ICPAK PRESS STATEMENT

CORPORATE GOVERNANCE OF PUBLIC INTERSEST ENTITIES IN KENYA

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The Institute of Certified Public Accountants of Kenya (ICPAK) notes with concern the events unfolding in the banking sector. Abuse of various banking processes is causing problems in the troubled banks. We would like to commend the Central Bank of Kenya for the steps it has taken to streamline Kenya's banking sector and strengthening the culture of corporate governance and accountability in these Institutions. Various existing financial laws in Kenya underline the essence of corporate governance in all sectors of the economy.

The Kenyan Companies Act is very clear the duties and responsibilities of the Board of Directors of any company, whether a bank or otherwise. Amongst the various duties and responsibilities, the Board of Directors is responsible for:

- Preparing financial statements which give a true and fair view of the state of financial affairs of the company;
- Maintaining proper books of account that disclose with accuracy the financial position of the company;
- Safeguarding the assets of the company;
- Designing and implementing suitable internal controls to prevent and detect fraud and other financial misreporting; and
- Providing the auditors and regulators all the necessary information and explanations with unrestricted access to the underlying financial records and documentation to allow them perform their work.

Annually, the Directors of each company formally acknowledge such responsibility within the annual report through the 'Statement of Directors Responsibilities'. The Companies Act also refers to the entire board and each of its members as the primary custodian of the above responsibilities. It does not distinguish between executive and non-executive directors and certainly does not permit delegation of this responsibility to management.

Specifically, in respect of banks, the Prudential Guidelines (PG) issued under the Banking Act imposes various specific responsibilities on the Board of Directors, some of which as drawn from PG02 on Corporate Governance are as follows:

- Section 3.3 indicates that the Board has overall responsibility for the bank, including strategy, risk strategy, corporate governance and corporate values. The Board is also responsible for oversight of senior management
- Section 3.3.7 further expounds that it is the duty of Board of Directors to define duties of management and appoint such competent persons and dispense undesirable staff
- Sec 3.3.8 Board is required to regularly review policies, process and controls with senior management and/or internal control functions (including internal audit, risk management and compliance)
- Sec 3.5.2 (ii) – the Board Audit Committee appointed by the Board and comprising some of the Board Members is to provide independent oversight of the institutions financial reporting and internal control system, ensure checks and balances are in place to take appropriate regular remedial action
- Sec 3.12 – the Board should be responsible for IT governance, a framework that supports effective and efficient management of IT

resources. The Guideline clearly directs that the IT governance is the responsibility of the board

CBK/PG/13 - Guideline on enforcement of banking laws and regulations provides that where an institution contravenes any of the provisions of the Banking Act, the CBK could impose conditions including joint and several liabilities of Directors and officers to indemnify the institution against any loss arising in respect of reckless and fraudulent advances or loans.

Various other regulations exist that elaborate the role of the Board of Directors – including the regulations issued by the Capital Markets Authority that are particularly relevant to institutions that have issued securities to the public. These regulations include the need for prompt dissemination of information to investors including adverse events and profit warnings.

Therefore, whilst it is very common to put the spotlight on the role of various regulators and the external auditors, the primary responsibility for fair presentation of the financial results is that of the Board of Directors.

In every company, agency theory provide for existence of shareholders who appoint external auditors to provide reasonable assurance on the financial performance and results of directors stewardship.

Contrary to common belief, financial statements of an institution are not prepared by and owned by auditors – auditors simply audit the financial statements as prepared by the Board of Directors in accordance with the International Standards on Auditing. Such procedures at best only provide reasonable and not absolute assurance on the financial statements - a fact that is clearly stated on the auditor's report.

It is also common misconception that the role of the external statutory auditor is the same, or in fact more elaborate than internal audit or a forensic audit. It is worth to appreciate that external audit is just that – external – it is not part of internal control and not a substitute therefore for good corporate governance. At best, external auditors spend a limited number of days/weeks focused on key financial information and financial statement presentation. It is not designed like a forensic audit that seeks to validate the authenticity of every single transaction. Neither is it designed as internal audit which seeks to critically review compliance with internal policies and procedures and regulatory requirements.

International Standards on Auditing (ISAs) make very clear that the external statutory auditor is not responsible for the prevention and detection of fraud. ISAs explicitly state that *"owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected even though the audit is properly planned and performed".* The ISAs further elaborate that such a limitation is even more significant where such fraud and deliberate misreporting is perpetrated by senior management as part of a sophisticated fraud scheme, where collusion is rife and there are deliberate misrepresentations to the auditor. Whilst ISAs do require specific procedures to be performed by the auditor to give him/her the best possible chance of detecting such fraud and misreporting, they also recognise the distinction and limitation in scope when compared to a forensic audit and state that *"Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuin*e.

The Institute also takes note that the Central Bank via letter dated 11 November 2015, to external auditors of commercial banks, expanded the scope of auditors to assess the IT environment of commercial banks and issue a report of findings to the Central Bank of Kenya. The institute believe that this initiative has contributed to increased scope of work for auditors hence the findings in the recent past and believe that these measures will go a long way in strengthening the banking sector's internal controls while also enhancing the supervisory role of CBK and effectiveness of statutory and IT audits, if implemented fully coupled with sound corporate governance practices by the boards of directors.

Conclusions

Based on these facts, ICPAK:

1. Strongly condemns the abuse of corporate governance guidelines by some directors of commercial banks that have been put under receivership or misappropriated assets. Their fast tracked prosecution and recovery of amounts advanced to them irregularly is highly supported.
2. Recommend that, due to the fast moving innovations in the financial services sector, the supervisory role of the Central Bank of Kenya should continue to be enhanced.
3. Supports speedy trial of all fraudulent and corrupt bank officials, Directors and Employees, who continue to taint the image of the Kenyan financial services sector.
4. Special audits should be conducted on all Public Interest Entities (PIEs) where doubts have been cast on their governance and mode of operations.
5. All regulators of Public Interest Entities should enhance their whistle blowing mechanisms in order to effectively flash out fraudulent practices before they become detrimental to the economy. The Institute will seek to enhance the collaborative efforts with other regulators to promote financial accountability and good governance practices.
6. The Companies Act 2015, has codified the duties and responsibilities of directors with the objective of enhancing corporate governance. We appeal to the office of the Attorney General to move with speed and

gazette phase II regulations which provides significant reforms on financial reporting and increases the penalties for non-compliance so as to punish such directors and officers who promote accounting fraud.

7. ICPAK will continue to take action on members of the Institute who are involved in perpetrating fraudulent practices while it is highly recommended that employers engage regulated Professional Accountants who are members of the Institute. ICPAK is revising its laws in order to expand the repercussions of its members purported to be involved in professional misconducts.

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The Institute of Certified Public Accountants of Kenya ***(ICPAK)*** *was established in 1978 and draws its mandate to develop and regulate the accountancy profession in Kenya in public interest from the Accountants Act (no 15 of 2008). For more information, please contact us on icpak@icpak.com or www.icpak.com . ##*