EFFECTIVENESS OF AUDIT COMMITTEES IN THE PUBLIC SECTOR

WEDNESDAY, 12TH OCTOBER 2016

@ Sarova Whitesands Hotel, Mombasa
OUTLINE

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3. BACKGROUND
4. METHODOLOGY
5. RESEARCH FINDINGS
6. POLICY RECOMMENDATIONS

Credibility, Professionalism, AccountAbility
Demand for accountability and efficient use of resources in the public sector – a key subject matter: Global financial crisis that began in mid-2007, spate of corporate failures and scandals coupled with globalization and expansion of financial markets are some of the factors that have led to increased demand for audit.

The Auditor General in the last two audit cycles reported glaring discrepancies in the financial management systems of Government.

In conjunction with the Office of the Internal Auditor General of the National Treasury conducted a survey on effectiveness of Audit Committees in the public sector in line with the Treasury Circular No. 16/2005

The core mandate of ACs is to undertake Audit and ascertain Risk and Compliance levels of an entity. How the committee fulfils that mandate varies according to; the clarity of the committee’s mission, the abilities of the committee’s members, and the tone set at the top of the governance structure
Establish the level of compliance with the Treasury Circular No. 16 of 2005

Examine the composition, level of independence and effectiveness of Audit Committees in discharging their mandates

Establish the challenges hindering effective performance of Audit Committees in the public sector

Propose recommendations to strengthen Audit Committees as oversight roles

Credibility, Professionalism, AccountAbility
EVOLUTION OF AUDIT COMMITTEES IN THE WORLD

- SEC-1940’s, NYSE 1978, Blue Ribbon Committee 1999; Sarbanes Oxley Act 2002
- Cadbury Committee 1991-CBP-92
- Greenbury Report 1995
- Hampel 1998; Turnbull, Higgs & Smith 2003
- Legislative support (PFMA no 1-1999) & MFMA 2003
- King I, II, III Reports
- TSE Dey Report 1994 & 1999
- Joint Committee on CG 2001
- Multilateral Instrument MI 52-10 2004

Credibility . Professionalism . AccountAbility
Establishment of Audit Committees in Kenya

- Treasury Circular No. AG/3/o80/6/ (61) of 2000. Prescribed the establishment of ACs in Ministries, Departments and Agencies of the central government and the local authorities.
- CMA Guidelines on Corporate Governance 2002; ACs with 3 Independent and NEDs.

INDIVIDUAL – Appropriate Technical Skills and Experience, independence, demonstrated leadership and integrity

COMMITTEE Attributes: Appropriate Skills mix, size, communication, periodic assessment
A Sample of 6 Ministries, 50 State Corporations and 15 Counties was selected using a Triangulated Approach. Utilising both Qualitative and Quantitative methods: different tools i.e. Survey Questionnaires, Key Informant Interviews, General Observations & Desktop review.

State corporations (46%), Ministries 33%, County Governments (80%) were selected.

Scope:
- Sample, Respondents
- Focus on Committees leaving out the audit function

Timing:
- Ministries, SCs, Counties

Response:
- low response rate from the sampled Ministries

RESEARCH FINDINGS

a) Establishment

Complied with Treasury Circular -2005 and CMA 2002 guidelines (Commercial entities)

b) Membership

Membership of 3 decried quorum challenges

<table>
<thead>
<tr>
<th>NUMBER OF MEMBERS IN THE AUDIT COMMITTEES</th>
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<tr>
<td>THREE</td>
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<td>24%</td>
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Credibility . Professionalism . AccountAbility
RESEARCH FINDINGS cont..

C) Composition

<table>
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<th>% of Committee Members who are</th>
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<tbody>
<tr>
<td>100%</td>
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<tr>
<td>80%</td>
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<td>60%</td>
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<td>40%</td>
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<tr>
<td>20%</td>
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Board members | Board and Non-Board Members

Global IIA recommends that the majority of the audit committee members should be independent of the organization in order to support the board in fulfilling its oversight responsibilities.

C) Composition

Credibility, Professionalism, AccountAbility

d) Minimum Requirements

- Most entities could not ascertain the minimum qualifications needed unless expressly stated in their respective enabling statutes. Largely so due to the nature of appointments to the board.

- In a number of entities, representatives from the Inspectorate of State Corporations (ISC) would be in-attendance in every committee sitting in an advisory capacity.
Meeting with the Chief Executive
ACs might find it useful and necessary to hold separate private meetings with both the internal and external auditors without the presence of executive management at least once a year.

f) Succession Planning

- Credibility: 33% (Yes)
- Professionalism: 67% (No)

no succession provisions given that the terms for all members of the Board came to an end at the same time.
It was observed that the Office of the Auditor General neither reviewed nor relied on the work of the Internal Auditor.
Related to capacity and skills, the respondents bemoaned absence of appropriate skills mix in the committees as well as lack of opportunity for continuous trainings for skill enhancement.

Other challenges identified include; limited financing, lack of succession planning, quorum challenges, committee independence due to political patronage.
Key reforms were carried out in year 2013 where there was a reduction of the Government Ministries from forty seven (47) Ministries to 18

The study observed that;

*The Ministerial Audit Committee Comprised of seven (7) members all drawn from the senior employees of the Ministry.*

*Nomination to sit in the audit committee was based on seniority in the Ministry with the minimum rank being that of a Director or Heads of Department.*

*Operation challenges remained dominant due to the merging of Ministries.* As such, the Min. ACs committees lacked a clear reporting structure. Moreover, unavailability of members to form quorum due to their day to day operations as heads of departments was reported
Prior to the establishment of the County Governments in Kenya, the defunct Local Government Authorities were also required through the Treasury Circular No. 16/2005 to establish and strengthen Audit Committees in order to enhance oversight, governance, accountability and transparency in the public sector.

Respondents from the counties indicated that they had not constituted Audit Committees due to lack of a guiding framework.

Notwithstanding, Nairobi City County reported that it had established and operationalized an Audit Committee on the basis of the draft Public Finance Management Regulations 2014.
STRUCTURAL RECOMMENDATIONS

Appointments

- National Treasury through PSASB should fast-track on issuance of guidelines on establishment, composition and minimum qualifications for members of Audit Committees in the public sector.
- Considerations should be made to qualification, experience, and skills mix of the entire committee and by extension the board.
- The appointment to be done competitively and or selection from professional bodies – to enhance independence.

Composition

- We recommend compliance with clause 3.4 (2) (b) of the Mwongozo Code which stipulates that “the Board should ensure that at least one member of the committee has relevant qualifications and expertise in audit, financial management or accounting with experience and knowledge in risk management and is a member of a professional body in good standing”
- Appropriate mix of skills and expertise to be informed by the nature and the mandate of the respective entity
- Minimum of five members to the Audit committee. This will help mitigate quorum challenges and offer a wide spectrum of skills for decision making
RECOMMENDATIONS CONT..

- **Mandate**
  - Audit function should be underpinned by an approved Audit Charter
  - Should monitor internal audit coverage to ensure that all key risk areas are considered
  - Appointment and assessment of performance of the head of internal audit should be driven by the ACs; in appraising IA, we recommend a three tier appraisal by the management, the Committee and audit staff peers

- **Succession**
  - Institutionalization of guidelines on succession with clear definition of transition processes so that the work of the committee is not affected – Provide staggered terms for members of Acs.

- **Funding the Audit Function**
  - The budget of audit function should be distinct from the executive budget. This shall contribute to the independence of the function.
**Recommendations...**

- **Improving Performance**

  - **Civic / Stakeholders Education**
    - Sensitize stakeholders on the role of Internal Audit so that it is seen as a value adding tool for corporate excellence.

  - **Periodic performance evaluation**
    - Through an independent evaluation process.

  - **Continuous tailor-made trainings**
    - For AC members to enhance their effectiveness and update themselves on emerging issues in risk management and governance.
AC MANDATE & RELATION WITH INTERNAL & EXTERNAL AUDITORS

- **Internal Auditor**
  - The drivers of the role must continuously seek knowledge on emerging risks and risk factors.
  - The office should be adequately supported by the entire organs of the entity.
  - For a start, the holder of the office should be hired at a level of senior management to develop the clout to relate and effectively deal with risk owners within the organization who in most cases are senior managers.

- **External Auditor**
  - The External Auditor should hold periodic discussions with the Internal Auditor on the efficiency and effectiveness of systems of internal controls. The External Auditor may then assess the reliability of the work of the Internal Auditor to place reliance on them in his final audit work.
THE END

Thank You!