

ANNUAL INTERNAL AUDIT CONFERENCE

- **WEDNESDAY 29TH- FRIDAY 30TH AUGUST 2013**
- **SAI EDEN ROC HOTEL, MALINDI**

Facilitator: Kariithi M. Murimi

CEO and Team Leader

THE VALUE DIRECTORS LTD

www.thevaluedirectors.com

29th August 2013

11:30am – 12:30pm

Auditor Independence: Self Preservation and Professionalism

Composition – King III

- All independent NEDs
- Suitably skilled as a group
- Chaired by an independent NED
- Chairman of board not also chairman of the audit committee
- Voluntary audit committee (required by MOI) to comply with requirements of the Companies Act, 2008
- Deemed director provision

King III on Independence

- Not representative of a shareholder who can control or significantly influence
- No direct or indirect interest in the company in excess of 5% of the total shares
- If less than 5% of shares, not material to his personal wealth
- Has not employed, auditor, legal advisor, professional adviser (business relationship)
- Not a family member
- No remuneration on contingency basis

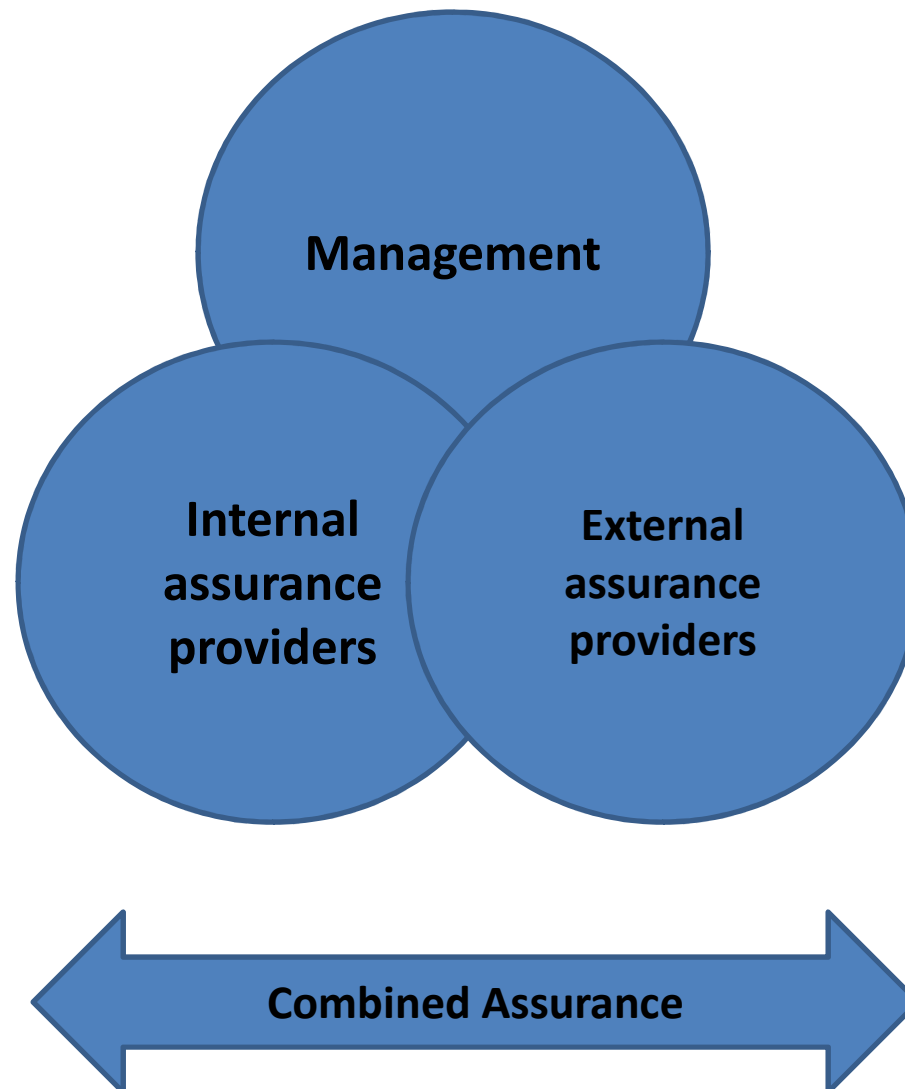
Skills

Suitably skilled and experienced – board to evaluate whether understanding of:

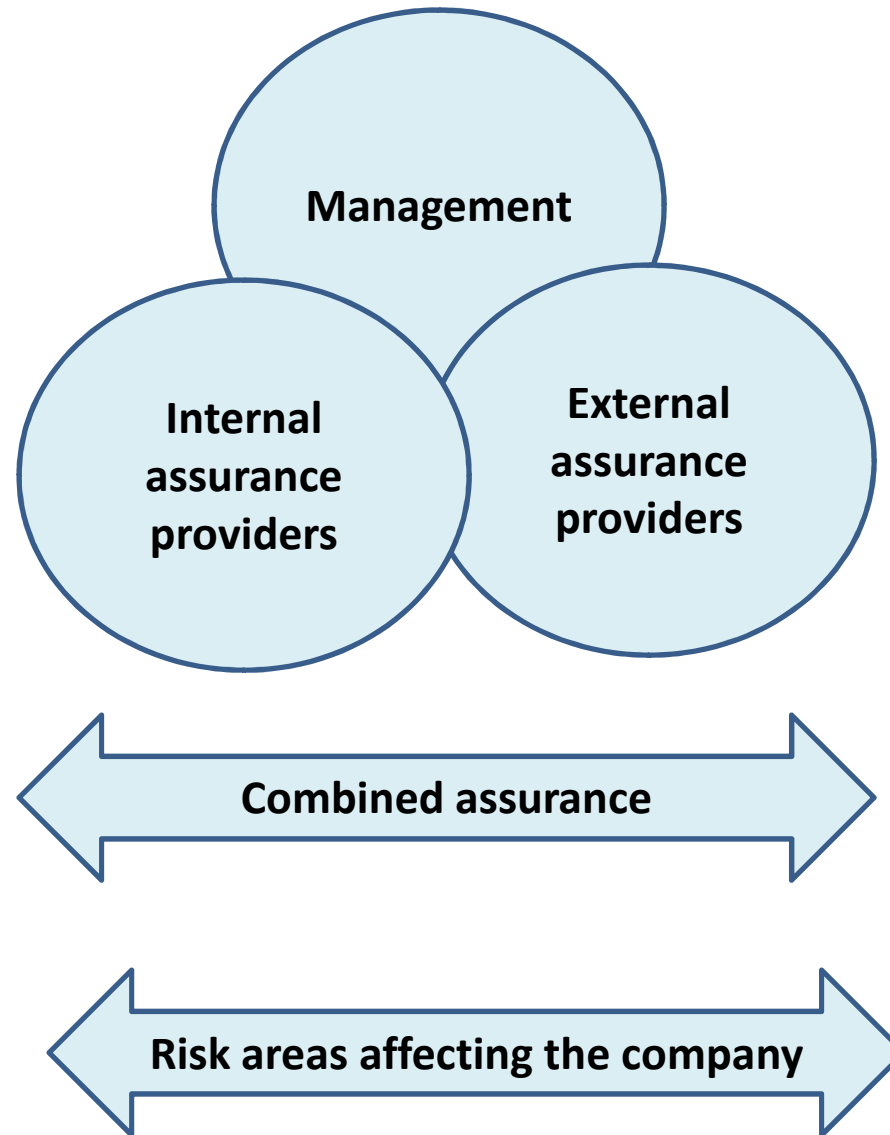
- Integrated and financial reporting
- Internal financial controls
- External and internal audit process
- Corporate law
- Risk management
- Sustainability issues
- IT governance related to reporting
- Governance processes in entity

Chairman

- Independent NED, appointed by the board
- Not the chairman of the board
- Attend AGM to answer questions on report on the activities of the audit committee, and other matters related to the scope of the audit committee



Combined Assurance



What is combined assurance

- A combined assurance model aims to optimize the assurance coverage obtained from management, internal assurance providers and external assurance providers on the risk areas affecting the company.
- The combined assurance provided by internal and external assurance providers and management should be sufficient to satisfy the audit committee that significant risk areas within the company have been adequately addressed and suitable controls exist to mitigate and reduce these risks.

Objectives/Benefits

- Coordinate the efforts of and increase collaboration between management, internal and external assurance providers;
- Develop a shared, holistic view of the combined assurance obtained over the organization's risks;
- Coordinate the relevant assurance efforts focusing on key risk exposures;
- Minimize business/operational disruptions;

Objectives/Benefits...cont

- Provide comprehensive and prioritized tracking of remedial action on identified improvement opportunities/weaknesses;
- Improve reporting to the board and committees, including reducing the repetition of reports being reviewed by the different committees;
- Identify sources and levels of assurance over key business risks;
- Identify areas of potential assurance gaps or duplication;
- Possibly reduce assurance costs.

Steps to follow

Step 1 – Establishing the business case – Gain a high level understanding of what assurance is provided for the risk exposures facing the enterprise. (Includes obtaining the key business risks from the risk assessment process)

Step 2 – Assurance reality check – Assess the actual assurance provided and to whom it is provided. The quality of the assurance should be assessed through interaction with the recipients of the assurance and assessment of the reports issued.

Steps to follow..cont

- **Step 3- Risk mapping** – Mapping the ‘actual’ assurance obtained against the ‘desired’ assurance for each risk to identify any gaps e.g. no assurance, excessive assurance. (A plan/approach will then need to be designed to address these gaps to get to the desired assurance levels).
- **Step 4 – combined assurance design** – Matrix to be convinced of the approach and respective...

Steps to follow..cont

- ...responsibilities. The key output is the combined assurance model/plan, which includes the risk based assurance coverage, analyzed per assurance provider and management. It should include the frequency and extent of assurance required.
- **Step 5 – Making combined assurance a continuing reality** – a combined assurance champion must be identified to implement the approach. The diligence and effort in establishing an effective combined assurance approach must be matched by ongoing efforts to ensure the approach provides the value it is designed to provide.

3 lines of defence

- **1st line of defence** – the controls an organisation has in place to deal with the day-to-day business. There should be adequate managerial and supervisory controls to ensure compliance and to highlight control and breakdown, inadequacy of process and unexpected events. The first line of defence provides management assurance, and informs the audit committee by identifying risks and business improvement actions, implementing controls, and reporting on progress.

3 lines of defence ...cont

- **2nd line of defence** – this describes the functions that are in place to provide an oversight of the effective operation of the internal control framework e.g. legal, compliance, health and safety, risk management, SOX, service or system providers etc. these oversight functions are responsible for designing policies, setting direction, introducing best practice, ensuring compliance and providing assurance oversight for audit committee members.
- **3rd line of defence** – entails independent challenge, audit of key controls and formal reporting on assurance of the overall adequacy and effectiveness of the risk management, governance and internal control as established by the first and second lines of defence. This is the role of internal audit, external audit and other external assurance providers

Role Players

Management

- How should management support the board?
- Interaction between management and board
- Management reporting to board

Internal assurance providers

- Internal audit
- Risk
- IT

External Assurance providers

- External audit
- Other advisors

Internal Controls

- Audit committee to monitor integrity of financial information and comment on the effectiveness of internal controls
- At least once a year internal audit should conduct a formal documented review of the design, implementation and effectiveness of the system of internal financial controls
- Conducted by suitable testing
- Report back to audit committees

Internal Audit

- Approve internal audit plan
- Oversee staffing and objectives of the internal audit function
- Appointment, performance assessment and dismissal of CAE
- Encourage cooperation between external and internal audit
- Compliance with IIA standards, including independent quality review of internal audit function

Internal Audit

PFMA:

- Review effectiveness of internal control and IT controls
- Reliability and integrity of financial and operational information
- Effectiveness of operations
- Safeguarding of assets
- Legal and regulatory compliance
- Processes through which objectives and value are established and communicated and accountability is ensured

Financial Risks

- Financial reporting risks
- Fraud risks (risk of material misstatement in reporting)
- IT risks related to financial reporting

Competence of Finance Function

- Satisfy itself of the expertise, resources and experience of the finance function.
- Annually
- Disclose results
- Listed companies:
 - evaluate the suitability of the expertise and experience of the FD
 - Recommend to the board if any changes are necessary

Other

- Fraud
- Whistle – blowing
- Compliance with relevant laws, regulations, standards and guidelines

AUDIT PLAN HAS

- BUSINESS unit to be audited
- PROCESS description
- Audit plan date
- Audit name of process
- Name of auditor
- PREVIOUS RISK OPINION
- Auditor to give opinion
- Date to be discussed by audit committee **ONLY AFTER MANAGEMENT COMMENTS**

STEPS FOR A INTERNAL AUDIT BASED ON RISKS

- Risk register in place- comprehensive RBIA depends on a risk management framework being available in an organization and , in particular, on the existence of a complete risk register.
- RISK REGISTER indicates, business unit, process, process description, key risk to process, process owner, cons of risk, likelihood, score, responsible means, control, monitoring

Four stages of rejuvenation

- Galvanize: create a top team dedicated to renewal
- Simplify: cut unnecessary and confusing complexity
- Build: develop new capabilities
- Leverage : maintain momentum and stretch the advantages

Foundation for success

- Concentrate scarce resources to key priorities and purposes
- Encourage innovation
- Enable cross-functional initiatives
- Build new ways of new business models

You alone transform to impact someone else

- The world is divided into people who do things and people who talk about doing things
- Wishing has never made a poor man wealthy
- A belief is worthless unless converted into action

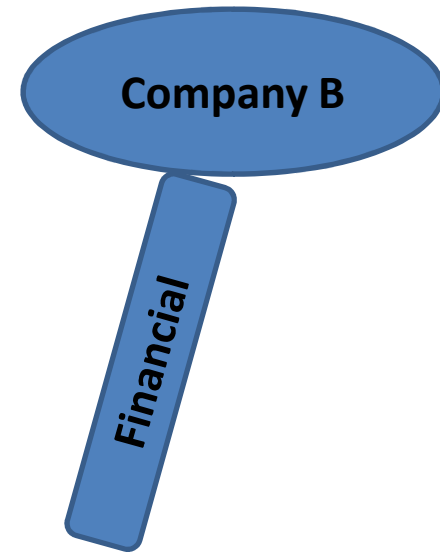
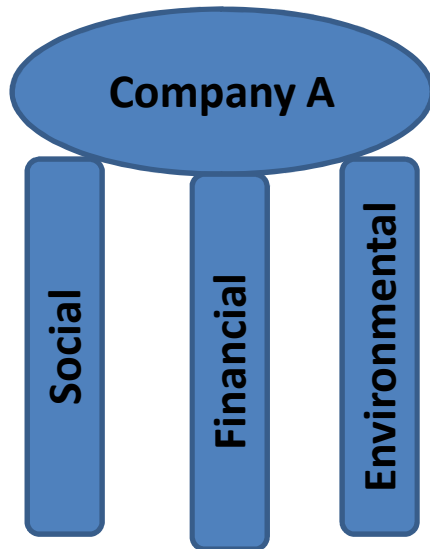


30th August 2013

9:00am – 10:15am

**Effectiveness of Audit Report:
Focus on Value Addition**

Integrated Report



Financial & Integrated Reporting

Financial Reporting:

- Consider judgments, decision making, accounting policies and disclosures
- Obtain info from management re unusual transactions
- Going concern
- Interim reporting
- Forward looking information
- Monitoring and enforcement actions against company

Financial and Integrated Reporting

Integrated reporting

- Holistic and integrated representation of performance to finances and sustainability
- Single vs. dual reports
- Controls to safeguard integrity of information in integrated report

Combined Assurance

- External (statutory auditor)
- Independence and credential of assurance provider to prove assurance over material elements of sustainability information
- Cover significant risk areas

What is integrated reporting?

- A holistic and integrated representation of the company's performance in terms of both its finances and its sustainability.
- A formal, more comprehensive and more transparent means of communicating with stakeholders.
- A forward looking approach and asks that those charged with governance agree that the company has assessed its strategy and performance against the most material issues identified in conjunction with its stakeholders
- It should tell us: **how the company has both positively and negatively impacted the economic life of the community in which it operates**

Limitations of Traditional Financial Reporting

- Financial reporting provides an important, but limited, view of company performance.
- It does not satisfy the requirements of all stakeholders who wish to see the Board assess the organization's future viability against environmental, social and governance criteria as well.
- The other shortcoming of traditional financial reporting is that it is historically focused picture of a point in time and past performance no guarantee of tomorrow success

Benefits of Integrated Reporting

- A more informed long term strategy and operational plans to support this strategy, based on an understanding of core value drivers;
- A true reflection of effective management of the opportunities and risks associated with sustainability considerations;
- Accountability of internal control management for their performance;
- A platform for strategic communication and conversations with stakeholders that provides a meaningful account of performance, builds trust and helps inform future strategy

Benefits of Integrated Reporting

- Unlocking “Value” from stakeholders and the market, through engagement on key issues
- A wider view of the organization's impact beyond financials, which can reveal valuable opportunities for value enhancement;
- Increased awareness about corporate social responsibility initiatives; and
- Increased trust, confidence and support by transparent reporting about the full societal impact;

King III

- **Principle 9.1:** the board should ensure the integrity of the integrated report.
- **Principle 9.2:** sustainability reporting and disclosure should be integrated with the company's financial reporting
- **Principle 9.3:** Sustainability reporting and disclosure should be independently assured

The Audit Committees role

- The audit committee should oversee the integrated reporting process
- This includes:
 - Integrated reports
 - Financial
 - Sustainability
 - Interim results
 - Summarized information

Integration is a journey

- Integrated reporting cannot be treated as a matter to be addressed at the end of the financial year. It should be incorporated in the company's strategy
- The report will end-result of an implementation process and strategy that considers the long-term viability of the company relative to its financial, economic, social and environmental impacts. Sustainability principles must be integrated into all aspects of organizational strategy.

Integration is a journey..cont

- The company's integrated report should then be a document which allows all executives and stakeholders of the company to evaluate the performance of the company (including strategic and operational performance) against the sustainability risks and challenges that it faces
- This process obliges companies to have upfront the appropriate conversations about the drivers and key measures of performance

The Process

1. Connecting business strategy, governance and sustainability

- 1.1 Identify the financial, social, environmental, governance and economic issues that are most relevant to the organisation, the sector and markets in which it operates
- 1.2 Determine those issues that are material to the organization's performance. Materiality must be determined in conjunction with key stakeholders and the audit committee should agree on the process and outcome.
- 1.3 Describe the process of determining which issues are material. This should explain why issues that are generally considered significant at sector, national or international levels are not considered material for disclosure by the business.

The Process

2. Key Performance Indicators and actions taken

2.1 Identify the actions taken to address each of the material issues (risks and opportunities) resulting from 1.2

2.2 establish the intended outcome for each action

2.3 Set out how progress towards outcomes will be measured, identifying key performance indicators (KPI) for each material issue.

2.4 Agree targets for each KPI and supporting performance (milestones)

2.5 identify the relationship between selected KPIs and financial or business performance, where possible quantifying the relationship in terms of impact on revenue, expenditure, investment, cash flow or measures of operational performance.

2.6 Align management performance appraisal and incentive structures with selected KPI's based on time horizons over which outcomes can be measured

The Process

3 The integrated report

- 3.1 Ensure appropriate information collection processes are established to provide complete, accurate and consistent information
- 3.2 Report on the actual performance achieved in the reporting period with reference to: Agree targets; Reporting baseline; Performance in prior years; peers, industry and national averages or other benchmarks.
- 3.3 Report related financial or business performance measures alongside KPIs providing a clear indication of the relevance of sustainability performance to the business results.

3.4 Describe clearly:

- The actions taken in response to each material issue;
- How these will achieve the intended outcomes;
- The KPIs which demonstrate performance, highlighting the connection with the strategic direction
- The governance arrangements in place to incentives and reward behaviour contributing to the delivery of intended outcomes

The Integrated Report

- A truly integrated report should reflect all of the material issues in a single report (Chapter 9 of the King III report does allow other formats but single report is preferred format)
- The integrated report should provide sufficient information on the company's positive and negative impact on its material stakeholders in the past year and how it plans to improve the positive impact in the following year.
- It should be as concise and pertinent as possible with a view to encouraging stakeholder to read it rather than file it. Focus on key and material issues. Use internet references for more detail.

Guidelines

- One of the challenges with an integrated report is that notwithstanding the progress that has been made regarding the standardization of reporting, it is still a complex issue.
- Unlike financial reporting, where rules are reasonably clear about what should be reported and how, with integrated reporting, especially with regard to economic, environmental and social performance, the matter is much more complex
- Going through a learning curve

To Assist

- Global reporting initiative (sustainability reporting)
- International integrated reporting commission integrated reporting commission

Progress

- Companies are increasingly realizing that corporate reporting is about more than just being a good corporate citizen; it drives innovation and promotes learning, which helps companies grow their business and increase their organizations value – KPMG
- Gaining International Traction

Boards Responsibility for Risk Governance

PRINCIPLE

- The board should be responsible for the governance risk

PRACTICES

- A Policy and plan for a system and process of risk management should be developed
- The board should comment in the integrated report on the effectiveness of the system and process of risk management

Boards Responsibility for Risk Governance..cont

PRACTICES

- The boards responsibility for risk governance should be expressed in the board charter
- The induction and ongoing training programmes of the board should incorporate risk governance
- The boards responsibility for risk governance should manifest in a documented risk management policy and plan.
- The board should approve the risk management policy and plan

Boards Responsibility for Risk Governance..cont

- The risk management policy should be widely distributed throughout the company
- The board should review the implementation of the risk management plan at least once a year
- The board should ensure that the implementation of the risk management plan is monitored continually

**“ Risk comes from not knowing
what you are doing.”**

Warren Buffet

Role of Audit Committees Under the new Constitution and PFM ACT ..cont

ARTICLE 35

35. (1) Every citizen has the right of access to—
- (a) information held by the State; and
 - (b) information held by another person and required for the exercise or protection of any right or fundamental freedom.
- (2) Every person has the right to the correction or deletion of untrue or misleading information that affects the person.
- (3) The State shall publish and publicize any important information affecting the nation.

Role of Audit Committees Under the new Constitution and PFM ACT ..cont

ARTICLE 46

46. (1) Consumers have the right—

- (a) to goods and services of reasonable quality;
- (b) to the information necessary for them to gain full benefit from goods and services;
- (c) to the protection of their health, safety, and economic interests; and
- (d) to compensation for loss or injury arising from defects in goods or services.

THANK YOU AND GOD BLESS YOU

- AUDIT COMMITTEES IS ABOUT TRANSFORMING YOUR ORGANIZATION, BEING THE ANSWER TO THE VERY BEST YOU CAN THINK
- CHALLENGE YOUR LIMITATION OF MIND,SEE THINGS WITH NEW LENSES AND AVOID BEING A POLICE
- THANK YOU