



The Architecture and Role of Audit Committees in the Public Sector

2nd Public Sector Audit Conference
12th October 2016

Facilitator: Musundi Amos Anthony



Outline

- ☐ Introduction
- ☐ Evolution of Audit Committees in Kenya
- ☐ Constitution, PFM Act, PFMR, Gazette Notice No. 2690 & 2691
- ☐ Objectives and Roles of AC & Composition Matrix,
- ☐ Value Creation of the AC,
- ☐ Improvement to be considered within the AC and Secretariat



Introduction

For many years internal auditing was a ‘Cinderella’ profession, working in the shadows while its glamorous cousin’ the external auditing profession, basked in the limelight. All this changed with the emergence of corporate governance as an imperative for listed companies and public bodies.

Internal Audit





Evolution of Internal Audit and Audit Committees in Kenya

- ❑ Kenya's internal audit system was abolished in 1962 and this gave the Office of Controller and Auditor General the “domineering” prominence.
- ❑ The system was re-introduced in 1984 after it became apparent that its absence contributed to laxity in the management of public resources
- ❑ Even after re-introduction heavily leaned towards pre-auditing



Evolution of Internal Audit and Audit Committees

- ❑ In 2000, a joint report of IMF/World Bank highlighted the weaknesses of Kenya's internal audit function. As a result, the Government launched a concerted effort to modernize internal audit function and government oversight in general.
- ❑ Acts of parliament were enacted and various circulars issued.



Evolution of Internal Audit and Audit Committees

- ❑ In 2004, Government Financial Management Act was enacted-it set out the legal mandate of Internal Audit
- ❑ Treasury Circular No.16/2005 was issued for establishment of Audit Committees in all public institutions.
- ❑ Treasury Circular no.18/2005 was issued requiring management to act on audit reports within two weeks.



Constitution of Kenya (2010)

- ❑ The Constitution does not mention arrangements for internal audit, however its spirit espouses the same through 10 on national values and principles of governance-Accountability, integrity, transparency and good governance.
- ❑ The spirit of the Constitution in support of the internal audit is also manifested through article 232 by providing principles of public service that ensure Economic, Efficient, Effective use of public resources.



Public Finance Management Act, 2012

- ❑ The Act was enacted to infuse the Constitutional spirit on governance, accountability, transparency in Government.
- ❑ Section 73 (1)(a) of the PFM Act requires National Government entity to put in place appropriate arrangements for conducting internal audit.
- ❑ Section 155(1)(a) of the PFM Act requires county governments to put in place appropriate arrangements for conducting internal audit.



Public Finance Management Act, 2012

- ❑ Sections 73 (5) and section 155(5) of PFM Act establishes audit committees for national government entities and county government entities whose composition and functions are prescribed by the regulations.



Public Finance Management Regulations, 2015

- ❑ Regulation 43 requires Accounting Officers Government entities have audit committees in place.
- ❑ The Kenya Gazette Notice Vol CXVIII No. 40 of 15th April 2016 issued detailed guidelines for establishment of audit committees in all public entities.
- ❑ A public notice issued by the Cabinet Secretary on 29th of June 2016, National Treasury emphasized operationalization of the guidelines



Purpose of the guidelines

- ❑ To help executive management, Accounting Officers, Boards of public entities to work out the best arrangements for their entities
- ❑ To make Audit Committees understand their role and the ways in which they should function
- ❑ To help the National Treasury officials to oversee an entity's board and audit committee practices



Objectives of Audit Committees

- Ensure that all financial and non-financial internal control and risk management functions operate effectively and reliably
- Ensure integrity of financial reporting
- Oversight over internal audit function
- Liaison between management and external audit
- Ensure compliance to legislative and regulatory requirements



Roles of Audit Committees

- ☐ Evaluate whether the process is in place to address key responsibilities in relation to risk management.
- ☐ Evaluate the adequacy of the control environment
- ☐ Independent review of financial statements
- ☐ Ensure compliance with performance management and performance reporting
- ☐ Evaluate quality of the internal audit function
- ☐ Engage external auditors
- ☐ Whistleblowing role



Audit Committees' Focus

Financial Reporting

- Disclosure requirements
- Appropriateness of Accounting policies

Risk management and Internal Control

- " understand key risk areas
- " Effectiveness of controls
- " Fraud risk

External Audit

- " Scope of work
- " Independence requirements
- " Audit findings and implementation of recommendations
- " Review performance of the auditor

Audit Committee: Areas of Focus

Internal Audit

- " Charter, authority and resources
- " Scope of work
- " Internal audit effectiveness
- " Responses to internal audit recommendations

Maintaining and measuring effectiveness

- " Training needs
- " Financial literacy
- " Annual performance

Communication and reporting

- " Relations with management
- " Updates and recommendations to the full board
- " Reports to the board and shareholders

Regulatory , compliance & ethical matters

- " Compliance with the laws
- " Code of conduct/ethics
- " whistleblowing



Composition Matrix

Entity	Composition
1. Ministries and Departments	<ul style="list-style-type: none">" 3 members external to the ministry one of whom shall be the chair" One Representative of the National Treasury
2. Parliament	<ul style="list-style-type: none">" 3 members from parliamentary service commission and a representative from national treasury
3. Independent Commissions whose Commissioners are full-timers	<ul style="list-style-type: none">" 2 members to be sourced competitively" 1 Commissioner" 1 National Treasury representative



Composition Matrix

Entity	Composition
8. Research Institutions, Public Universities, National Referral Health Facilities Boards, Fund Management Corporations.....	<ul style="list-style-type: none">“ Board nominate 3 members of their Board members , one to be the Chair“ Representative of the National Treasury
9. Public Funds (Within the Administration of a state department or any other National Government Entity)	<ul style="list-style-type: none">“ Guidelines under ministries and Departments
10. All public schools	<ul style="list-style-type: none">“ County education boards to constitute sub-county audit committee with 3-5 independent members“ Representative of CS-Education



Composition Matrix

Entity	Composition
4. Controller of Budget, OAG, DPP	Guidelines under ministries and Departments
5. All security organs	" 4 members nominated by National Security Council " Representative of National Treasury
6. Government Owned Enterprises operating on the basis of Commercial Principles	" Board nominate 3 members of their Board members , one to be the Chair " Representative of the National Treasury
7. Regulatory Agencies	" Board nominate 3 members of their Board members , one to be the Chair " Representative of the National Treasury



Composition Matrix

Appointment and Composition of Members of Audit Committees in County Governments

County Governments

County Assembly

- “ 3 members to be sourced competitively, one of whom shall be the Chair
- “ 1 officer nominated by the County Speaker
- “ Audit Committee to report to the County Assembly through the County Assembly Clerk

County Executive

- “ 4 members to be sourced competitively, one of whom shall be the Chair
- “ Governor to nominate one senior officer
- “ The Audit Committee reports to the Governor



Key Attributes of Audit Committee Members as per PFMR, 2015

- ☐ Independent of the entity
- ☐ Have a good understanding of the objects, principles and functions of the entity to which they are to be appointed
- ☐ Have requisite business and leadership skills
- ☐ Have a good understanding of government operation, financial reporting or auditing
- ☐ Integrity
- ☐ Relevant experience

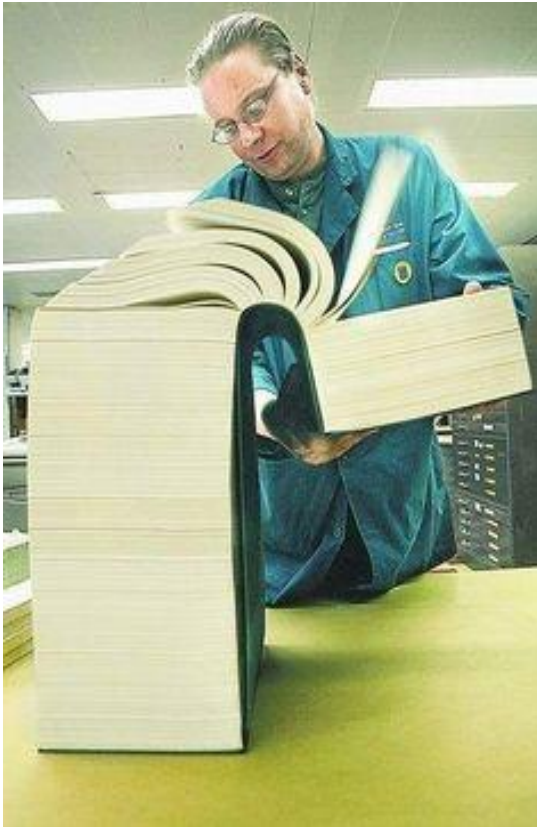


Terms of office

- ❑ 3 years renewable upon satisfactory performance
- ❑ Membership ceases if-
 - ❖ The person is convicted of a criminal offence and sentenced to a term of not less than six months
 - ❖ Absent from two consecutive regular meetings without leave of absence
 - ❖ Resigns
 - ❖ Term expires
 - ❖ Becomes an employee of the concerned entity
 - ❖ Conflict of interest or committee is disbanded



Committee Reporting



- ❑ Periodic reports to the accounting officer/governing body, oversight bodies, citizens
- ❑ Annual report showing
 - ❖ Audit Committee effectiveness
 - ❖ The internal audit effectiveness
 - ❖ Effectiveness of management
- ❑ Special/investigative reports



Audit Committee Performance

- ❑ Self performance of achievements of mandate, roles, duties and responsibilities should be done on annual basis
- ❑ The Committee should assess itself on:-
 - understanding, communication and oversight responsibilities in relation to financial statements, risk management, internal controls, compliance, ethics, management, internal & external auditing
- ❑ The AC may use an external facilitator to provide assistance with self-assessment process



The Value of Audit Committees

- ❑ The AC focus on the changing business environment and changing financial reporting requirement and hence can help the entity seize the prevailing opportunities
- ❑ AC operate at a strategic level with high degree of alignment with organization's statutory objectives and strategic direction-strategic value
- ❑ They add value by securing management attention in implementation of recommendations for both internal & external auditors



The Value of Audit Committees

- ❑ Promote and monitor ethical culture
- ❑ They promote effective communication amongst internal audit, external audit, management and the board
- ❑ Since the AC comprises of the industry specialists, the value they create tends outweigh the cost
- ❑ They provide a 'no surprise' environment-which increases productivity
- ❑ Provide in-depth knowledge that assists management discharge its responsibilities in an effective and efficient manner.



Issues to be considered in future

1	Committee composition and dynamics	<input type="checkbox"/> Periodically rotating audit committee members including the chairperson <input type="checkbox"/> Focus on financial expertise-for chairs position
2	Risk Management	<input type="checkbox"/> Consider divorcing risk management from audit
3	Appointment of Audit Committee members	<input type="checkbox"/> Commissions and other Government entities whose governance bodies comprises President's appointees source AC members competitively. While this is a good practice, the AC members are not at the same level as their appointing Authority-Independence issues are likely to occur
4	Position of Internal Audit	<input type="checkbox"/> Internal Audit Departments relatively at a lower lever compared to other departments <input type="checkbox"/> Other Government entities administrative reporting is not to



Issues to be considered in future



For the AC to have appropriate secretarial services all internal audit departments should have adequate staff with the right skills

