

WORKSHOP THE BOARD AUDIT COMMITTEE TRAINING

The Structure, Formation, Membership and Independence of Audit Committees

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Date : 18TH SEPTEMBER, 2019
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Subject



The Structure, Formation, Membership and Independence of Audit Committees

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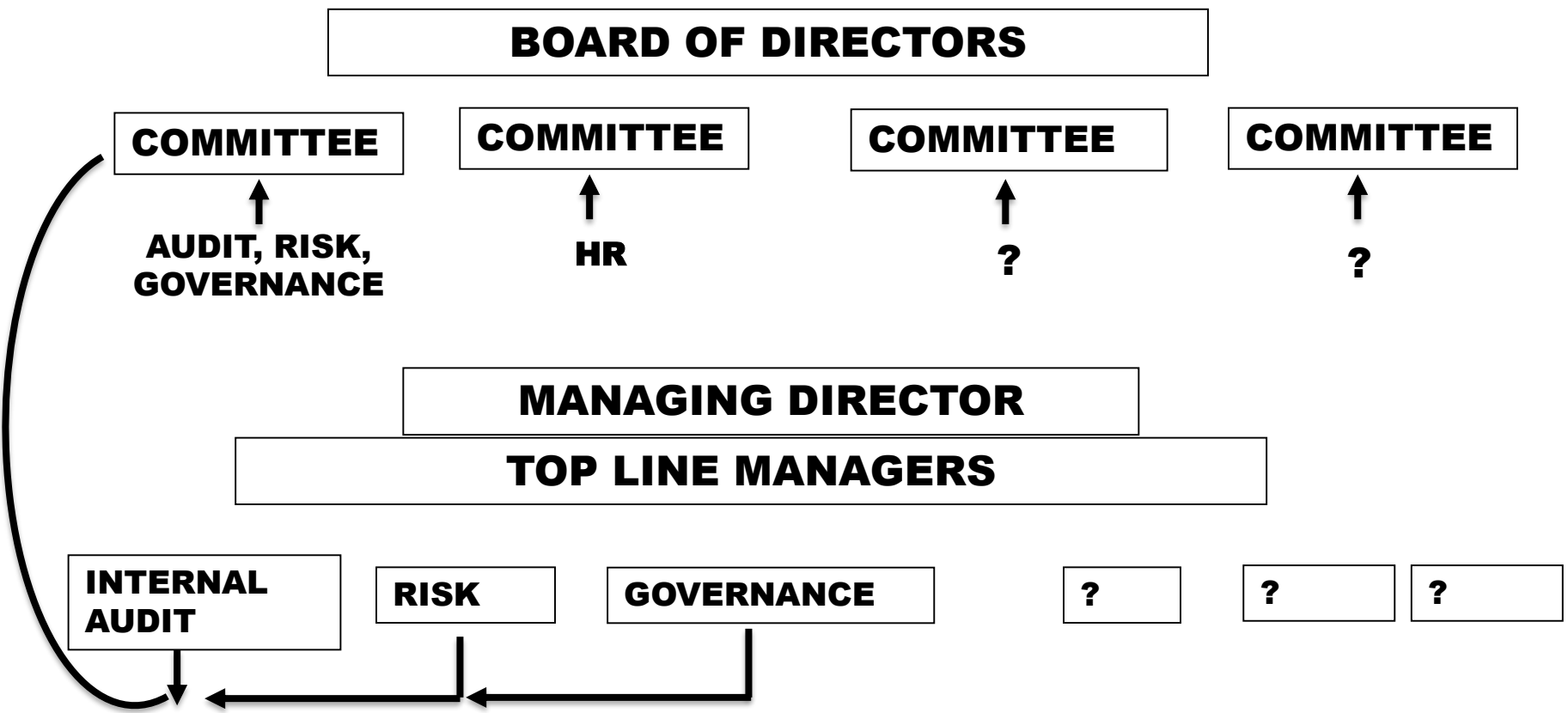
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The Structure, Formation, Membership and Independence



TYPICAL BOARD OF DIRECTORS ARRANGMENT



The Structure of Audit Committee



Key pillars in good corporate governance :-

- ❑ Board of Directors (Management);**
- ❑ Internal Audit;**
- ❑ Audit Committee and**
- ❑ External Auditor**

The audit committee's principle role is that of providing oversight over financial reporting, risk management, internal control, and governance processes.

The Structure of Audit Committee



Key Abilities – Structure should consider :-

- 1. Giving guidance on sound corporate governance practice.**
- 2. Overseeing matters related to financial management, appropriateness of the finance function and compliance with laws and other regulatory requirements.**
- 3. Monitoring / ensuring adequate and effective functioning of the system of internal controls.**

The Structure of Audit Committee



- 4. Monitoring the implementation of recommendations made by internal and external audit and other review activities**
- 5. Improving the quality of financial and performance reporting**
- 6. Facilitating an efficient audit process and improving risk management**

The Structure of Audit Committee



Audit Committee – Working Structure

- ❑ Chairperson (must be a financial expert)**
- ❑ At least three(3) independent directors determined by the Board of Directors**
- ❑ Other selected members as may be relevant and required to effectively perform in the specific organization**
- ❑ Sub – Committee(s) on Ad Hoc basis**

The Structure of Audit Committee



Key Tool

An Audit Committee Charter - a blueprint for its operation that addresses:

- Processes**
- Procedures**
- Responsibilities**

The Structure of Audit Committee



Meetings of Audit Committees

- **Should be held on a timely and regular basis;**
- **Meeting proceedings, recommendations and discussions should be formally minuted;**
- **A meeting agenda should be prepared and distributed in advance to enable adequate evaluation by committee members;**
- **A quorum should consist of a majority of members of the committee**
- **Strong chairing is vital in order that committee meetings remain focused.**

The Structure of Audit Committee



Techniques for running effective Audit Committee Meetings

- **Stakeholder engagement**
- **Leveraging the individual capability of committee members**
- **Annual meeting calendar**
- **Setting the forward agenda and individual meeting agendas**
- **Appointment, Appraisal, Removal and Positioning of the Internal Audit Function.**

The Structure of Audit Committee



Operation of the audit committee

- ❑ **Audit Committee shall have authority to delegate its authority to subcommittees, in each case to the extent permitted by applicable law / policy considerations.**
- ❑ **Audit Committee shall meet in executive session with the independent auditor, the chief internal auditor and management periodically**
- ❑ **Audit Committee meeting minutes of all its proceedings to be kept**

The Structure of Audit Committee



Operation of the audit committee

- ❑ **Audit Committee members to be furnished with copies of the minutes of each meeting and any action taken by unanimous consent.**
- ❑ **The Audit Committee is governed by the same rules regarding meetings, notice, waiver of notice, and quorum and voting requirements as are applicable to the Board of Directors of the company**

Formation of Audit Committee



Requirements for a newly formed audit committee / Public / Private Entities (as applicable)

The secretariat shall be required to produce:-

- ❑ **The Public Finance Management Act, 2012 Updated;**
- ❑ **The strategic plan of the entity;**
- ❑ **The service charter/audit committee charter;**
- ❑ **Performance contract;**
- ❑ **Budget and procurement plan;**

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Formation of Audit Committee



Requirements for a newly formed Audit Committee / Public / Private entities (as applicable)

The secretariat shall be required to produce:-

- ❑ Risk policy framework and risk profile;
- ❑ The Internal Audit Strategic plan;
- ❑ Internal Audit charter showing internal audit purpose, authority and responsibility for approval by the committee;
- ❑ Any other relevant legislations, guidelines or documents.

Formation of Audit Committee



Term of office of members

- ✓ **The initial term of appointment to the committee should be for a period of three years. The term of appointment can be extended**
- ✓ **The term should only be extended after the performance of the member has been reviewed.**
- ✓ **Appointment should be by individual letters of appointment clearly spelling out the effective date and the term for which the appointment will run;**

Formation of Audit Committees



A person shall cease to be a member of an audit committee if -

- ✓ **Convicted of a criminal offence and sentenced to a term of imprisonment of not less than six months;**
- ✓ **Regular absenteeism from consecutive meetings of the committees without leave;**
- ✓ **Resignation, in writing, from the audit committee;**
- ✓ **Expiry of term of office;**

Formation of Audit Committees



A person shall cease to be a member of an audit committee if -

- ✓ **Withdrawal of nomination to the audit committee by the nominating institution;**
- ✓ **Member becomes an employee or officer of the concerned entity;**
- ✓ **Member is discovered to have conflict of interest (loss of independence **seen or perceived**);**
- ✓ **The audit committee is disbanded**

Membership of Audit Committees



Board of Directors and Audit Committees must be:

- **Proactive**
- **Informed**
- **Investigative**
- **Accountable**

NOT JUA KALI RUN OF THE MILL PERSONS!!

Membership of Audit Committee – factors to consider



- ❑ **The complexity of the organization e.g. decentralized versus centralized;**
- ❑ **The size of the organization;**
- ❑ **The extent of responsibilities and expertise assigned to the Audit Committee;**
- ❑ **The size of the Board of Directors and number of board committees;**

Membership of Audit Committee - factors to consider cont...



- ❑ The assignment of members to other board committees and external commitments;**
- ❑ Roles and responsibilities of the audit committee as outlined in the charter;**
- ❑ Has appropriate skills mix.**

Independence of Audit Committees



The Board assesses the integrity and independence of an audit committee candidate

Factors to consider in determining independence

Whether the individual has:-

- a. been an employee of the organization in past;**
- b. had material business relationship with the organization either directly or indirectly in the past;**

Independence of Audit Committees



Factors to consider in determining independence

Whether the individual has:-

- a. **close family ties with any of the organization's advisers, directors or senior employees;**

- b. **cross directorships or has significant links with other directors through involvement in other organizations;**

Independence of Audit Committees



Attributes of an Audit Committee Member:-

- ✓ **Integrity and high ethical standards**
- ✓ **Strong interpersonal skills**
- ✓ **Sound judgment**
- ✓ **The ability and willingness to challenge and probe**
- ✓ **Time and personal commitment to perform effectively**

Independence of Audit Committees



Boundary Management

1. Audit Committee and Management

- ✓ **Be skillful at communicating with management**
- ✓ **Be ready to challenge and ask probing questions about the entity's risk management**
- ✓ **The audit committee should determine whether management's response to address the audit findings is satisfactory, cost-effective and in line with the entities risk management framework**

Independence of Audit Committees



Boundary Management

2. Audit Committee and the Auditor

- ❑ **Have a strong and candid relationship allowing the audit committee to utilize the technical knowledge and experience of the auditor in assessing quality of the entity's internal control systems and financial reports.**
- ❑ **Audit Committee facilitates communication and effective relationship between internal auditor and external auditor**

Independence of Audit Committees



THREATS TO INDEPENDENCE

RISK OF FILTERING & SLOW DOWN OF CRITICAL INFORMATION

From Line Manager(s) – Audit, Risk and Governance Committee (ARGC) before report(s) reach the Audit, Risk and Governance Board / Government / County Committee.

a) Line Managers themselves – inefficiency, lack of capacity to process and organize information plus answers to issues arising, from their work, familiarity, corruption, etc.

Independence of Audit Committees



THREATS TO INDEPENDENCE

RISK OF FILTERING & SLOW DOWN OF CRITICAL INFORMATION

a) Plain cases of **controlled flow** – suppressing and filtering of information at fellow management levels, at Managing Director level and at Audit, Risk and Governance Committee level before presentation to the Board / Highest level in your entity

➤ **HOW OFTEN DO YOU MEET AS ARGCG? ADEQUATE?**

Independence of Audit Committees



BEING AWARE !!

STANDARD EXTERNAL AUDITORS STATEMENT - EXTRACT

- **The risk of not detecting a material misstatement resulting from fraud, is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal controls.**
- **We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal controls that we identify during our audit.**

Assessment Mechanisms of Audit Committee Performance



i. Annual Self-Assessment

ii. Management feedback

iii. Use of an External Facilitator

iv. Use of External Evaluation Committees

FAMILIAR ?!

KIJANA, BAHASHA YETU IWE TAYAAARI NINA

HARAKA !!!! 🤪 🤪 🤪

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Some Challenges Audit Committees Face



- i. Unrealistic expectations**
- ii. Lack of effective communication to bridge the expectations gap (auditors, management and Board)**
- iii. Conflicts of interest**
- iv. Keeping the flow with new members quality of information**
- v. Knowledge of auditing standards**

References



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- ❑ **Office of the Auditor General reports. *County Governments Reports, 2018. Retrieved from (<https://www.oagkenya.go.ke>)***

Questions / Comments

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