AUDIT COMMITTEES IN THE PUBLIC SECTOR

A SURVEY REPORT ON THE ESTABLISHMENT AND EFFECTIVENESS OF AUDIT COMMITEES IN KENYA

Published by:

ICPAK
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The Institute of Certified Public Accountants of Kenya
CPA Centre, Thika Road
P. O. Box 59963 - 00200 Nairobi Kenya
Telephone : +254 (020) 2304226, 2304227
Fax : +254 (020) 8562206
Mobile : +254 727 531006 / 733 856262 /
721 469796 / 721 469169
Email: icpak@icpak.com
Website: www.icpak.com

ISBN No. 978-9966-1808-1-0

A SURVEY REPORT ON THE EFFECTIVENESS OF AUDIT COMMITTEES IN KENYA'S PUBLIC SECTOR

PREFACE

The Institute of Certified Public Accountants of Kenya (ICPAK) takes cognizance of the important role the Internal Audit Function and the Audit Committees play in enhancing systems of governance in all sectors of the economy. In conjunction with the Office of the Internal Auditor General, the Institute as the statutory body of accountants with the mandate to develop and regulate the accountancy profession in Kenya, conducted a survey on the effectiveness of Audit Committees in the public sector in light of the Treasury Circular No. 16/2005. The Circular required the establishment of Audit Committees with terms of reference consistent with generally accepted corporate governance practices.

The survey sought to assess among other objectives, the uptake and performance of Audit Committees as stipulated in the National Treasury circular cited above which, by the time of the survey, had been in existence for a decade. It also, took note of developments in the area of Internal Audit in order to advise further implementation of Audit Committees in the public sector especially at a time like this when the County Governments are commemorating two years since their establishment. It benchmarked the practice in Kenya with International best practices and makes recommendations to enhance the performance of Audit Committees in the country.

We are of the opinion that the governance situation in the country could get better with the strengthening of Audit Committees to effectively provide prompt internal assurance reports on implementation of policies within the Public Sector. The Institute as a key partner in this process would thus seek to collaborate with the National and County Governments and their related agencies to ensure the establishment of effective Audit Committees and better governance systems, a feat that can be achieved through continuous capacity building initiatives.

FCPA Fernandes Barasa

Chairman- ICPAK

ACKNOWLEDGMENT

The Institute acknowledges the selfless commitment of numerous individuals who dedicated time, expertise and diverse resources to see the completion of this report. We are profoundly grateful for to the partnership of The National Treasury through the Office of the Internal Auditor General in the development of the tool, analysis of the report and insightful validation of the report. To the team led by CS Henry Rotich, PS Dr. Kamau Thugge, CPA Benard Ndung'u, Mr. Alfayo Mogaka, Mr. Daniel Nyaga and Mr. Patrick Owiti; thank you for the support.

We acknowledge the significant contributions from all the respondents in various Ministries, Departments and Agencies and the Institute's Committees and Work-streams for their review and guidance.

We further appreciate the tireless professional guidance and support from the Institute's Public Policy and Governance Committee and the Devolution Work stream.

We are indebted to the gallant efforts, dedication and team spirit of the secretariat through the able leadership of CPA Dr. Patrick Ngumi (PhD) - Chief Executive (ICPAK), the Public Policy and Governance team - CPA Fredrick Riaga, CPA Georgina Malombe, Hillary Onami, Elias Wakhisi and Naomi Rono for gathering, collating and analyzing the data from the survey and making this report a great success. This was done with the support of the Internal Audit staff under the leadership of CPA Patrick Obura.

This report would not have been possible without the efforts of a large number of stakeholders from across the country including; Institute members, committees, branch officials, the editor, designers and printers to mention but a few, who in one way or another contributed in ways and means to the success of this report. Receive our sincere gratitude.

Thank you!

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ABBREVIATIONS

AC	Audit Committee
BRC	Blue Ribbon Committee
CEC	County Executive Committee
CICA	Canadian Institute of Chartered Accountants
CMA	Capital Markets Authority
EU	European Union
IFRS	International Financial Reporting Standards
IIA	Institute of Internal Auditors – Global
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
ISC	Inspectorate of State Corporations
MFA	Municipal Finance Act
NYSE	New York Stock Exchange
PAC	Public Accounts Committee
PFMA	Public Finance Management Act
PFM	Public Finance Management
PIC	Public Investments Committee
PSCGT	Public Sector Corporate Governance Trust
SEC	Securities and Exchange Commission
TSE	Toronto Stock Exchange
UK	United Kingdom
USA	United States of America

EXECUTIVE SUMMARY

Introduction

The demand for accountability and efficient use of resources in the public sector continues to be a subject of discussion by scholars, donors, the civil society and the public at large. Audit Committees in the public sector are tailored to enhance accountability in the use of public resources and provide independent advice and assurance on the organization's strategy, performance and compliance to the different statutes. Audit Committees in Kenya were granted a lifeline with the issuance of Treasury Circular No. 16/2005. Against this backdrop, the Institute in conjunction with the Office of the Internal Auditor General undertook a study to assess the implementation of the circular and ascertain the effectiveness of Audit Committees in the public sector.

The study reviewed the legal and regulatory framework in Kenya on the establishment of Audit Committees and benchmarked the same on international best practices. The study was anchored on the statutory role of the Institute in advising on matters relating to accountability in all sectors of the economy.

Methodology

The study adopted a triangulated approach to research. The methodology applied both qualitative and quantitative methods to gather data.

The survey tool was administered to a selected sample of 6 National Government Ministries. 50 State Agencies and 15 County Governments selected through stratified, random and purposive sampling techniques to achieve a desired representation from the various sub-groups in the population.

An extensive desk review was conducted to ascertain the gaps and inform the objects of the study. The desk-top review analyzed various reports from a wide range of government departments and entities, independent commissions, scholars and organizations on the respective subject matter.

Summary of Key Findings and Recommendations

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.

It was noted that most of the Ministerial Audit Committees became redundant with the restructuring of government which saw the number of Ministries reduced from 42 to 19. It was observed that the reorganization did not address itself to the structural changes around the committees. The findings of the study demonstrated that the reorganization affected the operations of the committees and also impaired and hindered their effectiveness.

Ninety percent (90 %) of the sampled entities had their committees appointed by and within the respective Boards with ten percent (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.

The Institute recommends that the National Treasury should through Public Sector Accounting Standards Board (PSASB), fast-track on issuance of guidelines on establishment, composition and minimum qualifications for persons to be appointed to Audit Committees of public sector institutions. The appointment of Audit Committee members should also be done competitively.

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. 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. This has however been addressed by the Mwongozo Code that prescribes minimum qualifications for Board appointments. We propose adherence to the provisions of the Code. In addition, action needs to be taken to establish a membership with appropriate mix of skills and expertise in line with the nature and mandate of the respective entity.

On 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. For seamless transition, we recommend staggered tenures, and that the process to replace retiring members should be initiated long before their retirement.

Sixty two percent (62%) of the respondents identified relevant capacity and skills as the greatest impediment to effectiveness of the Audit Committees. Continuous tailor-made trainings should be conducted to the members of Audit Committees to enhance their effectiveness and sensitize them on emerging issues in risk management and governance.

The study also observed that the process to re-organize the Ministerial Audit Committees had not proceeded in tandem with the overall reorganization of the Ministries rendering the Committees redundant.

At the County level, respondents indicated that County Governments had not constituted Audit Committees due to lack of a guiding framework. This notwithstanding, Nairobi City County reported that it had established its Audit Committee on the basis of the draft Public Finance Management Regulations 2014. We propose that the enactment of the Public Finance Management Regulations 2015 for both County and National Government, be expedited to operationalize Audit Committees at the two levels of government.

Developing countries like Kenya need to facilitate effective organization and operation of Audit Committees in all levels of Government Ministries, Departments and Agencies in order to achieve their development agenda. This report affirms the need and points out the key areas for improvement in order to strengthen the functioning of Audit Committees. The report has made recommendations that if implemented will strengthen and enhance the effectiveness of Audit Committees in the public sector.

INTRODUCTION

The global financial crisis that began in mid 2007, the spate of corporate scandals and failures, coupled with globalization and expansion of financial markets have created greater demand for enhanced regulation in public financial management to curb inefficiency, financial impropriety and mismanagement of resources in the public sector.

Audit has consequently been viewed as an integral part in enhancing accountability and general corporate performance of the public sector. Audit has evolved in many countries to take a more comprehensive view of government operations. As such, key reforms have been undertaken to modernize the Audit and more specifically, the Internal Audit function ensure that control mechanisms go beyond legal and regulatory compliance.

Kenya has over the years instituted internal controls and measures to enhance accountability in the management of public resources. The internal audit system was reintroduced in 1984 after its abolition in 1962. In 1985, Kenya established the Office of the Controller and Auditor General to tighten the control of financial resources and enhance accountability in statutory boards, commissions and bodies.

Similarly, the Government sought to enhance investigative and supervisory powers of the Inspectorate of State Corporations Advisory Committee by passing the State Corporations Act in 1986. However, continued poor governance in public institutions led to resource loss occasioning IMF's suspension of financial aid to Kenya in July 1997. The IMF's suspension sparked the withdrawal by other donors, resulting in increased interest rates and a pullout of foreign investments in Kenya.

In the last two decades, the country has undertaken reforms to enhance the effectiveness of the Audit Function. The National Treasury circular AG/3/080/6/(61) of 8th August 2000 represented the first initiative towards establishment of Ministerial Audit Committees. However, the performance of Audit Committees in such ministries was not effective due to lack of independence and objectivity. In order to address the issues of oversight, governance, transparency and accountability in management of public resources, the government issued the Treasury No. 16/2005 and No. 18/2005 dated 4th October 2005 and 12th October 2005 respectively.

In quest for stronger accountability environment, Kenya continues to develop strong accounting and auditing systems. For example, it adopted an internationally recognized reporting framework. In 1999 it adopted the International Financial Reporting Standards (IFRSs) and International Standards on Auditing (ISAs) for the Private Sector and of late, the International Public Sector Accounting Standards (IPSASs) in 2014. The Country restructured the public sector and adopted performance contracting, instituted vetting of State Officers, established Independent Commissions and Offices and other reforms that continue to strengthen corporate governance.

In the reform platform, Audit Committees play a pivotal role in enhancing the corporate governance in the public sector by providing an independent oversight over the institution's governance, including the organization's systems of internal controls. However, how the committee fulfils that mandate varies according to the clarity of the committee's mission, the abilities of the committee members, and the tone set at the top of the governance structure. An Audit Committee that operates effectively is a key feature in a strong corporate governance culture, and can bring significant benefits to the entity.

This survey therefore comes in the midst of this reform process to take stock of the entrenchment of corporate governance in Kenya and in particular, the performance of Audit Committees in the public sector.

1.1 STUDY OBJECTIVES

In fulfilling its statutory mandate to advice on matters related to accountability, the Institute undertook a situational analysis through this study to assess the effectiveness of Audit Committees in the public sector in Kenya.

The study focused on assessing the role, composition, governance and independence of Audit Committees and evaluating their effectiveness in providing oversight on financial reporting and monitoring the audit Function in the public sector in Kenya.

Specific objectives of the study were to:

1. Establish the level of compliance with the Treasury Circular No. 16 of 2005
2. Examine the composition, level of independence and effectiveness of the Audit Committee in the discharge of their mandate.
3. Establish the challenges hindering effective performance of the committees in the public sector
4. Propose recommendations to strengthen Audit Committees in the public sector entities

Guided by the Constitution of Kenya 2010, Public Finance Management Act 2012, and to some extent the Draft PFM Regulations 2015, the study reviewed the legal and regulatory framework on the establishment of Audit Committees and benchmarked the same against international best practices. The Institute seeks to utilize the findings of this study to strengthen the performance of the Audit Committees in the public sector.

1.2 Justification for the Study

The Auditor General in the last two audit cycles reported glaring discrepancies in the financial management systems of Government. The findings alluded to weaknesses in the public sector accountability systems by highlighting corruption by way of payments that are not supported by invoices and receipts from service providers, absence or lack of updated asset registers, weak risk management policies as required by the Public Finance Management Act, weak debt recovery systems and flouting of procurement regulations among others. These ought to have been picked and dealt with if the Audit Committees were effective enough.

The survey was further premised on the statutory role of the Institute in advising on matters relating to accountability in all sectors of the economy.

2. BACKGROUND

This section provides the historical overview of the establishment of Audit Committees in the public sector globally with specific reference to evolution of the practice in Kenya.

2.1 The Evolution of Audit Committees in The World

A significant recent corporate governance development in the private sector has been the use of Audit Committees to provide strengthened oversight of the financial and ethical integrity of public companies.

It is clear that there is a raging debate on the effectiveness of Audit Committees (AC's) as a governance tool; its emergence in the public sector however, has been highly influenced by events in private sector corporations. During the last two decades Audit Committees have emerged as key mechanisms in strengthening corporate governance internationally. They were initially applied as non-mandatory instruments to enhance accountability. Nonetheless, in recent years, numerous professional and regulatory institutions in many countries have recommended the universal adoption of AC's and advocated for the expansion of their role.

Some of the key reports and committees that informed the move to adopt ACs are; the Sarbanes-Oxley Act of 2002 in the US, the report of the Australian Treasury of 2002, the recommendations of the Smith Committee of 2003 and the Higgs review of 2003 in the UK. The move was also informed by the King reports on Corporate Governance in South Africa-King I (1994), King II (2002) and King III (2009); all of which made strong recommendations on the need to institutionalize ACs.

However, the incidence of high profile corporate failures, particularly since 2000 highlighted grave weaknesses in corporate governance structures exemplified by fraud, poor accounting and the failure of internal controls. This provided anecdotal evidence supporting perceptions on the inadequacy of ACs in monitoring risk and controls in corporations and their effective contribution to governance[1].

Notwithstanding, the oversight role of ACs has been essential to effective governance leading to their adoption in the public sector by many governments across the globe. In some

[1]See Sommer, 1991; Wolnizer, 1995; Lee, 2001; Turner (2001)

governments, Audit Committees are formed as subcommittees of the legislative branch or Board of Directors. Other governments may form ACs of members of the public who are selected by the legislative branch and/or the executive branch. Some government entities also form ACs comprising of Ministers or managers outside oversight agencies, members of the management hierarchy under audit, or a combination. However, to understand the structure and role of AC's, it is important to appreciate the historical evolution of this oversight body in a global context.

2.1.1 Evolution of Audit Committees in the USA

In the United States, the Securities and Exchange Commission (SEC) endorsed the concept of the Audit Committee in the 1940's informed by the investigation of McKesson & Robbins. AC's thereafter gained widespread acceptance between the 1960s and 1970s as the appropriate instrument for financial oversight. An important contributor to this was the American Institute of Certified Public Accountants (AICPA), who issued a policy statement in 1967 encouraging public companies to establish AC's composed entirely of a membership outside the directors.

The Congressional debate of 1976, regarding legislation that would require public companies to form independent Audit Committees further catalyzed the endorsement of ACs as a means of oversight. Despite failing to pass this Bill, Congress advocated for the voluntary formation of AC's through the enactment of the Foreign Corrupt Practices Act which introduced reforms in internal accounting controls, requiring the design of a mechanism to detect and report illegal payments to the Board of Directors. This influenced the New York Stock Exchange (NYSE) in 1978, which then required all listed firms to have Audit Committees. This was further strengthened in 1998, when the Securities Exchange Commission highlighted concerns regarding financial reporting by public companies, and thereafter called for the strengthening of Audit Committees.

In response to the NYSE directive, a Blue Ribbon Committee (BRC) was established to recommend ways to improve the committee's oversight process. Based on the 1999 BRC report recommendations, listed companies were required to disclose whether their board had adopted a written Audit Committee Charter and whether the committee members were "independent" as defined in the applicable listing standards. However, four years after the SEC's call for reform, there were a series of accounting scandals that resulted in a swift congressional action that led to the enactment of Sarbanes-Oxley Act of 2002, which has now emerged as the significant milestone in the establishment of AC's. This codified under federal law, the requirement for public companies to establish an Audit Committee consisting solely of independent members. Though this has been the basis of most corporate governance reforms in the private sector, the emergence and use of Audit Committees in the US Public sector is significantly influenced by these events.

2.1.2 Evolution of Audit Committees in the UK

In the United Kingdom, there were no statutory requirements for the establishment of Audit Committees in the public sector. However, in May 1991, few institutions including the Financial Reporting Council, the London Stock Exchange, and the accounting profession (Institute of Chartered Accountants of Scotland) established the Committee on the Financial Aspects of Corporate Governance better known as the Cadbury Committee. The committee sought to address the fluidity of accounting standards, the absence of a clear framework for ensuring that directors kept under review the controls in their businesses, and competitive pressures both on companies and auditors which made it difficult for auditors to stand up to demanding boards.

The Cadbury Committee Report of 1992 published a Code of Best Practice which largely reflected perceived best practice at the time and strongly recommended that all companies should establish and maintain Audit Committees as a means of raising the standards of corporate governance. They further highlighted its importance in strengthening the credibility of financial reporting, with particular emphasis on the independence of the Internal Audit Function.

Subsequent reports including the Greenbury Report (1995), the Hampel Report (1998), the 1998 Combined Code, the Turnbull Report (1999), Directors' Remuneration Report Regulations (2002), the Higgs Report (2003) and the Smith Report (2003) among other developments were issued to enhance corporate governance in the UK. In 2008, the 8th EU Company Law Directive further provided a legal requirement for quoted companies within the European Union to establish Audit Committees.

2.1.3 Audit Committees in Canada

In Canada, efforts to establish Audit Committees culminated with the issuance of a Multilateral Instrument ('MI 52- 110') by the Canadian Securities Administrators in 2004. This instrument outlined the requirements for the establishment and operation of Audit Committees of reporting issuers. The issuance of the MI 52-110, occurred following several efforts to strengthen governance mechanisms in public listed companies. This included efforts by the Toronto Stock Exchange Committee, which provided guidelines on the basic structure and mandate of an Audit Committee through issuance of the Dey Report in 1994. Although the report just issued guidelines, the TSE required entities listed on the TSE to disclose their own corporate governance policies and compare them to the Dey Report.

As a five-year follow up to the Dey report, in November 1999, the Toronto Stock Exchange issued further guidance on corporate governance disclosure. All TSE listed entities were thereafter required to specifically address each of the 14 recommended governance guidelines in their annual report and disclosure of the entity's system of corporate governance relative to each guideline. Thereafter, a Joint Committee on Corporate Governance was established in 2001 that involved the Canadian Institute of Chartered Accountants ("CICA"), the Canadian Venture Exchange ("CDNX") and the Toronto Stock Exchange ("TSE") to evaluate the corporate governance structure with a view to making recommendations in their report "Beyond Compliance: Building a Governance Culture", aimed at strengthening the financial reporting system. They emphasized the value of Audit Committees, recommending stronger responsibilities. The report included recommendations on the financial literacy of committee members, the composition of the committee and the necessity for a formal written mandate for the committee.

2.1.4 Audit Committees in South Africa

In South Africa, several legislations supported the establishment of public sector Audit Committees. The Public Finance Management Act (Act No. 1 of 1999) (PFMA) made it compulsory for all national or provincial public sector organizations to establish an (or share an established) audit committee. Prior to its enactment, the Municipal Finance Management Act (Act No. 56 of 2003) (MFMA), applicable to local government, mandated the entities to establish Audit Committees to provide oversight on the Audit Function at the local level. The act also prescribed the establishment of a single Audit Committee to be shared among a district municipality and the local municipalities within the district and also among a municipality and municipal entities under its sole control.

The Companies Act (Act No. 71 of 2008) also outlined the requirements for corporate governance of public entities registered as companies, which included the establishment of Audit Committees. This was further strengthened by the King Report on Governance for South Africa (King I) of 1994 which recommended that Audit Committees should be established for all companies. The King Report focused on the independence of the Audit Committee and indicated the value of a strong Internal Audit Function.

King II of 2002 emphasized the fact that the Audit Committee is an important committee of the board with increased responsibility in its oversight of the control and risk management systems. The appointment of an Audit Committee was only a recommendation of the King II Report, however, current statutory requirements in the Corporate Laws Amendment Act (2006) requires that companies that are able to offer their shares to the public (widely held companies), including but not limited to public listed companies, will be obliged to appoint Audit Committees.

2.2 International Regulatory Framework

In recent times, there has been progress in reaching consensus on what audit standards, governments and government agencies should apply. It is imperative to note that both the International Organization of Supreme Audit Institutions (INTOSAI) and the Institute of Internal Auditors (IIA) have issued standards to guide auditing in the public sector. In the case of internal audit and Audit Committees, guidelines must be in conformance with the Institute of Internal Auditors'-International *Standards for the Professional Practice of Internal Auditing*.

The IIA Standard 1110 states that the Chief Audit Executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The Chief Audit Executive must confirm to the board, at least annually, the organizational independence of the internal audit activity. In addition, IIA Standard 2060 provides that direct periodic reporting to the senior management and the board on the internal audit activity's purpose, authority, responsibility, and performance is relative to its plan.

It is on the basis of these provisions that governments and public sector entities establish Audit Committees to help in enhancing accountability in the management of public resources.

2.3 The Establishment of Audit Committees in Kenya

As part of public sector reforms and in a bid to enhance corporate governance in the public sector, the government of Kenya prescribed that the Ministries, Departments and Agencies of the central government and the local authorities establish Audit Committees in the year 2000, through the Treasury Circular No.AG/3/080/6/ (61) of 2000. The Audit Committees were meant to improve the level of fiscal probity in Government. The circular provided the mandate and the guidelines to be followed when establishing Ministerial Audit Committees.

During the same period, the Private Sector Corporate Governance Trust (PSCGT) in conjunction with the Commonwealth Association for Corporate Governance produced a sample code of best practice for corporate governance in June 2000. The key recommendations in the PSCGT code was that companies establish Audit Committees composed of independent non-executive directors to keep under review the scope and results of audit, its effectiveness and the independence and objectivity of the auditors.

This process gained momentum in 2002 when the Capital Markets Authority (CMA) issued guidelines on corporate governance practices for publicly listed companies. One of the guidelines requires the board to establish an Audit Committee with at least three independent and Non-Executive Directors.

In the CMA guidelines, the Board was required to disclose in its annual report whether or not it had an Audit Committee and the mandate of such committee. The guidelines gave very specific attributes of members to the Audit Committees[2]:

- Broad business knowledge relevant to the Company's business;
- Keen awareness of the interest of the investing public and familiarity with the basic accounting principles;
- Objectivity in carrying out their mandate and no conflict of interest.

The guidelines also prescribed that the Committee shall have adequate resources to discharge its duties.

[2] *Capital Market Authority guidelines 2002*

Treasury Circular No. 16 of 2005 and the Establishment of Audit Committees

There were concerns regarding the adequacy of the guidelines contained in the Treasury Circular of 2000 (See Annex.., particularly the appointment and composition of the membership to the ministerial Audit Committees.

These concerns led to the issuance of the Treasury Circular Number 16 of 2005 to enhance oversight, governance transparency and accountability in the public sector. This marked a watershed moment in the evolution of the internal audit function in Kenya.

This Circular obligated the Audit Committees with the responsibility for independent in-depth review of the framework on internal control and internal audit process. This was to be applied to all Accounting Officers, Chief Executive Officers of state corporations and clerks and to councils who were required to establish Audit Committees and ensure that they are fully functional. The Audit Committee shall have non-executive status and serve in an advisory capacity to the relevant Accounting Officer.

The Circular mandated Audit Committees to perform the following functions:

(i) Assist the Accounting Officer/Chief Executive Officer in enhancing internal controls in order to improve efficiency, transparency and accountability;

(ii) Review audit issues raised by both internal and external auditors;

(iii) Resolve unsettled and unimplemented Public Accounts and Public Investment Committees'(PAC/PIC) recommendations;

(iv) Enhance communication between management, internal and external audit and fostering effective internal audit function.

Equally, the duties and responsibilities of Audit Committees, as contained in the circular, cover three broad areas relating to compliance, internal controls, financial reporting and governance. Specifically, they include:

(i) Evaluating adequacy of management procedures with regard to issues relating to risk management, control and governance;

(ii) Reviewing and approving the audit charter where applicable and the internal audit work plans;

(iii) Reviewing the internal and external audit findings and recommendations and proposing corrective and preventive action where necessary;

(iv) Reviewing the systems established to ensure sound public financial management and internal controls, as well as compliance with policies, laws, regulations, procedures, plans and ethics.

(v) Initiating special audit/investigation on any allegations, concerns and complaints regarding corruption, lack of accountability and transparency in consultation with the Accounting Officer/Chief Executive.

Treasury Circular No. 18/ 2005

The National Treasury further issued Circular No. 18/2005 to guide the management action on Internal Audit reports. They based this on Matrix of Corrective Measures (MCM) agreed upon by the Ministry of Finance and the European Commission following an audit by independent auditors on advanced budget support that identified lack of action on internal audit reports as one of the factors contributing to the ineffectiveness of the internal audit function.

The circular proposed that:

i. All Accounting Officers be required to respond to internal audit reports within two (2) weeks and propose conclusive action to deal with the matters raised.

ii. Where the matters raised in the reports required further review/investigations exceeding two weeks, the Accounting Officer was required to acknowledge receipt of the report committing him/her to take action on issues raised within a specified period and

iii. Material issues raised by audit reports be brought to the attention of audit committee clearly indicating status and actions to be taken.

CBK Prudential Guidelines 2006

The Central Bank Prudential Guidelines 2006 required the Board of financial institutions to establish an Audit Committee to review the financial condition of the banking institution, its internal controls, performance and findings of the internal auditors, and to recommend appropriate remedial action regularly; preferably at least once in three months.

The Guidelines prescribed that the Audit Committee members elect a Chairman among them who is an independent Non-Executive Director and that the Chairman should not be the chairperson of the Board but could be invited to attend meetings as necessary by the chairperson of that committee. It also expressly prescribed that the Chief Executive Officer should not be a member of the Audit Committee, but may attend by invitation for consultation only.

Audit Committees and the Internal Audit Function in Post 2010 Kenya

The promulgation of the Constitution 2010 marked a significant change in the governance structure and management of public resources in Kenya. Article 10(2) on national values and principles of governance stipulates core principles such as good governance, integrity, transparency and accountability. Moreover, Article 201 of the Constitution provides the Principles of Public Finance that include openness, accountability and prudent use of public resources.

Article 232 further provides for personal integrity, values and principles of public service that ensures efficiency, effectiveness and economic use of resources in the public sector.

To embed the constitutional principles on accountability and public finance management in the public sector, the Public Finance Management Act, 2012 was enacted. The Act stipulates, among other provisions, the manner in which internal auditing at both national and county level shall be conducted and the core areas to be covered. This included:

i. Reviewing the governance mechanisms of the entity including the mechanisms for transparency and accountability with regard to the finances and assets of the entity;
ii. Conducting risk-based, value-for-money and systems audits aimed at strengthening internal control mechanisms that could have an impact on achievement of the strategic objectives of the entity;
iii. Verifying the existence of assets administered by the entity and ensuring that there are proper safeguards for their protection;
iv. Providing assurance that appropriate institutional policies and procedures and good business practices are followed by the entity; and
v. Evaluating the adequacy and reliability of information available to management for making decisions with regard to the entity and its operations.

Furthermore, Sections 73 and 155 of the Act requires all national and county governments respectively to establish Audit Committees whose composition and functions shall be prescribed by the regulations.

PFM Regulations 2015

The Draft Public Finance Management Regulations 2015 for both the national and county governments have provided elaborate guidelines on the establishment, operationalization, performance and reporting of the Audit Committees in the public sector. This forms one of the single-most attempts at strengthening these committees. Table 3 below provides a summary of the provisions related to Audit Committees in the regulations

PFM Regulations on Audit Committees - National and County Governments

Table 1: Summary of Provisions on Audit Committees- in Draft PFM Regulations 2015

Provision/ Regulation		PFM Regulations-National Government 2015	PFM Regulations-County Government 2015
		National Government- Provisions	**County Governments- Provisions**
1.	**Establishment of Audit Committees**	Sec 174- ♦ Each national government entity shall establish an audit committee; ♦ There shall be a minimum of three members, excluding a person who shall be appointed to represent the National Treasury in each audit committee and a maximum of five;	Sec 167- ♦ Each county government entity shall establish an audit committee; ♦ There shall be a minimum of three members, excluding a person who shall be appointed to represent the County Treasury in each audit committee and a maximum of five.
2.	**Duties, Functions and Powers of Audit Committees**	175- The main function of the audit committee shall be to support the Accounting Officers with regard to their responsibilities for issues of risk, control and governance.	168- The main function of the audit committee shall be to support the accounting officers with regard to their responsibilities for issues risk, control and governance and associated assurance.

3.	**Composition of Audit Committees**	174- There shall be a minimum of three members, excluding a person who shall be appointed to represent the National Treasury in each audit committee and a maximum of five.	167- There shall be a minimum of three members, excluding a person who shall be appointed to represent the County Treasury in each audit committee and a maximum of five.
4.	**Term of Appointment**	177- Members of Audit Committees shall be appointed, for a term of three years and shall be eligible for re-appointment for a further term of three years.	170- Members of Audit Committees shall be appointed, for a term of three years and shall be eligible for re-appointment for a further one term only.
5.	**Meetings of the Audit Committee**	179- The audit committee shall meet at least once in every three months.	172- The audit committee shall meet at least once in every three months.
6.	**Remuneration and Compensation**	181- Members of the audit committee shall be paid an allowance on account of attendance of audit committee meetings as determined by National Treasury in consultation with other relevant entities.	174- Members of the audit committee shall be paid an allowance on account of attendance of audit committee meetings as determined by County Treasury in consultation with other relevant entities.
7.	**Capacity Building of Audit Committees**	182- The accounting officer shall provide capacity building to all public national government entity Audit Committees;	175- The accounting officer shall provide capacity building to all public county government entity Audit Committees;

8.	**Independence of Audit Committee and Internal Audit Function**	162- ♦ The Head of Internal Audit unit under a national government entity shall enjoy operational independence through the reporting structure by reporting administratively to the Accounting Officer and functionally to the Audit Committee; ♦ Each year the internal audit unit of a national government entity shall assess its own effectiveness through an internal performance appraisal and shall carry out annual review of the performance of the internal audit activity commenting on its effectiveness in the annual report to National Treasury.	155- ♦ The Head of Internal Audit unit in a county government entity shall enjoy operational independence through the reporting structure by reporting administratively to the Accounting Officer and functionally to the Audit Committee. ♦ 159- Each year the head of internal audit unit shall assess its own effectiveness through an internal performance appraisal and shall carry out annual review of the performance of the internal audit activity commenting on its effectiveness in the annual report to County Treasury

2.4 COMPARATIVE JURISPUDENCE - THE STRUCTURE AND PERFORMANCE OF AUDIT COMMITTEES

2.4.1 AUDIT COMMITTEES IN AUSTRALIA

Audit Committees in Australia are established in the Public Governance, Performance and Accountability Act (PGPA). Section 45 of the Act provides that the accountable authority of a Commonwealth entity shall ensure that the entity has an Audit Committee, constituted to perform functions in accordance with the rules of the Act.

The PGPA Rules set out minimum requirements relating to establishing an Audit Committee for a Commonwealth entity and a Commonwealth company (sections 17 and 28 of the PGPA Rule respectively). These rules aim to help ensure that the committee provides independent advice and assurance to the entity's accountable authority or the company's governing body. While an audit committee needs to be established for each Commonwealth entity or company, and the accountable authority must determine the functions the committee is to perform for the entity. Section 17 does not prevent an audit committee from providing its services to multiple Commonwealth entities.

Functions of Audit Committee

The PGPA rules require the accountable authority, thorough written charter, to determine the functions of the Audit Committee. It further prescribes that the Charter should include particulars of the committee which include frequency of meetings, membership and quorum arrangements.

The functions of the Audit Committee that are outlined in the charter must include, at a minimum, reviewing the appropriateness of the accountable authority's; financial reporting, performance reporting, systems of risk oversight and management and systems of internal control.

Independence of Audit Committee Members

The Commonwealth of Australia facilitates independence of the Audit Committees by appointing a majority of external members to the committee. An independent member cannot be an official or employee of the entity. Board members of corporate Commonwealth entities or Commonwealth companies are not employees of the entity and are therefore considered to be independent. For the avoidance of doubt, an Audit Committee for a corporate Commonwealth entity may include independent persons who are not board members.

They also provide for the appointment of committee members from another Commonwealth entity as an independent member, particularly when the entities have working relationships or when a person has particular expertise in an area of Audit Committee responsibility. The need for appropriate privacy, confidentiality and conflict-of-interest provisions are also considered in these circumstances.

Persons excluded from being Audit Committee members

To ensure ongoing independence, section 17(5) of the rule provides for the exclusion of the Chief Financial Officer, the Chief Executive Officer and accountable authority—or, if the accountable authority consists of two or more people, the person who is the head of the accountable authority—from membership to the audit committee.

Skills and experience required of Audit Committee members

The rules provide that the Audit Committee must include people who have appropriate qualifications, knowledge, skills or experience to assist the committee to perform its functions. They specify that members should be financially literate (that is, able to read and understand financial statements), with at least one member of the committee possessing accounting or related financial management experience and/or qualifications, and a comprehensive understanding of accounting and auditing standards. It prescribes that collectively, the audit committee should possess broad business, financial management and/or public sector experience, and general knowledge of most of the areas listed in the following paragraph.

The rules also provide that the Audit Committee must consist of at least three persons, but by the common practice, most Audit Committees comprise of three to six members.

Sharing Audit Committees between agencies

The rules have also been designed to encourage, where practicable, the sharing of Audit Committees or members of Audit Committees in order to support independence and sharing of better practice among entities. The sharing of members between the Audit Committees of entities can also help to reduce operating costs and improve the utilization of high-calibre committee members.

It is recommended that where applicable, a single Audit Committee comprising senior Executive Service Officers from several agencies be established in order to reduce costs while improving independence. This group is often utilized as the Audit Committee for each agency that contributed an officer.

2.4.2 AUDIT COMMITTEES IN SOUTH AFRICA

There are three tiers of Government in South Africa: National, Provincial and Local Governments. The South African constitution stipulates that each tier should operate with autonomy (separate and distinct). Provinces in South Africa operate like Counties in Kenya except that in South Africa provinces are mainly funded by the National Government. At National and Provincial level, each Ministry has a number of departments and each department has its own public entities. The local government operates through the different municipalities which also have municipal entities. Municipalities are responsible ~~of~~ for delivering services to the public.

South Africa's public sector is governed by a vast number of Acts and Regulations. Corporate governance and Audit Committees are largely governed by the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA) and the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) together with the Treasury regulations. These requirements specify the mandate and qualifications of Audit Committees in the National and Provincial governments and the Municipalities.

Requirements

The PFMA requires the Accounting Officer to set up an independent Audit Committee, which operates in accordance with written terms of reference. A department, public entity must have an Audit Committee appointed by an Accounting Officer (Head of Department or CEO (public entity) in consultation with the Executive Authority (Minister in case of Department or Board in case of Public entity). If considered feasible, the relevant treasury (National or Provincial) may direct that institutions share Audit Committees. If such a determination is made, the Auditor-General must be informed within 30 days of the determination. A municipality or municipal entity must have an Audit Committee appointed by the Council on an advisory role.

The Audit Committee is also required to meet at least twice a year, and to meet at least annually with the Auditor-General.

Similarly, at the municipality level the MFMA proclaims that every municipality must have an Audit Committee which must meet as often as is required; it should however be at least four times a year.

Competence and Skills

The PFMA requires the chairperson to be independent, knowledgeable of the status and position, and have the requisite business, financial and leadership skills. At the Municipality level, MFMA states that the Audit Committee consists of at least three persons with appropriate experience of whom the majority should not be employees of the municipality. In addition, no councilor may be a member of the Audit Committee.

Appointment

For the National and Provincial governments, the Accounting Officer of an institution appoints Audit Committee members in consultation with the relevant Executive Authority. The Chairperson of the Audit Committee at the Municipality level must be appointed by the Council.

King Reports on Corporate Governance

Besides the legal requirements, it is imperative to note that the King Reports on Corporate Governance proved to be a major milestone in corporate governance in South Africa. Three reports were issued in King I (1994), King II (2002), and King III (2009). On Audit Committees, King II requires that companies have an effective internal audit function that has the respect and co-operation of both the board and management. King II further makes recommendations in regard to Audit Committees:

(i) That the audit committee should be comprised by a majority of independent Non-Executive Directors;

(ii) The majority of the members of the Audit Committee should have a financial background;

(iii) The chairperson should be an independent non-executive director and not the chairman of the board;

(iv) The Audit Committee should have written terms of reference that deal adequately with its membership, authority and duties.

(v) Companies should, in their annual reports disclose whether or not the Audit Committee has adopted formal terms of reference and if so, whether the committee has satisfied its responsibilities for the year in compliance with its terms of reference.

(vi) Membership of the Audit Committee should also be outlined in the annual report.

2.4.3 AUDIT COMMITTEES IN GHANA

Similar to other economies, the regulatory framework for an effective corporate governance practice in Ghana is contained in various pieces of legislation including; the Companies code 1963, the Audit Service Act 2000 (Act 584) and the Internal Audit Agency Act of 2003 among others. The role of internal audit function in Ghanaian public sector is manifest through the roles of the Governing Boards and Councils; and the Internal Audit Agency at the National Level.

Corporate Governance Manual for Boards & Councils in Ghana's Public Service

In Ghana, Public Service Organization Boards and Councils play a pivotal role in public sector management. This important responsibility necessitated the Ghana Public Service Commission to develop the Corporate Governance Manual for Governing Boards/ Councils of the Ghana Public Services 2015. The Manual is aimed at addressing the weak governance concerns and to respond to the numerous requests from public service organizations on matters relating to good corporate governance.

The Manual stipulates best practices in the areas of Corporate Governance, Architecture, Committees, Corporate Reporting and Compliance and Evaluation of the Board/Council among many other corporate governance issues. The Manual further identifies three key standing committees a Board/Council should form:

a) Human Resource, Administration and Legal Committee
b) Audit Report Implementation Committee
c) Finance Committee

The Audit Report Implementation Committee (ARIC)

The Audit Report Implementation Committee (ARIC) is formed to assist the Board/Council in carrying out its duties in relation to audit reports and regulatory conformance. The ARIC also serves as a forum for interaction between the Board/Council and internal and external auditors.

Relationship between ARIC and External Audit

The Committees' responsibilities relate to the following:

(i) Negotiate and agree on the level of audit fees;
(ii) Review the annual audit plan with external auditors;

(iii) Clarify matters arising in the management letter and satisfy itself that they are being followed up;

(iv) Obtain assurance from the external auditor that adequate accounting records are being maintained.

Relationship with the Internal Audit and Internal controls

The committee's responsibility relates to the following:

(i) Review the objectives, plans and policy of the internal audit department;

(ii) Review the quality of internal audit staff and the training needed to update their skills; and activities or operations of Internal Auditors

(iii) Review the adequacy of the internal control of the organization;

(iv) Request for reports from management on specific issues of internal control;

(v) Request for annual report from the Chief Executive Officer on the subject;

(vi) Review the whole system of internal control, including financial control and risk management.

The Central Internal Audit Agency

The Central Internal Audit Agency in Ghana was established under the Internal Audit Agency Act of 2003 to enhance efficiency, accountability and transparency in the management of resources in the Public Sector. The purpose of the Agency is to coordinate, facilitate and provide quality assurance for internal audit activities within the Ministries, Departments and Agencies (MDAs) and the Metropolitan, Municipal and District Assemblies (MMDAs).It operates as an apex oversight body.

Prior to its establishment, the Auditor- General had the legal mandate to carry out internal audits in the MDAs but the review of this internal audit function revealed limitations on the scope of the Audit Function and an unsatisfactory reporting relationship.

The governing body of the Agency is the Board, known as the Internal Audit Board. The Board, which is appointed by the President, comprises a membership of seven with the Minister for Finance, the Minister for Local Government and Rural Development and the Chairman of the Public Service as members. The day to day management of the Board is carried out by a Secretariat which is headed by a Director-General who is also an appointee of the President.

2.5 ATTRIBUTES OF EFFECTIVE AUDIT COMMITTEES

Several studies, guidelines and regulations have identified and categorized attributes of an effective Audit Committee into individual member attributes and committee related attributes as follows:

Individual Committee Member Attributes:

For effective contribution to the performance of the Audit Committees, the following attributes are key for members:

(i) Has appropriate technical skills and experience.

(ii) Satisfies requisite independence requirements

(iii) Demonstrates leadership and integrity with a 'doing the right thing' attitude

(iv) Is knowledgeable about the entity and its industry

Committee Attributes

The following attributes are essential for the collective performance of the committee:

(i) Has appropriate skills mix;

(ii) Its size and composition is commensurate with the mandate of the Institution:

A March 2009 Global Institute of Internal Auditors survey[3] of Chief Audit Executives listed seven organizational characteristics that should be considered when determining the ideal number of Audit Committee members. In order of importance, they listed;

a) The complexity of the organization (e.g., decentralized versus centralized, public versus private) and industry.
b) The size of the organization.
c) The extent of responsibilities and expertise assigned to the audit committee.
d) The size of the board of directors and number of board committees.
e) The culture of the organization and its needs.
f) The assignment of members to other board committees and external commitments.
g) The roles and responsibilities of the audit committee as outlined in the charter.

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[3]*See The IIA's Audit Executive C enter, Knowledge Report: Audit Committee Trends and Activities (November 2009).*

(iii) Effective Communication: The ease and demeanor of communications between the committee members and communication between management.

(iv) Guided by the Audit Committee Charter: There is a mutual understanding of the responsibilities and functions of the committee, and of the activities for which the committee is not responsible

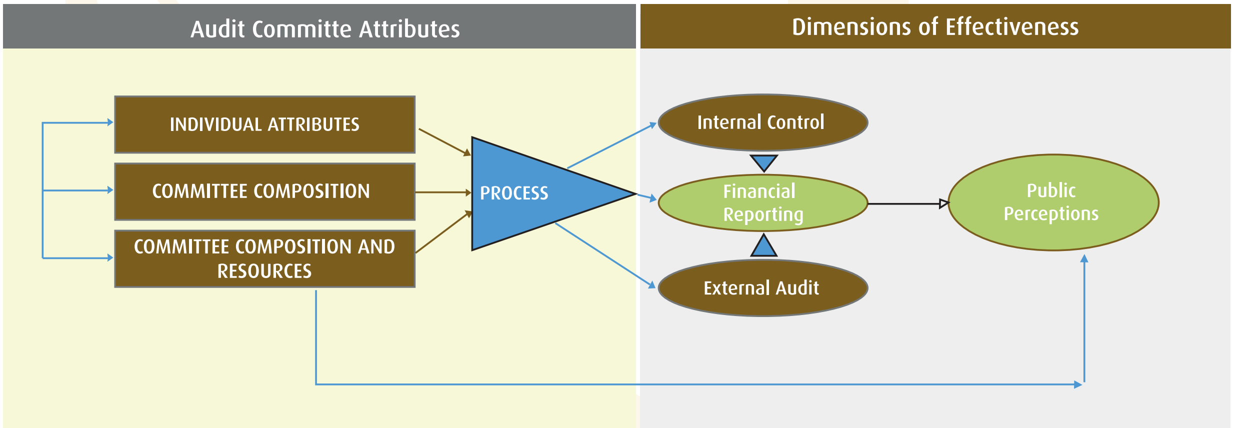
(v) Chaired by a person who is able to lead discussions, encourage the participation of other members, and conduct meetings in an effective manner.

(vi) Periodically assesses the performance of its members and collectively as a committee.

(vii) Monitors the implementation of recommendations made by internal and external audit and other review activities.

(v) Receives an appropriate level of support and provides committee members sufficient opportunities to keep abreast of key developments in the entity and the public sector generally.

The figure below provides the inter-linkages between the audit committee characteristics and various dimensions of effectiveness:



RESEARCH METHODOLOGY

RESEARCH DESIGN

The Institute adopted a triangulated approach in its methodology. It chose a descriptive research utilizing both qualitative and quantitative methods to gather and disseminate data. The following research tools were employed to gather the primary data; Survey questionnaires, key informant interviews and general observations. The survey tools were administered to a selected sample of National Government Ministries and Agencies; and, County Governments.

The research questionnaire was developed in conjunction with Internal Auditor General's Department of the National Treasury guided by the National Treasury Circular, pronouncements of the Institute of Internal Auditors-International and the draft Public Finance Management Regulations.

DESKTOP REVIEW

An extensive desktop review to ascertain the gaps and inform the objects of the study was conducted. It reviewed various reports from a range of government departments and entities, independent commissions, scholars and organizations on the respective subject matter of the establishment and operation of Audit Committees within the public sector.

POPULATION OF STUDY

The survey targeted public sector institutions at the National and County level. The unit of analysis in the study was the Audit Committees as set up in the institutions.

Study Sample

The population was stratified as follows:

a) **National Government Ministries**

The following sample of 6 ministries was drawn from the population of 18 using random sampling technique:

i. The National Treasury
ii. Ministry of Devolution and Planning
iii. Ministry of Defence
iv. Ministry of East African Affairs, Commerce and Tourism
v. Ministry of Health
vi. Ministry of Mining

a) State Corporations

A sample of fifty (50) State Corporations was drawn using stratified and purposive sampling technique to achieve desired representation of the population. The technique was employed taking into consideration the report by Presidential Task Force on Parastatal Reforms which classified state corporations into five categories. This defined the research stratum as follows: purely commercial state corporations, state corporations with strategic functions, executive agencies, independent regulatory agencies and state agencies that are research institutions.

This is illustrated below:

Table 2: Population Sample Selection

	PARENT MINISTRY	NO. of SCs	Purely Commercial SC	SC with Strategic Functions	Executive Agencies	Independent Regulatory Agencies	State agencies-Research Institutions	No. of Entities Sampled
1	State House – Executive Office of the President	1	-	-	1	-	-	0
2	Ministry of Interior and Coordination of National Government	5	-	-	1	-	-	1
3	Ministry of Devolution and Planning	11	-	-	5	1	2	6
4	The National Treasury	26	3	3	9	2	-	5
5	Ministry of Defence	1	-	-	1	-	-	0
6	Ministry of Foreign Affairs		-	-	-	-	-	0
7	Ministry of Education, Science & Technology	49	7	-	4	3	31	8
8	Ministry of Health	12	-	-	7	-	2	3

9	Ministry of Transport and Infrastructure	15	1	3	3	3	-	4
10	Ministry of Labour, Social Security and Services	4	-	-	2	-	-	2
11	Ministry of Energy and Petroleum	9	-	6	1	1	-	5
12	Ministry of Agriculture, Livestock and Fisheries	42	10	4	3	1	3	2
13	Ministry of Industrialization and Enterprise Development	18	5	1	3	2	1	5
14	Ministry of East Africa Affairs, Commerce, and Tourism	15	6		2	1	1	1
15	Ministry of Mining		-	-	0	-	-	0
16	Ministry of Sports, Culture and the Arts	8	-	-	6	1	0	1
17	Ministry of Information, Communication and Technology	9	-	2	2	1	1	2
18	Ministry of Environment, Water and Natural Resource	26	-	1	2	2	2	1
19	Ministry of Land, Housing and Urban Development	3	2		0	1	-	2
20	Office of the Attorney General & Department of Justice	8	-	-	3	1	2	2
	Totals	**262**	34	20	55	20	45	
	No. Sampled		**11**	**9**	**13**	**10**	**7**	**50**

Source: Compiled from the Parastatal Reform Committee Report 2014 on the Reclassification of Government owned entities as of October, 09 2013

Sample Distribution within Ministries

Table 3: State Corporations Sample Stratification

	PARENT MINISTRY	Purely Commercial SC	SC with Strategic Functions	Executive Agencies	Independent Regulatory Agencies	State agencies-Research Institutions	No. of Entities Sampled
1	Interior and Coordination of National Government			1			1
2	Devolution and Planning			3	2	1	6
3	The National Treasury	3	1	1			5
4	Education	2		2	2	2	8
5	Health			2		1	3
6	Transport and Infrastructure	1	2		1		4
7	Labour, Social Security and Services			2			2
8	Energy and Petroleum		4		1		5
9	Agriculture, Livestock and Fisheries	1				1	2
10	Industrialization and Enterprise Development	2			2	1	5
11	East Africa Affairs, Commerce, and Tourism	1					1
12	Information, Communication and Technology		2				2
13	Environment, Water and Natural Resource				1		1
14	Land, Housing and Urban Development	1			1		2
15	Ministry of Sports, Culture and the Arts			1			1
16	Office of the Attorney General & Department of Justice			1		1	2
	TOTALS	**11**	**9**	**13**	**10**	**7**	**50**

b) County Governments

A sample of 15 counties was drawn from the population of 47 using a random sampling technique.

1. Mombasa
2. Kakamega
3. Uasin-Gishu
4. Kisumu
5. Homabay
6. Busia
7. Nairobi
8. Vihiga
9. Elgeyo Marakwet
10. Trans-Nzoia
11. Kitui
12. Machakos
13. Nyeri
14. Kiambu
15. Kilifi

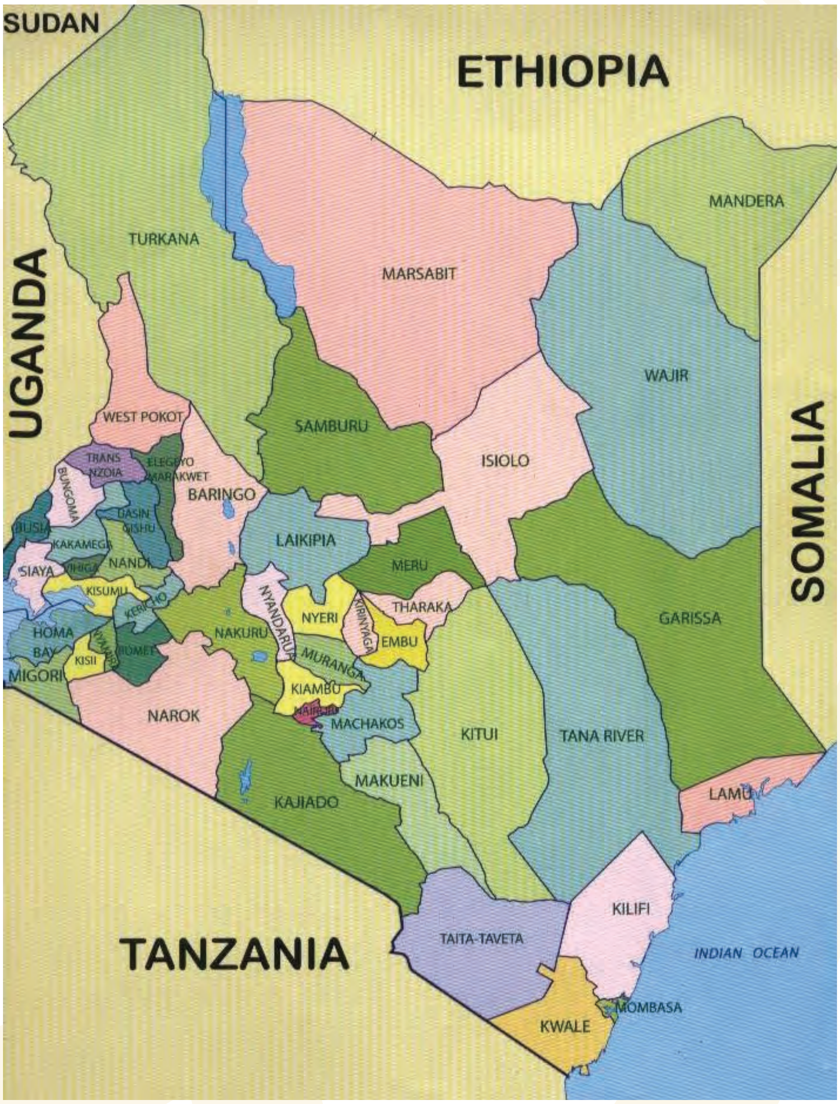


Photo by: Courtesy of Google

DATA COLLECTION

The data was collected using a survey questionnaire administered through in-depth interviews with the respondents. The researchers sought responses from the secretaries to the Audit Committees of the sampled entities in the months of February and March 2015. Out of the sampled entities, the following table reflects the response rate;

	Strata	Population (n)	Sample size (z)	Response (r)	Response rate (r/z)%
1	National Government State Corporations	262	50	23	46%
2	National Government Ministries	18	6	2	33%
3	County Governments	47	15	12	80%
	Total	**327**	**71**	**37**	**52%**

DATA ANALYSIS

The quantitative data was analyzed using statistical tools such as Microsoft Excel, the Statistical Package for Social Sciences (SPSS) and likerts type scale and are presented through Frequency tables, charts and graphs. All incomplete surveys were discarded from the analysis.

RESEARCH LIMITATIONS

1. Scope

The research was limited in its scope given the choice of a sample of public entities rather than the total population. Moreover, a majority of the respondents were the secretaries to the Audit Committees and or the Company Secretaries. The research could have benefited out of feedback from other members of the committees. Notwithstanding, assumption is made that the findings reflect the true picture of the status of Audit Committees in the public sector.

2. Timing of the Research

The research was conducted at a time when the public sector was being restructured which resulted in the reduction of Ministries from 42 to 18. As such, the internal structures had not fully taken shape. In the same period, the president initiated parastatal reforms that aimed to streamline and reduce the number of parastatals in the public sector. Moreover, at the time of the research most counties had not established Audit Committees.

3. Response by Ministries

The study was also limited by a low response rate from the sampled Ministries. As such, as out of the six sampled Ministries only one responded.

RESEARCH FINDINGS

The following section provides the findings of the survey:

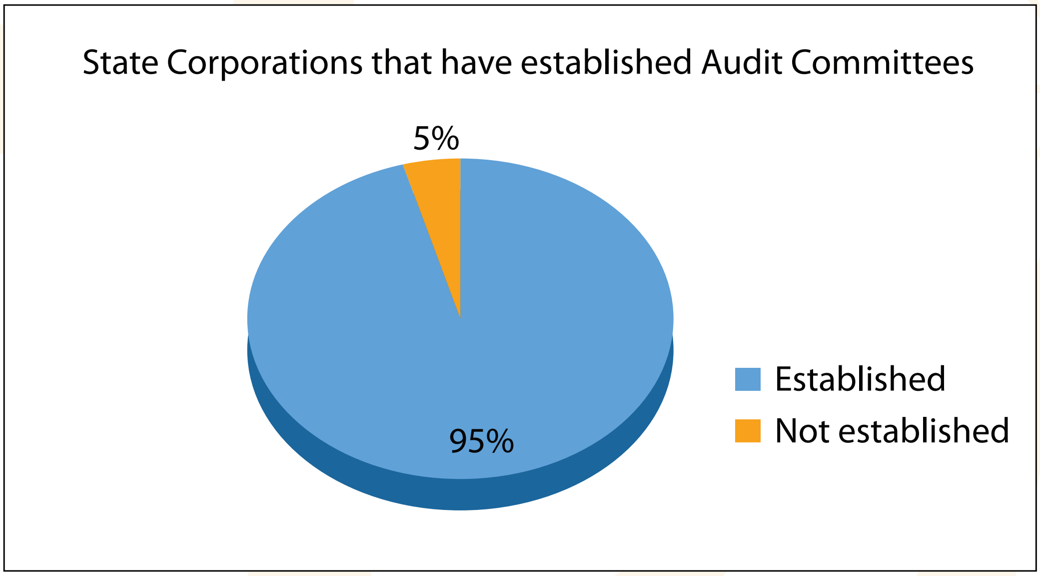
4.1 ESTABLISHMENT OF AUDIT COMMITTEES IN STATE CORPORATIONS

4.1.1 Establishment and Composition of Audit Committees

4.1.1.1 Establishment of the Audit Committees

The study sought to find out how many state corporations had complied with the issued circular and established the Audit Committees. It was observed that ninety five percent (95%) of the respondents had established Audit Committees as per the National Treasury Circular No. 16/2005.

Figure 1: Percentage of entities with established Audit Committees



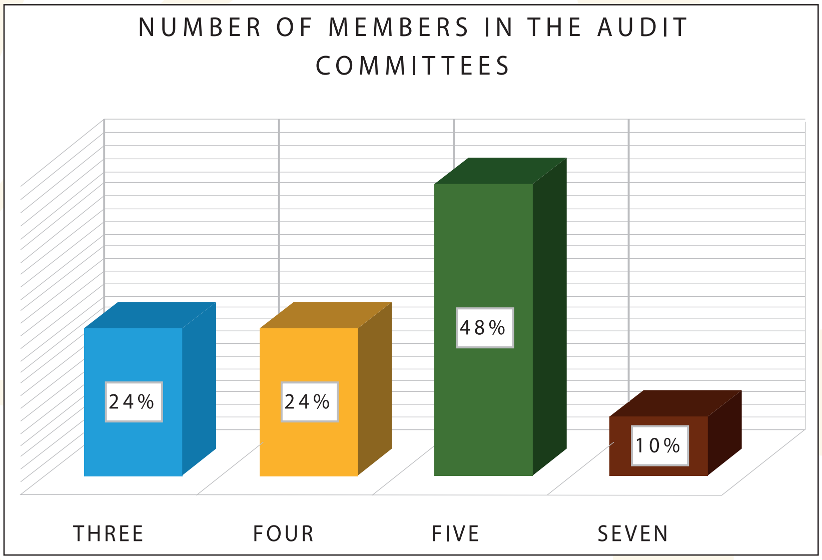
We further established that most entities had established the committees within three years of issuance of the circular in August 2005. It was also observed that under the purely commercial entities, the financial institutions had established Audit Committees prior to the circular under the CMA Guidelines of 2002.

The five percent (5%) that had not established Audit Committees indicated that they were in the process of establishing the committee.

4.1.1.2 Membership to Audit Committees

The survey sought to ascertain the average membership of Audit Committees and established that forty eight percent (48%) of the entities sampled had established Audit Committees of five members. Twenty four percent (24%) had committees with three members and similar percentage with four members and only ten percent (10%) having a membership of seven as illustrated below:

Figure 2: Membership of the Audit Committee



The respondents that had a committee membership of three, decried quorum challenges given that all members formed a quorum. In the event that a member failed to attend, the meeting would not proceed hindering effective performance of the committee.

It is empirically demonstrated that the smaller the size of the committee the lesser the chance to create an appropriate skills mix within the committee contributing to reduced effectiveness. This position is confirmed by the findings of a study by Beasley (1996)[4] in which he observed that the number of restatements of financial reports decreased as the audit committee size increased. The possible explanation for these results is that as the Audit Committee size increases, the Audit Committee gets more combination of skills and is able to vet and monitor in detail, the quality of financial statements. This in turn reduces the number of misrepresentation of financial reports necessitating restatements.

[4] Beasley, M. S. (1996) study on the empirical analysis of the relation between the board of director composition and financial statement fraud. Published in the *Accounting Review* page 443-465

We further observed in a number of entities that representations from the Inspectorate of State Corporations (ISC) would be in-attendance in every committee sitting in an advisory capacity. The respondents acknowledged the valuable contributions from the Inspectorate of State Corporations. However, the respondents have noted a significant decline in attendance of the ISC representatives in the recent past.

In all of the entities sampled, the Internal Auditor would serve as a secretary to the Audit Committee. In few instances, the Chief Executive or Manager Finance would attend the Audit Committee meetings.

4.1.1.3 Appointment of Audit Committee members

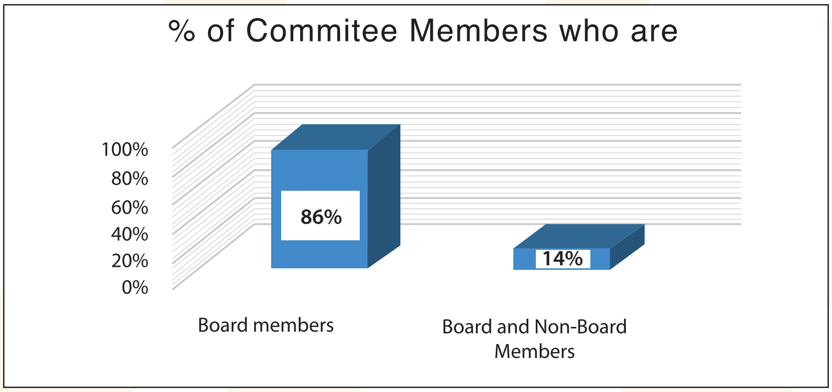
The study sought to understand the process and procedure of appointing members of the Audit Committees in the public sector. Three modes of appointment were observed including; appointment by the board, by statute or by a selection committee. The findings indicated that ninety percent (90 %) of the sampled entities had their committees appointed by the Board with ten percent (10%) having members to Audit Committee appointed in accordance with the provisions of the enabling statutes. None of the entities sampled instituted a selection committee to propose names for consideration and appointment.

It was further observed that the appointing authority would often take long to either extend the term or do a fresh appointment thus crippling the operations of the committee.

4.1.1.4 Composition of the Audit Committees

The study found that eighty six percent (86%) of the respondents had their committee members drawn from the Board. On the contrary, fourteen percent (14%) of the respondents indicated that their committee members were drawn from the Board and outside the Board.

Figure 3: Composition of Audit Committee Members



Two respondents reported that their Audit Committee comprised of some members who were either past or present employees.

4.1.1.5 Minimum qualifications for members of Audit Committees

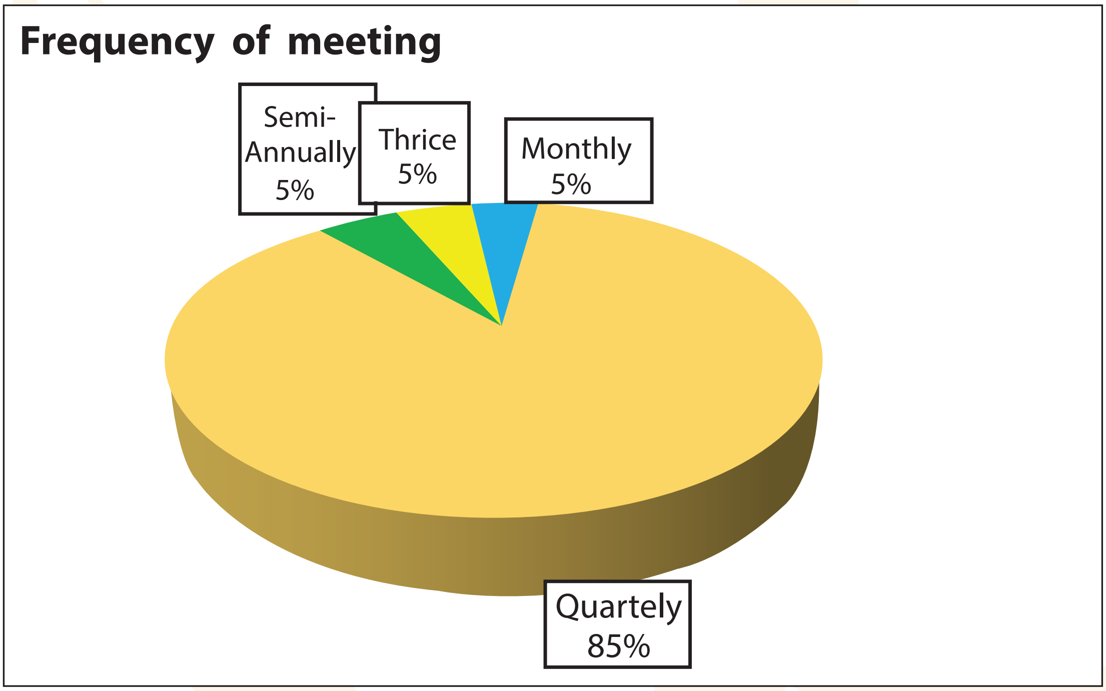
With regard to the minimum qualifications for appointment to serve in the Audit Committee, it was observed that most entities could not ascertain the minimum qualifications. This was because most Audit Committees were drawn from the Board as dictated by their respective enabling statutes. The Board would then select an Audit Committee from among its members.

4.1.2 Meeting, Communication and Reporting of the Audit Committees

4.1.2.1 Frequency of Meeting

The study sought to establish the frequency of the committee meetings. Desktop review revealed that most legislations and regulations prescribe that committees meet at least once every quarter. The study found out that eighty five percent (85%) of the committees met on a quarterly basis. Five percent (5%) met bi-annually, thrice a year and on a monthly basis respectively.

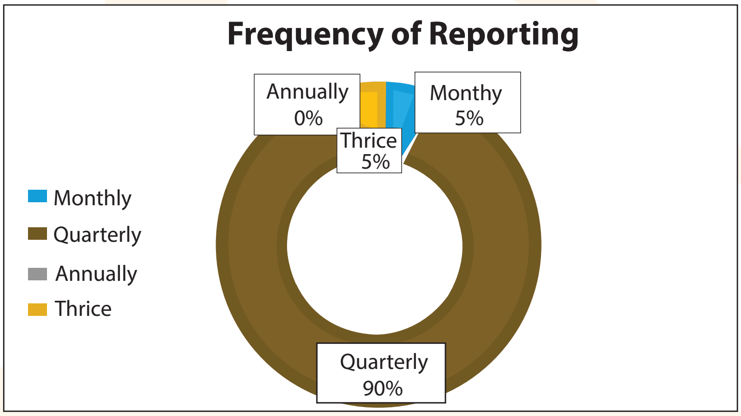
Figure 4: Frequency of Committee Meetings



4.1.2.2 Frequency of Audit Committee Reporting

It was observed that ninety percent (90%) of the respondents indicated that their Audit Committees would report on quarterly basis their proceedings and recommendations to the board. Five percent (5%) reported monthly and thrice a year respectively.

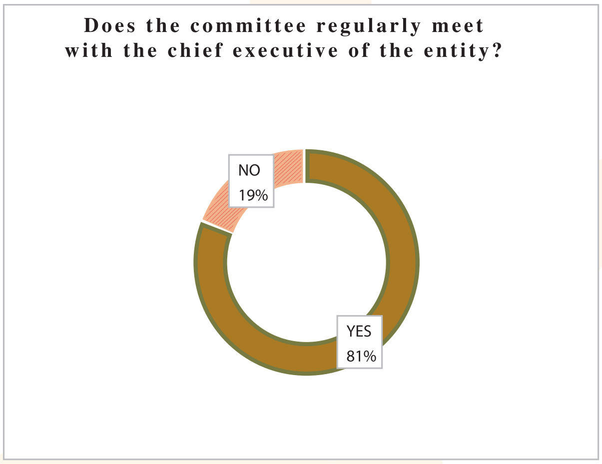
Figure 5: Frequency of Committee Reporting to the Board

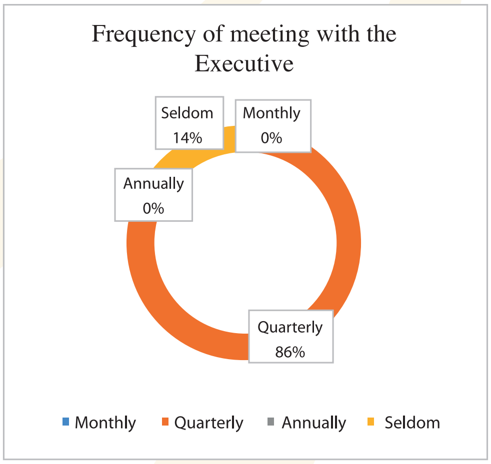


4.1.2.3 Meeting with the Chief Executive

In response to the survey question, eighty one percent (81%) of the respondents indicated that the Audit Committee chairpersons regularly met with the entities' Chief Executive. Most often, the committee chair would meet the Chief Executive on a quarterly basis as illustrated below:

Figure 6: Committee's Interaction with the Executive

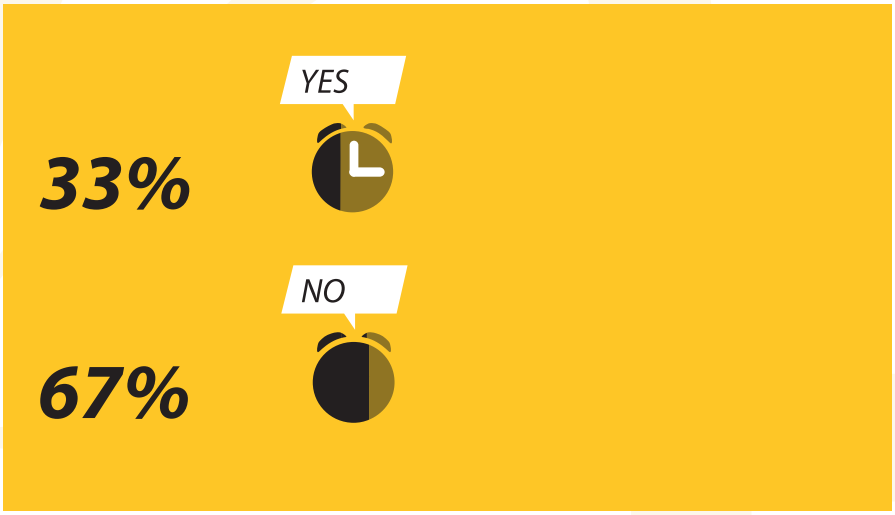




4.1.2.4 Succession Planning

It was observed that thirty three percent (33%) of the respondents had in place provisions for succession in the committees. Sixty seven percent (67%) of the respondents had no succession provisions given that the terms for all members of the Board came to an end at the same time.

Figure 7: Percentage of entities with succession planning

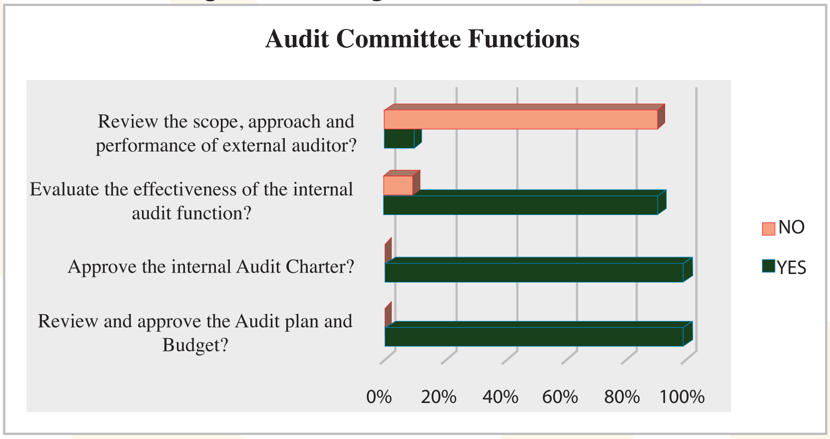


4.1.3 Oversight of Audit Functions

4.1.3.1 Review and Approval of Internal Audit Charter

All respondents affirmed that the Audit Committees approved the Internal Audit Charter and the committee annual work plans. To address the independence of the Audit Committees, the study revealed that the budgets of the committee were approved by the Board as part of the overall governance budget.

Figure 8: Oversight of Audit Functions



4.1.3.2 Performance evaluation of the Internal Audit Function

Although ninety percent (90%) of the respondents indicated that the committees evaluate the performance of the Internal Audit Function, it was observed that the scope of the assessment lacked objectivity.

Some respondents further intimated that performance evaluation on Internal Audit staff was carried out by the Chief Executive of the entities. They noted a lack of objectivity on the appropriate performance evaluation mechanism for Internal Audit Function in the public sector.

4.1.3.3 Scope and approach of external audits

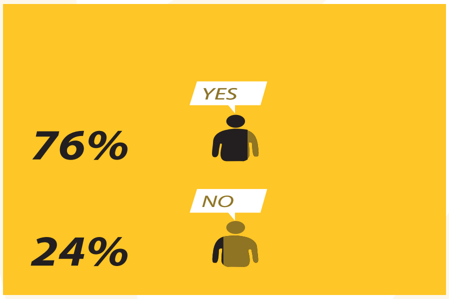
All the respondents indicated that statutory audits are conducted by the Auditor General of the Republic of Kenya. This being a Supreme Audit Institution, it was observed that the Constitution and the enabling PFM Act have extensively stipulated the scope of the Auditor General's work. In light of this, Audit Committees do not get an opportunity to define the scope of work for the external audit. It is understood that the Auditor General as an independent office, determines the scope and approach of the Audit of all public sector entities.

Whilst it is best practice that the Auditor General in the conduct of his work, reviews the work of the Internal Audit with a view to determining if reliance should be placed on it. It was observed that the Office of the Auditor General neither reviewed nor relied on the work of the Internal Auditor.

4.1.3.4 Engagement of External Parties

The study observed that seventy six percent (76%) of the respondents indicated that the committees engaged external parties to consult as appropriate on matters that required skills and expertise not resident within the committees.

Figure 9: Engagement of expertise



4.1.3.5 Monitoring Activities

The study established that although ALL the respondents affirmed that they reviewed management letters and provided management responses. In respect to implementation of audit recommendations, ninety five (95%) of the respondents indicated that they maintained implementation reports, while five percent (5%) of them did not. It was not clear how the five percent of the respondents followed up on audit issues and thus put to question their effectiveness.

4.1.3.6 Annual Performance Evaluation of the Audit Committee

The study established that fifty two percent (52%) of the respondents had audit committee appraised through the board performance contract evaluation. Forty eight percent (48%) did not conduct annual evaluation of the committee.

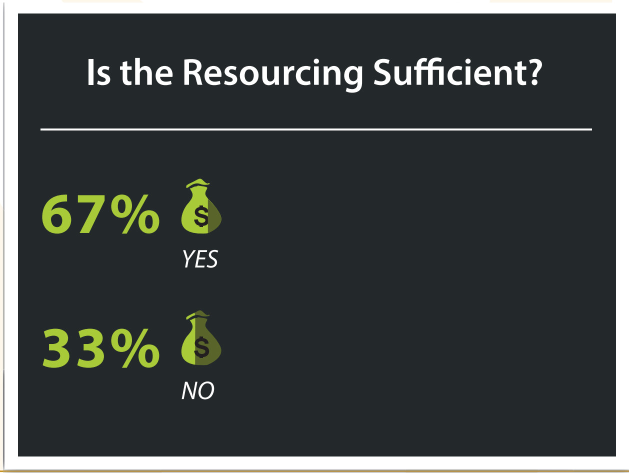
4.1.4 Committee Resourcing

Most respondents reported that the operation of Audit Committees was financed through a vote under the overall board budget. Some respondents indicated that the budget of the Audit Committee was restricted to the sitting allowances of board members which-were limited to at-least four sittings in a year. This provision restricted the committees' ability to undertake other activities such as in-depth analysis of audit reports and capacity building.

In other entities, the committee would be financed through a budgetary vote under the finance department.

On sufficiency of funding, sixty seven percent (67%) of the respondents indicated that funding allocated to the committees was sufficient.

Figure 10: Committee Resourcing

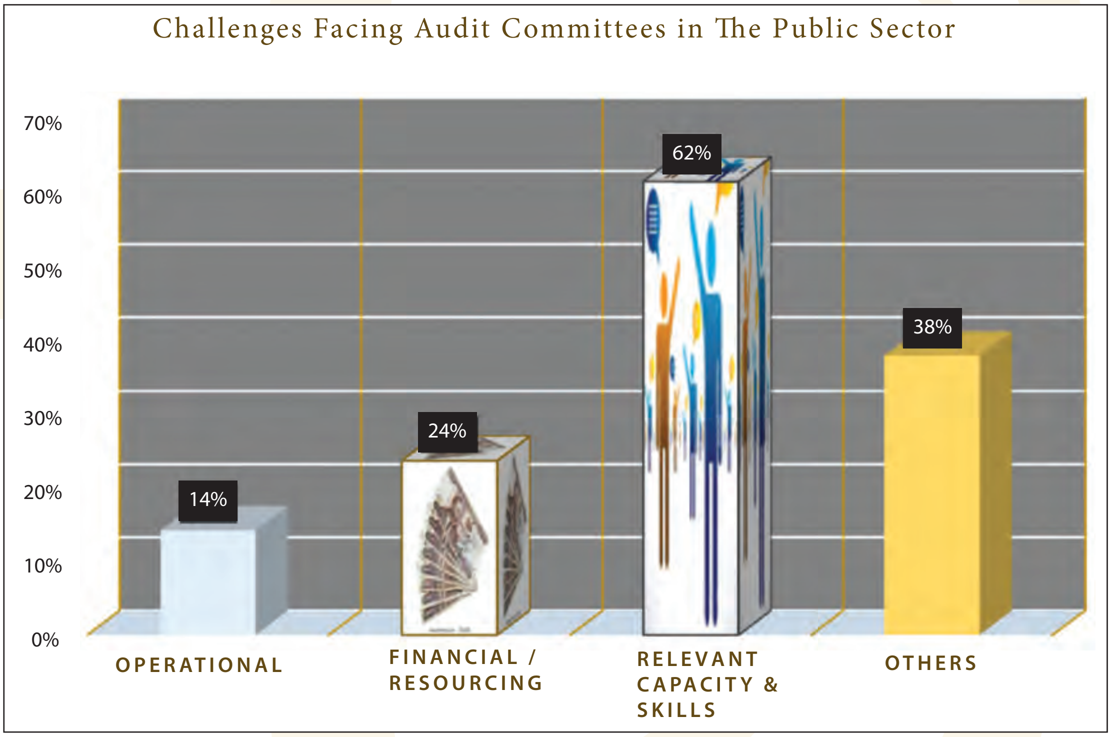


Thirty three percent (33%) indicated that the resources were not sufficient citing the need for funds to enhance the capacity of the committee members.

a) Challenges facing the Audit Committees

The study sought to identify the impeding factors to effective performance of the Audit Committees in the public sector. Sixty two percent (62%) of the respondents identified relevant capacity and skills as the greatest impediment to effectiveness of the Audit Committees as illustrated below;

Figure 11: Challenges facing the Audit Committees



The respondents further observed the absence of appropriate skills mix in the Committees as well as lack of opportunity for continuous trainings for skill enhancement. Other challenges identified included limited financing, lack of succession planning, quorum challenges and committee independence due to political patronage.

The respondents further noted that some Audit Committees were not assertive enough to put management to account on issues raised for fear of victimization.

4.2 ESTABLISHMENT OF AUDIT COMMITTEES IN THE COUNTY GOVERNMENTS

Corporate Governance principles s are essential for effective management of any corporate entity in both public and private sectors including Government at both levels. 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.

The study sought to establish which among the counties sampled had Institutionalised Audit Committees or adopted the previous committees under the defunct Local Authorities and or when they intended to establish the committees.

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

It was also observed that two of the sampled counties had established advisory committees which in the interim played the role of the Audit Committee as they awaited the gazette notice to give effect the Public Finance Management Regulations for County Governments.

Notwithstanding, majority of the sampled counties appreciated the importance of establishing the Audit Committees and indicated that as soon as the Public Finance Management Regulations 2015 for County Governments are passed, they shall set up the committees.

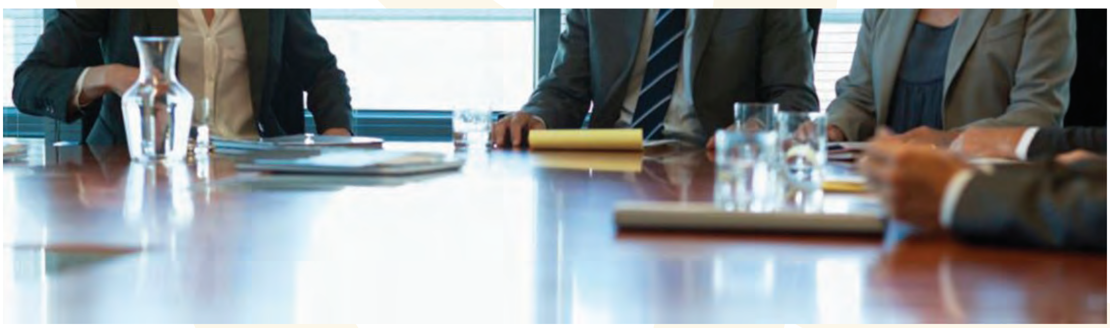


Photo by: Courtesy of Google

4.3 ESTABLISHMENT AND OPERATION OF MINISTERIAL AUDIT COMMITTEES AT THE NATIONAL GOVERNMENT LEVEL

4.3.1 Establishment of Audit Committees

The Study sought to check compliance to the Treasury Circular No. 15/2005 with regard to the establishment of Ministerial Audit Committees. Prior to the promulgation of the Constitution of Kenya 2010, all Ministries had established ministerial Audit Committees in compliance with the circular.

Article 152(1) (d) of the Constitution stipulated that the Cabinet shall consist of not fewer than fourteen (14) and not more twenty two (22) Cabinet Secretaries, thus capping the number of Ministries to twenty two. In adherence to the Constitution, the Cabinet was restructured from forty two (42) to the current nineteen (19) Ministries.

We observed that the process to re-organize the Ministerial Audit Committees had not proceeded in tandem with the overall reorganization of the ministries. Consequently, Audit Committees in the mainstream government at the national level remained in limbo awaiting clarification of the status.

4.3.2 Composition of Audit Committees

It was established that the committees were still in place but with no clear operational guidelines hence not effective. The Committees comprised of seven (7) members drawn from senior employees in the respective Ministries at the level of Director or Heads of Departments. It was further observed that the committees were appointed by the accounting officers of each Ministry. It was noted that in appointing the Audit Committee, the Accounting Officer factored in representatives from Accounting, Finance and Procurement departments. It was observed that the Chair of each Audit Committee would be the representative of the Economic Planning Secretary.

It was also established that Committees met on a quarterly basis unless there were urgent issues that required immediate redress.

On succession planning, it was established that the committee would be appointed on a two year term and reconstituted upon expiry. Given that membership to the Committees was based on the specific heads of department, membership remained similar unless a member was transferred or retired.

4.3.3. Communication and reporting

The survey established that the committee reported on a quarterly basis to the accounting officer. However, for Ministries with more than one accounting officer, the committee shared the report with all the accounting officers. The Accounting Officer often discussed the committee report with the Cabinet Secretary.

It was further established that the Internal Auditor developed an audit plan and charter which would be approved by the Audit Committee. Although the Audit charter allowed the committee to seek the services of an expert, the committee rarely sought these services. In addition, the Internal Auditor kept track of the audit implementation report.

In regard to committee performance evaluation, it was established that the evaluation was not conducted given that they were newly established.

4.3.4. Committee Resourcing

It was established that the committee activities were sufficiently resourced and financed through the administration vote. The resourcing was adequate for their capacity building needs and operations.

4.3.4. Challenges

A significant challenge related to operations was unavailability of members to form a quorum due to their day to day operations as heads of departments.

The merger of the Ministries had an impact on the survey as only 33% of the ministries responded.

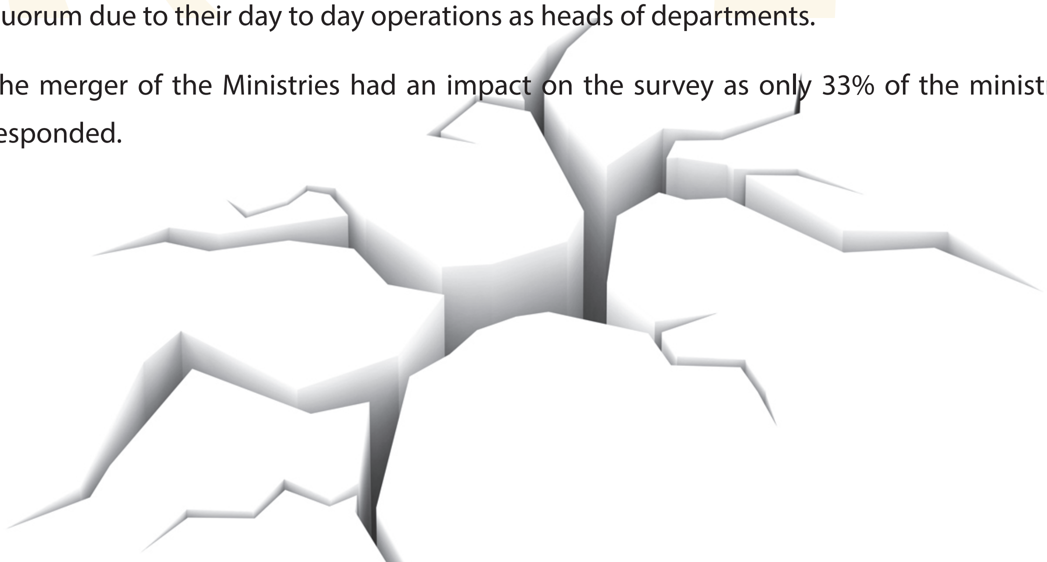


Photo by: Courtesy of Google

RECOMMENDATIONS

In view of the findings and challenges enlisted above, the Institute proposes the following measures to enhance the operation and the effectiveness of the Audit Committees in the public sector:

Appointment

The appointments of boards in the Public Sector do not give due regard to the competencies required for Board and by extension the Audit Committees. In this regard:

1. The National Treasury through Public Sector Accounting Standards Board (PSASB) should fast-track on issuance of guidelines on establishment, composition and minimum qualifications for persons to be appointed to Audit Committees of public sector institutions.
2. Considerations should be made to qualification, experience, and the appropriate skills mix of the entire Committee and by extension the Board since the committee is drawn from the members of the board.
3. The appointment of Audit Committee members should be done competitively. Each public entity should establish a selection committee for the purpose of identifying persons of integrity for appointment to Audit Committees in accordance to guidelines issued by PSASB.

The Global Institute of the Internal Auditors (IIA)[5] 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.

Composition

Many entities decried lack of adequate capacity of the Audit Committees to decipher financial reports. This was further attested to by many respondents that financial risk was the greatest risk that Audit Committees needed to prioritize.

[5]Global Institute of Internal Auditors (IIA) on its June 2014 issue on Global Public Sector Insight: Independent Audit Committees in Public Sector Organizations

4. 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 qualification s 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".*

5. The membership to Audit Committees should be diverse through an appropriate mix of skills and expertise to be informed by the nature and the mandate of the respective entity. An appropriate skills mix would ensure effectiveness of the internal oversight having availed the required expertise within the Committees.

6. A number of the entities indicated that the prescribed membership of their Audit Committees was pegged at three. Such committees faced quorum challenges and hence hindering their ability to deliver on the mandates. To address the quorum issue, we recommend a maximum of five members to the Audit Committee. This will help mitigate quorum challenges and offer a wide spectrum of skills for decision making.

7. Capping of the Committee membership at three makes it less likely that each Committee would effectively strike an appropriate skills mix. Therefore, there is need for the leadership of the committees to be allowed to co-opt people with specialized skills on a need basis where such specialized skills are not available within the Committees. This would be vital in enabling the committees to arrive at objective and informed decisions.

Mandate

8. The audit function should be underpinned by an approved Audit Charter. The charter should prescribe clear reporting lines right from the audit department level through to the Board. The Internal Audit should report functionally to the Audit Committee and administratively to the Accounting Officer. The committee should provide direct oversight of the Internal Audit function to guarantee functional independence.

   Audit Committees should monitor internal audit coverage to ensure that all key risk areas are covered within the Internal Audit annual work plans.

9. The responsibility for appointment and assessment of performance of the head of internal audit should be driven by the Audit Committee and should not be left entirely at the discretion of management.

   This recommendation aims to address functional independence of the internal audit department which was observed as being too much under the control of management and hence may impede or compromise independence and objectivity.

   We further recommend a three tier appraisal by the management, the Committee and audit staff peers. Thus in appraising the Internal Audit Function, a hybrid appraisal by the Audit Committee, by management through the office of the Chief Executive and through peer review may be considered.

10. The Head of Internal Audit should hold at least quarterly meeting with the Chair of Audit Committee and the Chief Executive to discuss key audit findings and risk mitigating measures.

11. 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.

12. Audit Committees should be mandated to bring to the attention of the Cabinet Secretary, the County Executive Committee (CEC) Member in charge of a particular ministry or an institution's Board, any issues that might impair the effective working of the audit department.

13. It is expected that Audit Committee will keep in touch on a continual basis with the key people involved in the entities' governance. They will find it useful and necessary to hold separate and private meetings with both the internal and external auditors away from the executive management of the entity. This should be done at least once a year.

    While all board members have the obligation to act in the interest of the entity, the audit committee has a particular role, acting independently from the executive to ensure that the interests of the stakeholders are properly protected in relation to financial reporting and internal control.

Succession

14. To address the apparent delays in constituting committees which then have the impact of crippling operations of Internal Audit, there is need to streamline the appointment process to allow for seamless transition and continuity of the committees. For seamless transition, the establishment processes should provide for staggered terms. Mechanisms to replace retiring members should be initiated long before their retirement.

Funding the audit function

15. To address the study findings that the performance of internal audit function is often curtailed by budget restrictions, we recommend that the budget of audit function should be distinct from the executive budget. This shall contribute to the independence of the function.

Improving Performance

16. Continuous tailor-made trainings should be conducted to the members of Audit Committees to enhance their effectiveness and sensitize them on emerging issues in risk management and governance.
17. Each Audit Committee should undertake periodic performance evaluation through an independent evaluation process.
18. Efforts should be made to educate stakeholders on the role of Internal Audit so that it is seen as a value adding tool for corporate excellence.
19. Inter-agency and/or sectoral collaboration should be undertaken to enhance sharing of experiences. For instance, departments within the energy sector could collaborate to peer review each other to enhance learning and effectiveness derived from the shared experiences.

The Internal Auditor

20. The internal auditor should be knowledgeable on issues relating to risk management and internal controls. 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.

Confidentiality and Code of Conduct

21. When carrying out their duties, the Audit Committee members should comply with the principles laid down in the Code of Conduct by the respective professional bodies and Chapter 6 of the Kenya Constitution, which sets out the responsibility to safeguard the integrity and reputation of the institution.

Photo by: Courtesy of Google

ACTION PLAN

RECOMMENDATION AREA	PROPOSED ACTION	IMPLEMENTING ENTITY	PROPOSED TIMELINES
Appointments	• Competitive recruitment of Members to the Audit Committees • Due regard to requisite skills	• National Treasury • Heads of Ministries	• Immediate / Upon renewal of terms
Independence	• Establish and issue guidelines on thresholds for independence. • Reinforce in the Audit Charter	• Office of the Director General – Accounting Services (National Treasury) • Boards of Public sector entities	• Immediate
Composition	• Swift implementation and adherence of the Parastatal reform report and the Mwongozo guide, providing for relevant skills in the appointment of boards.	• National Treasury • Heads of Ministries	• Immediate
Mandate	• Adherence to the Audit Charter by the Audit Committee. • Comprehensive charter to include key performance areas.	• Boards of Public sector entities	• Immediate
Succession Planning	• Institutionalize succession through guidelines to all public entities. • Amendment of relevant statutes to provide for succession	• National Treasury • Heads of Ministries	• Within one year
Funding	• Distinction of the Internal Audit Budget within Institutional Budgets	Boards of Public sector entities	• Within one year
Capacity	• Intentional efforts to upskill Audit Committee members to improve performance	National Treasury Boards of Public sector entities ICPAK, IIA	• Within one year
Areas for further Research	• Establishment of the Institutional Risk Management Policy Framework (IRMPF) and the Implementation guidelines for IRMPF issued in February 2011 • Effectiveness of the Internal Audit Function in Ministries Departments and Agencies in Kenya. • The role and contributions of Internal Audit Function as a Governance Structure within the County Governments. • Effectiveness of the Risk Management process in Ministries Departments and Agencies.		• Next phase of research

CONCLUSION

The importance of the Audit Committee in the public sector cannot be overstated; it evaluates risk exposures relating to an organization's governance and its operations and information systems; and subsequently ensures effective and efficient operations. This action enables reliability and integrity of financial and operational information. Additionally, it safeguards assets and ensures compliance with laws, regulations, and contracts. An Audit Committee also plays a key role in assessing ethics and values within an organization. Besides, its valuation of performance management, its communication of risk, and control of information in organizations to facilitate good governance, is critical in the daily management of public entities.

This report affirms the need for apposite checks and balances and points out key areas that need improvement to strengthen the functioning of the Audit Committees in Kenya.

It highlights key areas that need to be addressed to strengthen Audit Committees in National Government MDA's and County Government entities.

It recognizes the ongoing efforts to strengthen governance frameworks in the public sector, but outlines specific recommendations to strengthen the independence of Audit Committees.

It also gives definite recommendations on mainstreaming succession planning in Audit Committees and on strengthening the legal framework governing Audit Committees in the public sector.

Finally, developing countries like Kenya need to facilitate an effective organization and operation of Audit Committees in all levels of Government, Ministries, Departments and Agencies in order to achieve their development agenda.

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APPENDICES

9.1 GLOSARY

Agencies: Public organizations that are clearly a part of the government and deliver public programs, goods, or services, but that exist as separate organizations in their own right — possibly as legal entities — and operate with a partial degree of operational independence.

Board: The highest level of governing body charged with the responsibility to direct and/or oversee the activities and management of the organization. Typically, this includes an independent group of directors (e.g., a board of directors, a supervisory board, or a board of governors or trustees). If such a group does not exist, the "board" may refer to the head of the organization. "Board" may refer to an audit committee to which the governing body has delegated certain functions. (Source: Standards Glossary)

Independent board member: An independent board member is not an employee, immediate family member, or member of the public sector organization. An independent board member may not carry out any other activities on behalf of the organization

Independent audit committee: A public sector organization board-level committee made up of at least a majority of independent members with responsibility to provide oversight of management practices in key governance areas.

Audit committee: Unless otherwise noted, "Audit committee" means independent audit committee.

Public enterprises: Agencies that deliver public programs, goods, or services but operate independently of government and often have their own sources of revenue in addition to direct public funding. They also may compete in private markets and may make profits.

Public sector: Governments and all publicly controlled or publicly funded agencies, enterprises, and other entities that deliver public programs, goods, or services

Independence: The freedom from conditions that threaten the ability to carry out responsibilities in an unbiased manner. (Source: adapted from the Standards Glossary)

9.2 LIST OF SAMPLED ENTITES FOR THE SURVEY

Table 4: list of Sampled Entities to the Survey

	SAMPLED ENTITIES	
	SELECTED SAMPLE ENTITY	**PARENT MINISTRY**
	Purely Commercial State Corporations	
1	Kenya Reinsurance Corporation ltd	The National Treasury
2	Kenya Literature Bureau (KLB)	Education
3	Kenya National Shipping Line	Transport and Infrastructure
4	National Housing Corporation	Land, Housing and Urban Development
5	Kenya National Trading Corporation	East Africa Affairs, Commerce, and Tourism
6	University of Nairobi Enterprises Ltd.	Education
7	New Kenya Co-operative Creameries	Industralisation
8	Consolidated Bank of Kenya	National Treasury
9	Kenya National Assurance Co. (2001) Ltd	National Treasury
10	Development Bank of Kenya Ltd.	Industralisation
11	Nyayo Tea Zones Development Corporation	Agriculture
	SC with Strategic Functions	
1	Industrial and Commercial Development Corporation (ICDC)	The National Treasury
2	Kenya Broadcasting Corporation (KBC)	Information, Communication and Technology
3	Kenya Electricity Generating Company (KENGEN)	Energy and Petroleum
4	Geothermal Development Company (GDC)	Energy and Petroleum
5	National Oil Corporation of Kenya	Energy & Petroleum
6	Kenya Electricity Transmission Company (KETRACO)	Energy & petroleum
7	Postal Corporation of Kenya	ICT
8	Kenya Airports Authority (KAA)	Transport & infrastructure
9	Kenya Railways Corporation (KRC)	Transport
	Executive Agencies	
1	Kenya Revenue Authority (KRA)	The National Treasury
2	Constituency Development Fund	Devolution and Planning
3	Kenya Law Reform Commission	Office of the Attorney General & Department of Justice
4	National Council for Persons with Disability	Labour, Social Security and Services
5	National Hospital Insurance Fund (NHIF)	Health
6	National Campaign Against Drug Abuse Authority	Interior and Coordination of National Government
7	Drought Management Authority	Devolution & planning
8	Higher Education Loans Board	Education

9	Kenya Film Development Service	Sports, Culture & The Arts Technology
10	Kenya Institute of Curriculum Development	Education
11	Kenya Medical Supplies Authority	Health
12	Kenya National Bureau of Statistics	Devolution
13	National Social Security Fund Board of Trustees	Labour
	Independent Regulatory Agencies	
1	Public Benefits Organizations Regulatory Authority	Devolution and Planning
2	Kenya Civil Aviation Authority (KCAA)	Transport and Infrastructure
3	Kenya Bureau of Standard (KBS)	Industrialization and Enterprise Development
4	Water Services Regulatory Board	Environment, Water and Natural Resource
5	Commission for University Education	Education
6	Competition Authority	National Treasury
7	Energy Regulatory Commission	Energy
8	Kenya Bureau of Standard (KBS)	Devolution
9	National Construction Authority	Lands
10	Kenya National Accreditation Service	Industrialization
	State agencies- Research Institutions	
1	Jomo Kenyatta University of Agriculture And Technology	Education
2	Kenya Industrial Research & Development Institute	Industrialization
3	Kenya Institute of Public Policy Research & Analysis (KIPPRA)	Devolution
4	Kenya Medical Research Institute (KEMRI)	Health
5	Kenya Multi-Media University	Education
6	Kenya School of Government	Devolution and Planning
7	Kenya School of Law	Office of the Attorney General & Department of Justice
8	University of Nairobi Enterprises Ltd.	Education

9.3 TREASURY CIRCULAR NO. 16 OF 2005

REPUBLIC OF KENYA
MINISTRY OF FINANCE

Telephone No. 252299
FINANCE-NAIROBI
Fax No. 330426
When replying please quote

Ref No: MOF/IAG /GEN/055/(16)

The Treasury
P.O. Box 30007
NAIROBI.

4th October, 2005

TREASURY CIRCULAR No. 16/2005

To: All Accounting Officers

All Chief Executives of State Corporations

All Clerks to Local Authorities

ESTABLISHMENT AND OPERATIONALISATION OF AUDIT COMMITTEES IN THE PUBLIC SERVICE

INTRODUCTION

Treasury Circular No.AG/3/080/6/(61) of 8th August 2000 provided the mandate and the guidelines to be followed when establishing ministerial audit committees. However, concerns have been raised regarding the adequacy of the guidelines contained therein particularly on the appointment and composition of the membership which has hindered the ministerial audit committees from being effective due to lack of independence and objectivity.

In order to enhance oversight, governance, accountability and transparency in public service, the government has decided to enforce establishment and strengthen audit committees in all ministries, departments, state corporations and local authorities. The audit committees will have the responsibility for independent in-depth review of the framework of internal control and of the internal audit process.

All accounting officers, chief executive officers of state corporations and clerks to councils are, therefore, required to establish audit committees and ensure that they are fully functional.

The following terms of reference with regard to their establishment and operations shall be observed.

STATUS

The audit committee shall have non-executive status and shall serve in an advisory capacity to the relevant accounting officer/chief executive officer.

MANDATE, DUTIES & RESPONSIBILITIES

2.1 Mandate

The mandate of the audit committee shall include: -

2.1.1 Assisting the accounting officer/chief executive officer in enhancing internal controls in order to improve efficiency, transparency and accountability.

2.1.2 Reviewing audit issues raised by both internal and external auditors

2.1.3 Resolving unsettled and unimplemented Public Accounts and Public Investment Committees' (PAC/PIC) recommendations.

2.1.4 Enhancing communication between management, internal and external audit and fostering an effective internal audit function.

However, the mandate of the audit committee shall not be limited in any way, which would prevent it from properly performing its duties and responsibilities.

2.2 Duties & Responsibilities

Duties and responsibilities covering three broad areas relating to compliance with internal controls, financial reporting, and governance shall include: -

2.2.1 Evaluating adequacy of management procedures with regard to issues relating to risk management, control and governance.

2.2.2 Reviewing and approving the audit charter where applicable and the internal audit annual work plans.

2.2.3 Reviewing the internal and external audit findings and recommendations and proposing corrective and preventive action where necessary.

2.2.4 Reviewing the systems established to ensure sound public financial management and internal controls, as well as compliance with policies, laws, regulations, procedures, plans, and ethics.

2.2.5 Initiating special audit/investigation on any allegations, concerns and complaints regarding corruption, lack of accountability and transparency in consultation with the accounting officer/chief executive officer.

The above responsibilities should not prevent the audit committee from carrying out any other tasks, which are within its mandate.

3.0 MEMBERSHIP

3.1 The membership of the audit committee in line ministries/departments to be appointed by the respective accounting officers shall comprise of at least five (5) members who shall include:-

3.1.1 The chairperson, who shall be a serving public officer either within or outside the line ministry but not below job group "R" or equivalent.

3.1.2 Three (3) members appointed from the heads of departments but not directly involved in the processing of financial transactions of the ministry/department.

3.1.3 One (1) member to represent the Permanent Secretary/ Treasury.

3.2 The membership of an audit committee in a state corporation to be appointed by the chief executive officer in consultation with the board shall comprise of non executive board members including either a representative of the Permanent Secretary/Treasury or the accounting officer of the line ministry. The existing audit committees, if any, shall be required to adapt these terms of reference.

3.3 The membership of an audit committee in a local authority to be appointed by the clerk to the council in consultation with the full council shall comprise of councilors who are not chairpersons of any other committee of the council. The provincial local government officer or his/her representative shall represent the accounting officer in an ex-officio capacity.

3.4 In all the above cases the chairperson should be a person with broad knowledge, skills and understanding of the central, local government or state corporation environment and accountability structures

3.5 The head of the internal audit unit or his/her representative shall provide the audit committee with a secretariat.

3.6 The heads of finance, accounting, procurement, internal audit shall form part of the technical team to guide the committee but shall have no voting power. Other technical representatives may be co-opted as and when required.

4.0 MEETINGS

4.1 The audit committee shall meet at least four times a year. However, the chairman may convene additional meetings as may be deemed necessary.

4.2 A minimum of three (3) members, including the chairman, of the audit committee present shall form a quorum.

4.3 The audit committee may request/co-opt any member of staff of the ministry/state corporation/local authority to attend any meeting(s) to assist it with its discussions on any particular matter.

5.0 ACCESS

The heads of internal and external audit units or their appointed representatives shall have unrestricted and confidential access to the chair of the audit committee at all times.

6.0 REPORTING

6.1 Report/minutes shall be made available to the accounting officer, chief executive officer, clerk to the council following an audit committee meeting, clearly indicating its findings, conclusions, and recommended plan of action.

6.2 A register shall be maintained by the secretariat on all external and internal audit findings /recommendations deliberated upon by the committee for follow up and evaluation of action taken.

7.0 INFORMATION REQUIREMENTS

The audit committee, through the secretariat, shall be provided for each meeting with: -

7.1 A progress report from the head of internal audit unit summarizing:

7.1.1 Work performed compared with work planned.
7.1.2 Key issues emerging from internal audit work done.
7.1.3 Status of management response to audit findings and recommendations.
7.1.4 Changes to the annual work plan.
7.1.5 Any limitation in resources that may affect the implementation of internal audit work plan.

7.2 The audit committee shall review and discuss all external audit reports and queries received and make appropriate recommendations for necessary action. The external audit representative may attend meetings of the audit committee during which reviews and discussions take place.

The above list suggests minimum requirements for the inputs, which should be provided to the audit committee. In some cases more information may have to be provided as requested by the audit committee.

Therefore, these terms of references shall become operational with effect from 31st October, 2005 and super-cedes the guidelines contained in Treasury Circular No. AG/3/086/6/(61) of 8th August 2000.

The contents of this circular should be brought to the attention of all officers working within your ministry/state corporation/local authority.

JOSEPH K. KINYUA, CBS
PERMANENT SECRETARY

cc: Permanent Secretary/Secretary to the Cabinet
And Head of Public Service
Office of the President
NAIROBI

Hon. Attorney General
Attorney General Chambers
Sheria House
NAIROBI

Controller & Auditor General
Kenya National Audit Office (KENAO)
Kencom House
NAIROBI

Inspector General of State Corporation
Office of the President
NAIROBI

Internal Auditor General
Bima House
NAIROBI

9.4 TREASURY CIRCULAR NO. 18 OF 2005

REPUBLIC OF KENYA
MINISTRY OF FINANCE

Telegraphic Address: 22921
FINANCE-NAIROBI
Fax No. 330426
When replying please quote

THE TREASURY
P.O. Box 30007
NAIROBI.

Ref: MOF/IAG/GEN/055(21)

Date: 12th October 2005

TREASURY CIRCULAR NO.18/2005

To All Accounting Officers

RE: MANAGEMENT ACTION ON INTERNAL AUDIT REPORTS.

According to the Matrix of Corrective Measures (MCM) agreed upon between Ministry of Finance and The European Commission following an audit by independent auditors on advanced budget support, lack of action on internal audit reports was identified as one of the factors contributing to the ineffectiveness of internal audit function.

In order to address this concern on a sustainable basis and also enhance transparency and accountability, it has been decided that:-

1. All Accounting Officers will be required to respond to internal audit reports within two (2) weeks and propose conclusive action to deal with the matters raised.
2. Where the matters raised in the reports require further review/investigations exceeding two weeks, the Accounting Officer will acknowledge receipt of the report committing himself/herself to take action on all issues raised within a specified period.
3. Material issues raised by audit reports will be brought to the attention of audit committee clearly indicating status and actions to be taken.

Please ensure that the contents of this Circular, which take effect from 31st October 2005 are brought to the attention of the officers working under you.

Joseph K. Kinyua, CBS

9.5 PUBLIC FINANCE REGULATIONS 2015

9.6 CAPITAL MARKETS AUTHORITY GUIDELINES 2002

GAZETTE NOTICE NO. 3362

THE CAPITAL MARKETS ACT (*Cap. 485A*)

GUIDELINES ON CORPORATE GOVERNANCE PRACTICES BY PUBLIC LISTED COMPANIES IN KENYA

3.5 Best Practices Relating to Accountability and the Role of Audit Committees

As a matter of best practice, the constitution of Audit Committees represents an important step towards promoting good corporate governance. The following shall represent the recommended best practice relating to the role and constitution of Audit Committees by public listed companies

3.5.1 The Audit Committee

The board shall establish an audit committee of at least three independent and non-executive directors who shall report to the board, with written terms of reference, which deal clearly with its authority and duties. The chairman of the audit committee should be an independent and non-executive director. The board should disclose in its annual report whether it has an audit committee and the mandate of such committee.

3.5.2 Attributes of Audit Committee members

Important attributes of committee members should include:

(i) broad business knowledge relevant to the Company's business;

(ii) keen awareness of the interests of the investing public and familiarity with basic accounting principles; and

(iii) objectivity in carrying out their mandate and no conflict of interest.

3.5.3 Duties of Audit Committees

Audit Committees should have adequate resources and authority to discharge their responsibilities. The members of the audit committee shall:

(i) be informed, vigilant and effective overseers of the financial reporting process and the Company's internal controls;

(ii) review and make recommendations on management programs established to monitor compliance with the code of conduct;

(iii) consider the appointment of the external auditor, the audit fee and any questions of resignation or dismissal of the external auditor;

(iv) discuss with the external auditor before the audit commences, the nature and scope of the audit, and ensure co-ordination where more than one audit firm is involved;

(v) review management's evaluation of factors related to the independence of the Company's external auditor. Both the audit committee and management should assist the external auditor in preserving its independence;

(vi) review the quarterly, half-yearly and year-end financial statements of the Company, focusing particularly on:

  (a) any changes in accounting policies and practices;

  (b) significant adjustments arising from the audit;

  (c) the going concern assumption; and

  (d) compliance with International Accounting Standards and other legal requirements;

(vii) discuss problems and reservations arising from the interim and final audits, and any matter the external auditor may wish to discuss (in the absence of management where necessary);

(viii) review any communication between external auditor(s) and management;

(ix) consider any related party transactions that may arise within the company or group;

(x) consider the major findings of internal investigations and management's response;

(xi) have explicit authority to investigate any matter within its terms of reference, the resources that it needs to do so and full access to information;

(xii) obtain external professional advice and to invite outsiders with relevant experience to attend, if necessary; and

(xiii) consider other issues as defined by the Board including regular review of the capacity of the internal audit function.

3.5.4 Audit Committee and Internal Audit Functions

The Board should establish an internal audit function. The internal audit function should be independent of the activities they audit and should be performed with impartiality, proficiency and due care. The Audit Committee should determine the remit of the internal audit function and in particular:

(i) review of the adequacy, scope, functions and resources of the internal audit function, and ensure that it has the necessary authority to carry out its work;

(ii) review the internal audit program and results of the internal audit process and where necessary ensure that appropriate action is taken on the recommendations of the internal audit function;

(iii) review any appraisal or assessment of the performance of members of the internal audit function;

(iv) approve any appointment or termination of senior staff members of the internal audit function;

(v) ensure that the internal audit function is independent of the activities of the company and is performed with impartiality, proficiency and due professional care;

(vi) determine the effectiveness of the internal audit function; and

(vii) be informed of resignations of internal audit staff members and provide the resigning staff members an opportunity to submit reasons for resigning.

3.5.5 Participation in the Meetings of Audit Committees

(i) The finance director, the head of internal audit (where such a function exists) and a representative of the external auditors shall normally attend meetings of the audit committee while other board members may attend meetings upon the invitation by the audit committee.

(ii) At least once a year the committee shall meet with the external auditors without executive board members present.

(iii) The audit committee should meet regularly, with adequate notice of the issues to be discussed and should record its conclusions.

(iv) The board should disclose in an informative way, details of the activities of Audit Committees, the number of audit committee meetings held in a year and details of attendance of each audit committee member at such meetings.

NOTES

Contacts

P.O BOX 59963-00200, CPA Center, Ruaraka , Thika road. Nairobi, Kenya.
Tel: +254 (0) 20 2304226, 2304227
Mobile: +254 (0) 727 531006 / 733 856262 / 721 469796/ 721469169
Email: icpak@icpak.com / www.icpak.com