EFFECTIVENESS OF AUDIT COMMITTEES IN THE PUBLIC SECTOR

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@ Sarova Whitesands Hotel, Mombasa
OUTLINE

1. INTRODUCTION
2. OBJECTIVES
3. BACKGROUND
4. METHODOLOGY
5. RESEARCH FINDINGS
6. POLICY RECOMMENDATIONS
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 existence of an Audit Committee is a pre-requisite for good corporate governance, EFFECTIVESS is the key.

The core mandate of ACs is to provide internal assurance in respect of:
- independent review of effectiveness of financial reporting process;
- internal control and risk management system of the company;
- oversight over audit process
Study Objectives

- 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.
ESTABLISHMENT OF AUDIT COMMITTEES IN KENYA

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

Treasury Circular No. 16 of 2005
Aimed at enhancing oversight, governance transparency and accountability in the public sector


Acs on Banking Institutions

Treasury Circular No. 18 of 2005
Guide Management Action on Internal Audit Reports

Credibility . Professionalism . AccountAbility
ATTRIBUTES OF AN EFFECTIVE AUDIT COMMITTEE

- INDIVIDUAL – Appropriate Technical Skills and Experience, independence, demonstrated leadership and integrity
- COMMITTEE Attributes: Agreed sets of ToRs, approved work plans, Appropriate Skills mix, appropriate numbers of Committees, periodic communication, periodic assessment; Credibility. Professionalism. AccountAbility.
RESEARCH METHODOLOGY

DESIGN

Triangulated Approach

Utilising both Qualitative and Quantitative methods: different tools i.e Survey Questionnaires, Key Informant Interviews, General Observations & Desktop review

SAMPLE

A Sample of 6 Ministries, 50 State Corporations and 15 Counties was selected

RESPONSE

State corporations (46%) Ministries 33% County Governments (80%)

ANALYSIS

Statistical

LIMITATIONS

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

Timing
- Ministries, SCs, Counties

Response
- low response rate from the sampled Ministries

Credibility .  Professionalism .  AccountAbility
RESEARCH FINDINGS

a) Establishment

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

b) Membership

- Under membership of 3 – Observed quorum challenges
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. Mwongozo Code, King III

RESEARCH FINDINGS cont..

C) Composition

% of Committee Members who are

0%  20%  40%  60%  80%  100%
Board members
Board and Non-Board Members

Credibility  Professionalism  AccountAbility
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

33% YES

67% NO

no succession planning – terms began and 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; 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:

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
- Considerations should be made to qualification, experience, and skills mix of the entire committee and by extension the board.
- The appointment of the independent members be done competitively – consider collaborating with professional bodies – to enhance independence.

Composition
- Appropriate mix of skills and expertise to be informed by the nature and the mandate of the respective entity;
- The Committee should be appointed from amongst the non-executive directors of the Board only and consist of:
  - a minimum of three members
  - a majority of whom, including the chairman, should be independent.
- Minimum of three (3) and a maximum of five (5) members. 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 detailing the terms of references that clearly details Audit Committee’s authority;
  - Should monitor internal audit coverage to ensure that all key risk areas are considered
  - Appointment and assessment of performance and performance management of the head of internal audit should be owned and driven by the ACs;

- **Succession**
  - Institutionalization of guidelines on succession with clear definition of transition processes so that the work of the committee is not affected – adopt staggered terms (tenures) 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.
**Reporting**

- The Audit Committee should provide regular and informative reporting to the Board.
- A statement should be included in the annual report which discloses, inter alia, the composition, role (including reference to the frequency of its meetings), function and activities of the Audit Committee.

**Communication**

- The Audit Committee should understand the roles and responsibilities of the parties involved in the financial reporting and audit process, and should have good and independent communications with the management and the internal auditors as well as the external auditors.

**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**

  - Continuous tailor-made trainings
  - Periodic performance evaluation
  - Civic / Stakeholders Education

  For AC members to enhance their effectiveness and update themselves on emerging issues in risk management and governance.

  Sensitize stakeholders on the role of Internal Audit so that it is seen as a value adding tool for corporate excellence.

  Through an independent evaluation process.
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 (OAG)**
  - 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
Thank You!
“You make mistakes. Mistakes don’t make you ”

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Thank You!!

Uphold Public Interest