribed by the *Financial Management and Accountability Orders 2008* (FMA Orders 2008) made under section 63 of the FMA Act. On 20 March 2009, the FMA Orders 2008 were repealed and relevant requirements from those Orders, such as order 2.1 on audit committees, were relocated into the Principal Regulations:

- *Financial Management and Accountability Amendment Orders 2009* repealed the FMA Orders 2008;
- *Financial Management and Accountability Amendment Regulations 2009 (No. 2)* relocated order 2.1 of the FMA Orders 2008 into the Principal Regulations as regulation 22C; and
- *Financial Framework Legislation Amendment Act 2008* amended references in the FMA Act to the FMA Orders 2008 (e.g. in section 46) to be a reference to the Principal Regulations.

At the time of the 2009 reforms, regulation 22C reflected the text formerly in order 2.1 of the FMA Orders 2008.

On 8 December 2010, Senator the Hon Penny Wong, the Minister for Finance and Deregulation, announced amendments to the Principal Regulations to strengthen the role of audit committees in her speech on 'Better Government' at the Commonwealth Authorities & Companies Discussion Forum. The Minister raised awareness about the invaluable role played by audit committees in the private sector in uncovering corporate fraud. She suggested that the public sector will equally reap the benefits of good governance and assurance mechanisms by bringing about significant reforms to the membership and functions within audit committees.

The changes to regulation 22C enhance the role of audit committees to support Chief Executives and Agency management by:

- providing more guidance on the membership of audit committees. In particular, requiring Chief Executives, wherever practicable, to appoint at least one external member; and
- broadening the functions of an audit committee, to expressly include reference to the ability of an audit committee to:
 - review the adequacy of an Agency's governance arrangements;
 - review the adequacy of an Agency's risk management framework, internal control environment, and ensure legislative compliance;
 - advise the Chief Executive on the standards to be used by internal auditors; and
 - make recommendations to help the Chief Executive to comply with Chief Executives obligations under the FMA Act.

Membership

New subregulation 22C(1) sets out the considerations that a Chief Executive must have regard to when appointing members to a new or existing audit committee.

Given the broader functions that audit committee will have in advising the Chief Executive on the Agency's governance arrangements, risk management framework, internal control environment and legislative compliance, paragraphs 22C(1)(a) and (b) requires the Chief Executive to have regard to these aspects when appointing the audit committee.

In appointing members, consideration should be given to the individual versus the collective skills of the audit committee members. Each individual committee member should have general business knowledge and collectively the committee should have finance, accounting, audit, risk and industry experience.

While many FMA Act Agencies already have external members on their audit committees, paragraph 22C(1)(c) reinforces this requirement, by requiring Chief Executives, as far as practicable, to appoint at least one external member. An external member is someone who is not an employee of the Agency. An employee is defined broadly in regulation 3 of the Principal Regulations, and can include members of the Defence Force, statutory officer-holders and persons engaged under one of the Acts listed in that definition. Paragraph 22C(1)(c) therefore permits a Chief Executive to appoint a person who is an employee of another Agency as an external member of the audit committee.

New subregulation 22C(1) does not prescribe the minimum number of members that an audit committee should have or procedural aspects, such as how many members are required to form a quorum of the committee. These are matters that the Chief Executive may nevertheless wish to address in the audit committees' terms of reference. For example, a Chief Executive may want to specify that the Agency's audit committee has at least three members, the majority of which are external or independent, or the Chief Executive of a large, complex Agency may want to specify that at least two members of the audit committee should be external members.

New subregulation 22C(2) clarifies that the Chief Executive appoints the Chair of the audit committee, and that the Chief Executive may appoint any member of the committee (including any external members) as the Chair. The purpose of this provision is not to impose any obligations on Agencies or Chief Executives.

New subregulation 22C(3) reflects former subregulation 22C(1), in that it requires Chief Executives to give audit committee terms of reference that include particulars of:

- (a) the functions of the audit committee;
- (b) the frequency of committee meetings; and
- (c) the membership of the committee.

Functions

Section 46 of the FMA Act establishes broad principles regarding the functions of audit committees. Pursuant to the Chief Executive's responsibilities under the FMA Act, section 46 provides overarching guidance for audit committees. The new subregulation 22C(4) should be read in conjunction with section 46. Subregulation 22C(4) lists functions that an audit

committee will ordinarily have to perform, unless otherwise determined in writing by a Chief Executive. The functions listed in subregulation 22C(4) are not intended to be exhaustive, rather they are intended to provide a minimum standard, which can be exceeded in scope if determined by Chief Executives. This subregulation is also not intended to create compliance issues for Agencies. Rather, it is to enable Chief Executives to decide whether or not to include one or more of the functions in this subregulation in the audit committee's terms of reference.

New subregulation 22C(4) clarifies and expands on the five functions prescribed in former subregulation 22C(2). The functions in subregulation 22(4) have been developed in consultation with the Australian National Audit Office (ANAO) with reference to the ANAO's better practice guide on audit committees. Many Chief Executives who follow the better practice guide already require their audit committees to perform the new functions that will be included in subregulation 22(4). Chief Executives may agree for their audit committee to perform other functions that are not be prescribed in new subregulation 22(4), for example a Chief Executive could ask the audit committee to be involved in any change of the head of internal audit.

The following table sets out the functions that will be in new subregulation 22C(4) and indicates how the functions that are currently in subregulation 22C(2) will be preserved and amended and which functions have not previously been prescribed in the Principal Regulations.

Functions in new subregulation 22C(4):	Comment
(a) reviewing periodically the adequacy of the Agency's governance arrangements	New
(b) reviewing the operational effectiveness of the Agency's risk management framework	New
(c) reviewing the adequacy of the Agency's internal control environment	New
(d) reviewing the adequacy of the Agency's controls that are designed to ensure the Agency's compliance with legislation	New
(e) advising the Chief Executive about the internal audit plans of the Agency	Former regulation 22C(2)(a) amended
(f) advising the Chief Executive about the professional standards to be used by internal auditors in the course of carrying out audits in the Agency	New
(g) as far as practicable, coordinating work programs relating to internal and external audits	Former regulation 22C(2)(d) amended
(h) reviewing the adequacy of the Agency's response to reports of internal and external audits	New
(i) reviewing the content of reports of internal and external audits, for the purpose of identifying material that is relevant to the Agency, and advising the Chief Executive about good practices	Former regulation 22C(2)(b) amended
(j) advising the Chief Executive about action to be taken on significant matters of concern, or significant opportunities for improvement, that are mentioned in reports of internal and	Former regulation 22C(2)(c) amended

external audits	
(k) advising the Chief Executive on the preparation and review of the Agency's financial statements	Former regulation 22C(2)(e) amended
(l) providing any other advice to the Chief Executive about the Chief Executive's obligations under the Act	New

New paragraph 22C(4)(a) requires audit committees to periodically review the adequacy of the Agency's governance arrangements. This paragraph requires the review to be conducted periodically to determine whether the governance arrangements continue to be suitable. It is expected that a Chief Executive will discuss with the audit committee the timing and scope of these reviews and set out those expectations in the terms of reference, or the Chief Executive's charter with the audit committee.

New paragraph 22C(4)(b) requires audit committees to review the operational effectiveness of the Agency's risk management framework. The role of the audit committee is not to manage the implementation of the Agency's risk management framework nor to manage the risk itself, but rather to review and test the operational effectiveness of the risk management framework, as it is in the application of the risk management framework that the problems generally occur.

New paragraph 22C(4)(c) requires audit committees to review the adequacy of the Agency's internal control environment. As with the other functions, this paragraph does not provide further details on the internal control environment as this could potentially restrict the function. Rather, it is envisaged that Chief Executives will discuss their expectations with the audit committee to obtain reasonable assurance regarding the achievement of Agency objectives.

New paragraph 22C(4)(d) requires audit committees to review the adequacy of the Agency's controls that are designed to ensure its compliance with legislation. It is envisaged that Chief Executive will discuss the scope of this function with the audit committee and determine how the audit committee can best assist the Chief Executive to review compliance with legislation.

New paragraph 22C(4)(e) requires audit committees to advise the Chief Executive about the internal audit plans of the Agency. It is expected that an audit committee will consult the Chief Executives prior to advising on the internal audit plans of the Agency. This paragraph incorporates the function in former paragraph 22C(2)(a).

New paragraph 22C(4)(f) requires audit committees to advise the Chief Executive about the appropriate professional standards to be used by internal auditors in the course of carrying out audits in the Agency. The purpose of this function is to advise the Chief Executive of the most appropriate standards for internal audits, not to require audit committees to review/approve/endorse standards on an audit by audit basis.

New paragraph 22C(4)(g) requires audit committees to, as far as practicable, coordinate work programs relating to internal and external audits. This paragraph incorporates the function in former paragraph 22C(2)(d).

New paragraph 22C(4)(h) requires audit committees to review the adequacy of the Agency's response to reports of internal and external audits.

New paragraph 22C(4)(i) requires audit committees to review the content of reports of internal and external audits, for the purpose of identifying material that is relevant to the Agency, and advising the Chief Executive about good practices. This paragraph incorporates the function in former paragraph 22C(2)(b) while recognising that it is the role the Chief Executive to decide how to disseminate information about good practices.

New paragraph 22C(4)(j) requires audit committees to advise the Chief Executive about action to be taken on significant matters of concern, or significant opportunities for improvement, that arise from the audit process, including reports of internal and external audits.

New paragraph 22C(4)(k) requires audit committees to advise to the Chief Executive on the preparation and review of the Agency's financial statements. This paragraph incorporates the function in former paragraph 22C(2)(e).

New paragraph 22C(4)(l) requires audit committees to provide any other advice to the Chief Executive about how the Chief Executive can comply with the Chief Executive's obligations under the Act.

New subregulation 22C(5) simply clarifies that the Chief Executive may add to or vary the functions of an audit committee at any time. It is expected that the Chief Executive will consult the audit committee before changing any of the committees' functions.

Special arrangements for audit committees

On 1 July 2011, two FMA Act Agencies, Commonwealth Services Delivery Agency (Centrelink) and Medicare Australia, will cease to be separate Statutory Agencies and will be encompassed within the Department of Human Services (DHS) (see, accordingly, the amendments in item 2 of Schedule 1 of the Regulations which will remove Centrelink and Medicare Australia).

New regulation 22D provides explicit clarity about the transitional arrangements affecting the interactions of the relevant audit committees. It allows the Secretary of the DHS to discharge her obligations under section 49 of the FMA Act (annual financial statements).

Along with the functions of Centrelink and Medicare Australia that will be transferred to DHS, the submission of financial statements required under section 49 of the FMA Act in relation to those functions will also become the responsibility of the Secretary of DHS.

The arrangements in new regulation 22D provides that the audit committees for Centrelink and Medicare Australia will continue to exist to assist the Secretary of DHS to discharge her obligations under section 49 of the FMA Act for the 2010-2011 financial year in relation to the functions previously performed by Centrelink and Medicare Australia. Access to papers and other committee procedures would be continued until determined otherwise by the Secretary of DHS.

Item [2] – Schedule 1, items 133 and 152

On 1 July 2011, Centrelink and Medicare Australia will cease to operate as separate Statutory Agencies and become Divisions within the DHS. The *Human Services Legislation Amendment Act 2011*, which received Royal Assent on 25 May 2011, gave effect to this new

service delivery approach by amending the *Medicare Australia Act 1973* and the *Commonwealth Services Delivery Agency Act 1997*.

This item amends Schedule 1 to the Principal Regulations to remove Centrelink (item 133) and Medicare Australia (item 152) as separate FMA Act agencies.

Item [3] – Schedule 1, after item 125

Section 5 of the FMA Act provides that for the purposes of the FMA Act, an Agency includes a body, organisation or group of persons prescribed by the regulations for the purposes of that definition. Agencies are prescribed in Schedule 1 to the Principal Regulations.

This item amends Schedule 1 to the Principal Regulations to prescribe the Australian Skills Quality Authority (ASQA) as a new Statutory Agency under the *Public Service Act 1999*, commencing 1 July 2011.

The ASQA was established as the National Vocational Education Technical Regulator (NVR) by section 155 of the *National Vocational Education and Training Regulator Act 2011* (NVR Act), to act as a national regulator for vocational education and training. Section 155 of the NVR Act also enabled the NVR to be given a different name in the regulations. Regulation 5 of the *National Vocational Education and Training Regulator Regulations 2011* establishes that the NVR will formally be known as the Australian Skills Quality Authority. Accordingly, this item prescribes ASQA in Schedule 1 as a new Agency.