

# **Relooking at the Effectiveness of Audit Committees in Public Sector**

**Annual Internal Audit Seminar  
2019**

**Presented by  
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# Presentation Layout



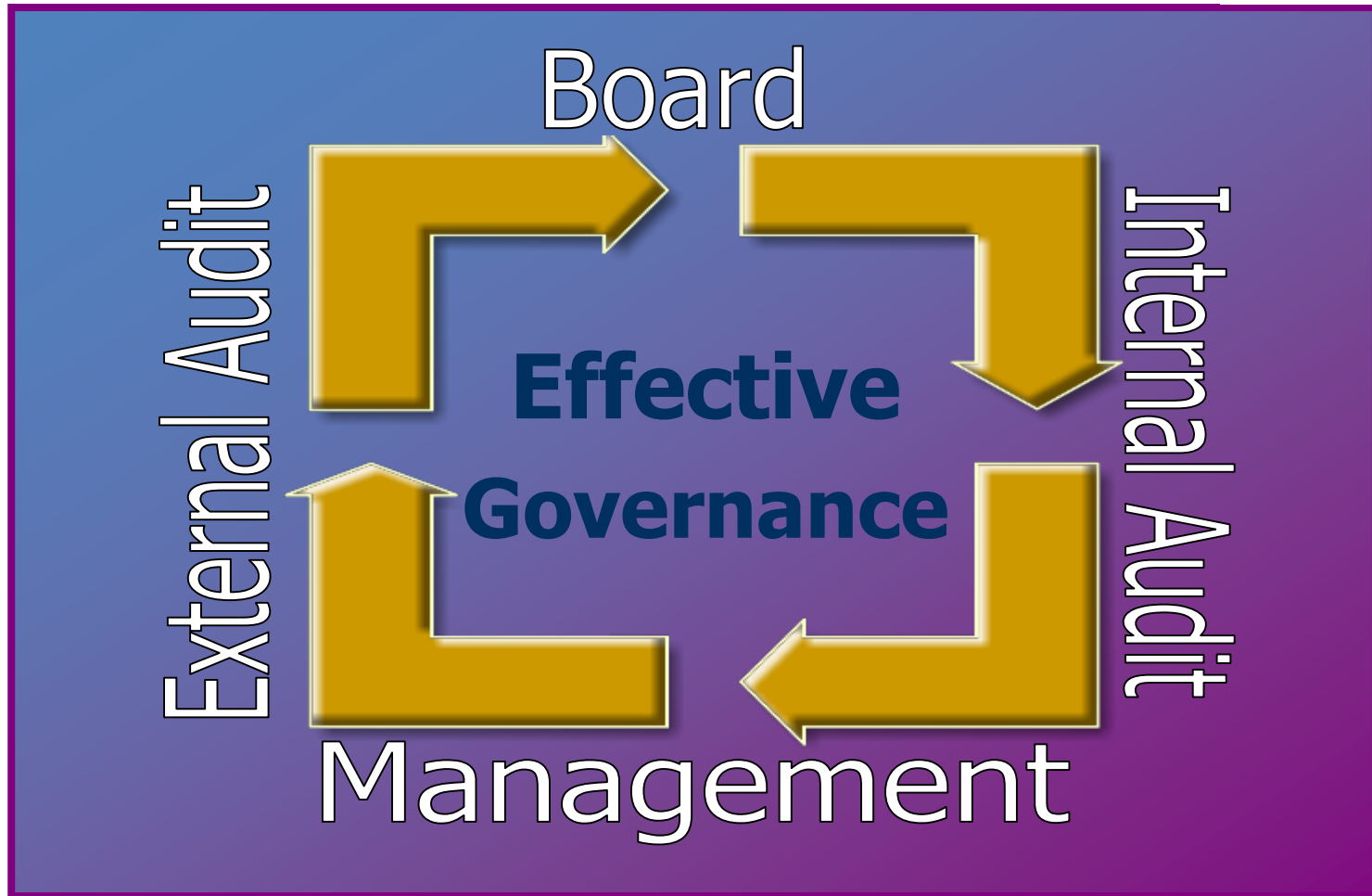
- 1) Background information
- 2) Understanding the role of Audit Committees
- 3) Understanding the role of Internal Audit function
- 4) Effectiveness of Audit Committees
- 5) Conclusion

# Background information



- ❖ Audit Committee is a part of **governance** of entity. Governance is the system by which organizations are directed and controlled.
- ❖ It includes rules and procedures for making decision on corporate affairs to ensure success while maintaining the right balance with stakeholder's interest.
- ❖ Audit Committee is one of the major pillars of governance system in organisations.

# The IIA Corporate Governance Model



# AUDIT COMMITTEE



# Understanding the Role of BAC



- ❖ “A Committee composed of **independent, non-executive** directors charged with oversight functions of ensuring responsible corporate **governance**, a reliable **financial reporting** process, an effective **internal control** structure, a credible **audit** function, an informed **whistle-blower** complaint process, and an appropriate **code of business ethics** with the purpose of creating long-term shareholder value while protecting the interests of **other stakeholders**.

# Legislative Requirement of BAC in the Public Sector



- ❖ Treasury Circular No. 16/2005- Establishment & Operationalization of Audit Committees in the Public Service.
- ❖ Kenya Gazette Notice Vol CXVII No 40 of 15<sup>th</sup> April 2016- Audit Committee Guidelines for National & County Governments.
- ❖ Mwongozo Code of Governance for State Corporations of 25<sup>th</sup> March 2015.
- ❖ PFM Act and Regulations

# Financial Reporting



- ❖ Audit committees should review financial statements quarterly, semi-annually and annually in most organizations.
- ❖ Ensuring that financial statements are understandable, transparent, and reliable.
- ❖ Review significant reporting issues and accounting policies
- ❖ Monitor and approve material related party transactions
- ❖ Audit committee members should know the right questions to ask to build their financial acumen.
- ❖ The Committee may institute a special investigation using an expert as deemed necessary.

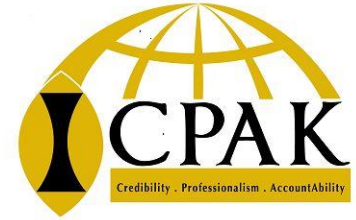


# Risk Management & Internal Control



- ❖ Ensuring the risk management process is comprehensive and ongoing, rather than partial and periodic.
- ❖ Ensure a comprehensive internal controls framework is in place
- ❖ Ensure presence of a *risk management policy document*.
- ❖ Helping achieve an organization wide commitment to strong and effective internal controls, emanating from the tone at the top.

# The AC have responsibility of overseeing the Risk Management process



- ❖ How Mgt identifies events that could put the company at risk and how it assess the likelihood and impact of identified risks
- ❖ How Mgt has tailored the process to meet the organisation specific needs- Top 10/significant strategic risks?
- ❖ Whether the process of risk management is continuous.
- ❖ If individuals are assigned primary responsibility for RM and has appropriate expertise, statute within the company and available time.

# The AC have responsibility of overseeing the Risk Management process



## Role of AC in Fraud Risk Management

- ❖ Assessing the tone at the top
- ❖ Overseeing company compliance programs
- ❖ Review the whistle-blower programs
  - ❖ *The whistleblowing must be reported periodically to the Audit Committee.*
  - ❖ *It is important to get a summary of all complaints received at least annually and disposition*
  - ❖ *Audit Committees should determine how often they wish to receive information.*

# Oversight Over Internal Audit



- ❖ Ensuring Internal Auditors' access to the Audit Committee & encouraging communication beyond scheduled committee meetings.
- ❖ Review and approve the Internal Audit Charter
- ❖ Review the integrity by way of qualification and relevant experience of internal audit, risk management and compliance personnel.
- ❖ Reviewing internal audit work plans, reports, and significant findings.
- ❖ Review and approve the proposed annual internal audit plan and ensure that it addresses key areas of risk within the entity.

# Oversight Over External Audit



- ❖ Audit Committees should ensure that External Auditors are independent as they issue an opinion on the accuracy of the entity's annual financial statements
- ❖ Establishing a direct reporting relationship with the external auditors.
- ❖ Ensure significant findings & recommendations of the EAs are received and discussed in a timely manner
- ❖ Review EAs proposed audit scope and approach
- ❖ Review other sections of the Annual report before its release and consider whether the information is understandable and consistent with members knowledge about the organization and its operations

# Regulatory, Compliance, and Ethical Matters



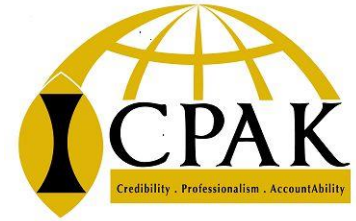
- ❖ Reviewing corporate policies relating to compliance with laws and regulations, ethics, conflicts of interest, gifts and the investigation of mis-conduct and fraud.
- ❖ Ensure new developments in the regulatory field are infused into the Organization's operations.
- ❖ Reviewing current and pending corporate governance related litigation or regulatory proceedings to which the organization is a party.
- ❖ Ensure code of conduct is in place and distributed to staff.
- ❖ Ensure whistleblowing arrangements are in place necessary.

# Maintaining & Measuring Effectiveness



- ❖ Audit committees need to be independent and must review management decisions with healthy scepticism.
- ❖ This process necessarily includes a close analysis of the way Organisations assess and manage risk to ensure effectiveness in achievement of both strategic and operational objectives.
- ❖ A process for assessing and reporting on not only financial controls, but also fraud prevention and detection program should be established

# Communication and Reporting



- ❖ Continually communicating with Senior Management regarding status, progress, and new developments, as well as problematic areas.
- ❖ The AC should balance their role as advisor and counsellor to Management with their fiduciary duty to monitor and oversee management is, to say the least, challenging for most audit committees.
- ❖ They must communicate openly and often with management, carefully review information received, and challenge management as appropriate.



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# Understanding the Role of IAF



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- ❖ Internal auditing is an
  - ✓ *independent*,
  - ✓ *objective assurance* and
  - ✓ *consulting activity* designed to *add value and improve an organization's operations*.
- ❖ It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

# Understanding the Role of IAF Cont..



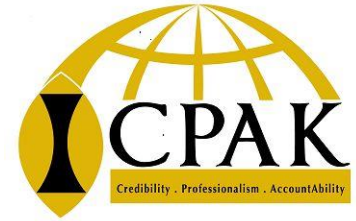
- ❖ Internal audit has evolved significantly in recent times, having moved from being seen as the bloodhound to watchdog to consultant to risk expert to, in more recent times, confidant to the leadership.
- ❖ As the profession matured, it became more refined and evolved to a much more strategic role.
- ❖ Internal audit is most effective when its resource level, competence, and structure are aligned with organizational strategy, and it follows IIA standards.

## Effectiveness of Audit Committee Cont...



- ❖ Internal audit is a vital tool of the audit committee ;
- ❖ The audit committee's tasks include reviewing the company's Internal controls, Governance and Risk Management systems.
- ❖ AC ensures that internal audit is free to work independently and objectively, i.e. free from the influence of those being audited.
- ❖ AC ensures that internal audit has the necessary resources and access to information to enable it to fulfil its mandate

# Effectiveness of Audit Committee Cont.



- ❖ AC balances their role as advisor and counsellor to management with their fiduciary duty to monitor and oversee management .
- ❖ They must communicate openly and often with management, carefully review information received, and challenge management as appropriate.
- ❖ AC must not, though, play the management role. Some refer to this oversight responsibility as “Noses in; fingers out.”
- ❖ To do this, it utilises the skills and expertise of the internal audit function.....



# Characteristics of effectiveness of IAF to support AC.



- ❖ Internal audit is pitched at an **appropriate senior level**.
- ❖ Internal audit department is **truly independent** with access to all information and persons within the organization.
- ❖ Internal audit function has the right **combination of skills**.
- ❖ The annual audit plan is aligned to the **performance objectives** and is **risk based** with enough focus on strategic risks.
- ❖ Internal audits are performed in accordance with the International **Standards**.
- ❖ Management is embracing internal audit it is taking the findings and **recommendations seriously**.
- ❖ Internal Auditors are members of IIA Kenya.
- ❖ The IAF is adequately resourced (funding).

# Effectiveness of Audit Committee Cont



## Limitations of assurance:

- ❖ Assurance can never be absolute - effective assurance seeks to conclude whether the audit evidence obtained is sufficient to reasonably conclude on the efficiency and effectiveness of an organization's risk, governance and internal control processes.
- ❖ It is important to manage the expectation gap, which sometimes exists due to a lack of understanding of the role of audit, making it clear and emphasizing the actual role, function, and limitations of internal audit.
- ❖ For example in respect of external audit, a clean audit opinion does not mean a 100% guarantee that the accounts will be correct - it is a statement that they are 'materially' correct.



# Effectiveness of Audit Committee

## Cont.



### Limitations of assurance:

- ❖ Internal audit's assurance should generally be based around whether the controls can be reasonably reliable upon to manage risks within appetite, which will vary by risk type.
- ❖ As internal auditors, have a professional responsibility to challenge the acceptance of residual risk which may be unacceptable to the organization and which appears to be beyond its risk appetite.
- ❖ It is important that all auditors make clear the risks and limitations of the work done, so that core stakeholders can engage in a debate about areas for greater focus based upon their needs.

# Assessment of the effectiveness of Audit Committee



- ❖ The audit committee should regularly assess its own effectiveness. In doing so, it should consider ascertaining whether the board is satisfied with the committee's performance and comparing the committee's activities to: any relevant guidelines or recommendations; leading practices in different sectors; any previously established effectiveness criteria; any previously identified shortcomings; and the terms of reference, the committee's aspirations and any objectives set by the board.
- ❖ An effective audit committee isn't simply one which checks that it is compliant with relevant.

# Assessment of the effectiveness of Audit Committee Cont...



- ❖ The precise method by which the audit committee chooses to assess its own effectiveness may differ from organization to organization.
- ❖ Self-assessment is common practice though audit committees should also consider requesting feedback on its performance from management, auditors and other relevant stakeholders.
- ❖ No single process will be appropriate for all organizations, but whatever process is used, the following guidelines are recommended:

# Assessment of the effectiveness of Audit Committee Cont...



- ❖ Independence: To be credible, the assessment process must be independent – and be seen to be independent – of executive influence or authority:
- ❖ Clearly established goals: Clear goals for the assessment should be established. If the assessment of the audit committee is to be more than a box ticking exercise.
- ❖ Tailoring evaluations to the organization.
- ❖ Ensuring confidentiality and trust.
- ❖ Regular review of the assessment process
- ❖ Feedback

# Criteria for assessing Effectiveness of Audit Committee



## 1. Process approach;

- ❖ Focusing largely on committee charters and composition (in terms of the independence and financial literacy of members).
- ❖ Specific areas to pay attention to when considering the effectiveness of the committee include;
  - ✓ appointments to the committee
  - ✓ the skills, experience and training of the committee members
  - ✓ participation of members at meetings
  - ✓ the frequency and attendance of meetings
  - ✓ the resources and support available to assist the committee in fulfilling its role
  - ✓ the relationship between the committee and its assurance providers
  - ✓ the relationship between the committee and senior management
  - ✓ the reporting relationship between the audit committee and the board

# Effectiveness of Audit Committee Criteria;



## 2. Enhanced approach

- ❖ In a more comprehensive process audit committees should be asking themselves how they can become more effective, by enhancing their oversight of core issues, as well as by ensuring that they are getting the right information and holding the right discussions.

### Leadership

- ❖ Strong leadership is essential. The chair plays a crucial role in driving the agenda for committee meetings, ensuring that all relevant issues are included – and that they all get discussed.

### Group dynamics

- ❖ The dynamics of the committee – the way in which its members interact with each other, with the chair and with the board, management and auditors – is a vital, and often overlooked, factor for review and development.

# ICPAK Survey on effectiveness of BAC in the Public Sector in 2015.



## 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.

# ICPAK Survey on effectiveness of BAC in the Public Sector in 2015 Cont..



The survey tool was administered to a selected sample of;

- ❖ 6 National Government Ministries.
- ❖ 50 State Agencies and
- ❖ 15 County Governments.



# ICPAK Survey on effectiveness of BAC in the Public Sector in 2015 Cont...



Attributes of effectiveness:

## ❖ INDIVIDUAL:

- ❖ Appropriate Technical Skills
- ❖ Experience,
- ❖ independence

## ❖ COMMITTEE Attributes:

- ❖ Appropriate Skills mix,
- ❖ size,
- ❖ communication,
- ❖ periodic assessment

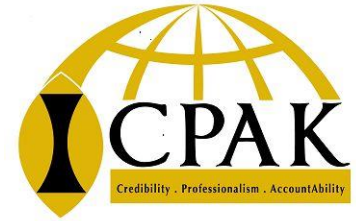
# ICPAK Survey on effectiveness of BAC in the Public Sector in 2015-Findings:



## 1. Establishment:

- ❖ Most of the entities sampled under the National Government category had established Audit Committees pursuant to the National Treasury circular. However, under the County Government
- ❖ category, with the exception of the Nairobi City County, all other counties sampled had not constituted Audit Committees at the time of the survey.

# ICPAK Survey on effectiveness of BAC in the Public Sector in 2015-Findings:



## 2. Independence:

- ❖ Ninety percent (90 %) of the sampled entities had their committees appointed by and within the respective Boards.
- ❖ (10%) having their Audit Committee established through the provision of the various statutes.
- ❖ None of the entities sampled instituted an independent selection process to identify candidates for appointment.

# ICPAK Survey on effectiveness of BAC in the Public Sector in 2015-Findings:



## 3. Size:

- ❖ The study established that the size of Audit Committees was between three (3) and seven (7)
- ❖ members. Forty eight percent (48%) of the respondents indicated a membership of five (5) in their committees.

# ICPAK Survey on effectiveness of BAC in the Pubic Sector in 2015-Findings:



## 4. Qualification :

- ❖ With regard to the minimum qualifications for appointment to serve in the Audit Committee, it was observed that most entities could not ascertain the minimum qualifications.
- ❖ *Sixty two percent (62%) of the respondents identified relevant capacity and skills as the greatest impediment to effectiveness of the Audit Committees.*

# ICPAK Survey on effectiveness of BAC in the Public Sector in 2015-Findings:



## 4. Succession Planning :

Only one third of the entities sampled had in place provisions for succession in the committees. Sixty seven percent (67%) of the respondents had no succession provisions given that the tenure for all members of Boards came to an end at the same time..

# ICPAK Survey on effectiveness of BAC in the Public Sector in 2015-Recommendations:



## 1. Appointments:

- ❖ 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.

# ICPAK Survey on effectiveness of BAC in the Public Sector in 2015-Recommendations:



## 2. Composition:

- ❖ We recommend compliance with clause 3.4 (2) (b) of Mwongozo.
- ❖ Appropriate mix of skills and expertise to be informed by the nature and the mandate of the respective entity.



# ICPAK Survey on effectiveness of BAC in the Public Sector in 2015-Recommendations:



## 3. Mandate:

Should be articulated by an approved Audit Charter to enable the AC to adequately monitor internal audit coverage to ensure that all key risk areas are considered.

# ICPAK Survey on effectiveness of BAC in the Public Sector in 2015-Recommendations:



## 4. Succession Planning:

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.

# ICPAK Survey on effectiveness of BAC in the Pubic Sector in 2015-Recommendations:












## 5. Funding of the Internal Audit:

The budget of audit function should be distinct from the executive budget. This shall contribute to the independence of the function.








# Audit Committee Effectiveness



	Item	How to achieve effectiveness
<b>1</b>	Establishment and terms of reference of the Audit Committee	 Have at least three independent non-executive directors.  Main roles and responsibilities be set out in written terms of reference (Committee Charter)  Appointment, rotation and renewal of terms in office be staggered.
<b>2</b>	Meetings	 At least 4 times in a year  Private meetings with the Head of Internal Audit  Inviting non-members to their meetings.
<b>3</b>	Resources	 Receive information and papers in a timely manner  Financial resources  Access to the CEO & Senior management








# Audit Committee Effectiveness



	Item	How to achieve effectiveness
4	Remuneration	 According to SRC*
5	Skills, Experience & training	 At least one member with relevant financial experience- <b>Hold Accountancy Qualification</b>  Induction programme for new members  Ongoing trainings in specialized areas
6	Relations with the Board	 Report of the Committee tabled before the full Board.  Renew Terms of Reference annually in consultation with the Board  Board review the effectiveness of the AC annually.

# Audit Committee Effectiveness



	Item	How to achieve effectiveness
7	Roles and responsibilities	 AC to review its role annually- financial reporting, risk management, communication, whistleblowing, oversight over internal and external audit.
8	Adequacy of Internal Audit Function	 Organizational Independence-Internal Audit position in the organization hierarchy be re-looked afresh  Adequate number of staff  Right skills
9	Risk Oversight	 Increase focus on risk culture and assessment  Periodically re-assess the list of top risks  Focus on IT milestones-IFMIS???

# Composition of Audit Committees



## ❖ Ministries and Departments

- ❖ 3 members external to the Ministry one of whom shall be the chair
- ❖ 1 National Treasury Representative

## ❖ Parliament

- ❖ 3 members from parliamentary service commission
- ❖ 1 National Treasury representative.

## ❖ Independent Commissions

- ❖ 2 members to be sourced competitively
- ❖ 1 Commissioner
- ❖ 1 National Treasury representative

# Composition of AC



## ❖ Government Owned Entities operating on Commercial Basis

Board Nominated 3 members, 1 to chair

1 National Treasury Nominee

## ❖ All Security Organs

4 members nominated by National Security Council

1 National Treasury representative

## ❖ Regulatory Agencies

3 members nominated by the Board

1 National Treasury Nominee

Research Institutions and Universities



## Take Home -Effective AC



1. Doing the right things:-spelt out in the charter.
2. Having then right people:-Skills sets
3. Having the necessary Industry experience.
4. Managing critical relationships; board, mgt, assurance providers etc.
5. Asking the right questions.
6. Doing the right things right-strong leadership.
7. Striving for continuous improvement;

# END



**Everyone loves a  
Watchdog .....until it  
barks!!**

**Richard Chambers, President IIA Global**