



Audit Committees & Enhanced Accountability at the County

Level – Is the Rationale for Establishment Justified?

by:

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Uphold public interest

Credibility

Professionalism

Accountability

Presentation Agenda



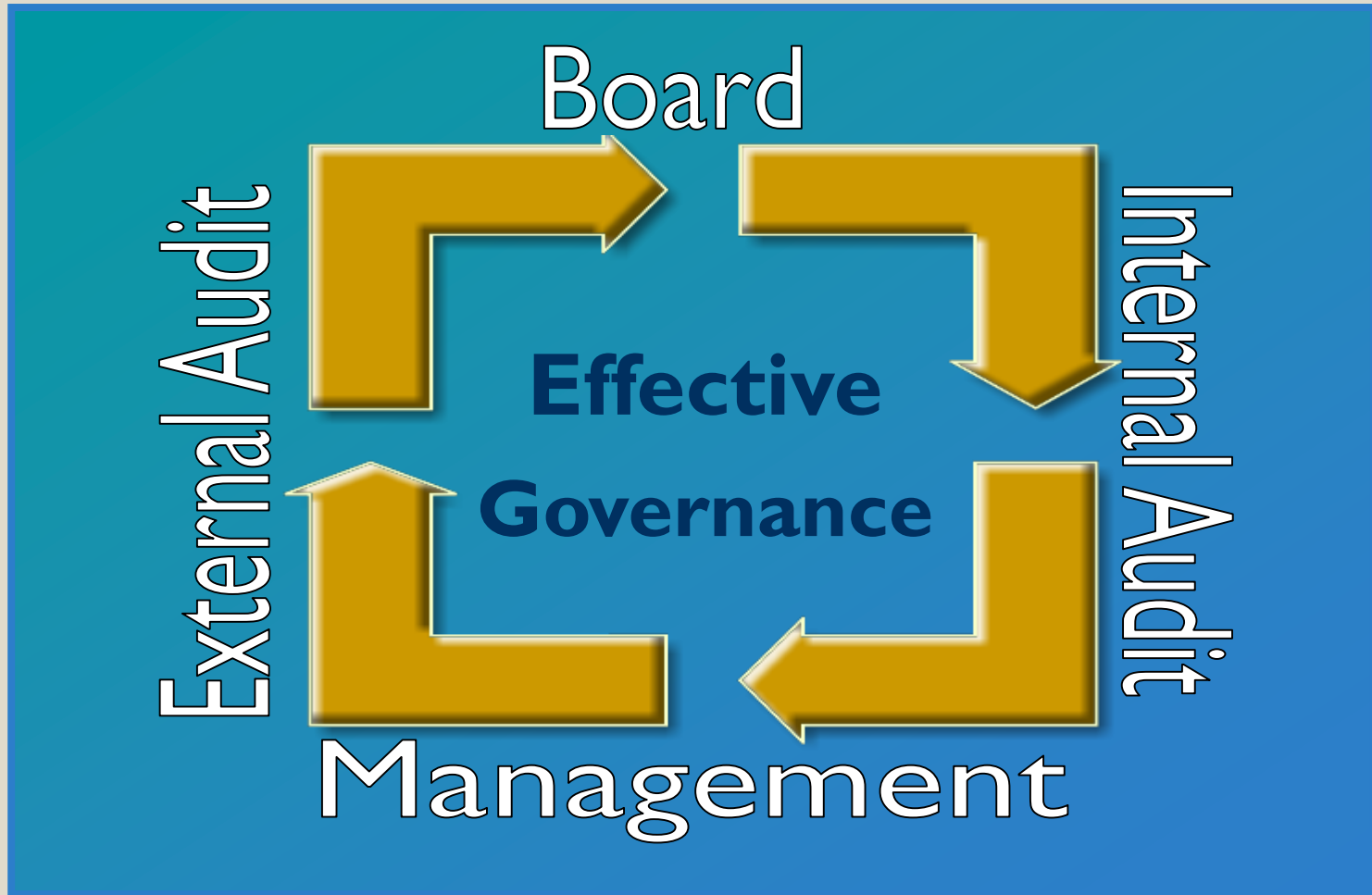
- ☐ Introduction
- ☐ Definition of Audit Committees
- ☐ Rationale for Audit Committees in County Governments
- ☐ Legislative Requirements & Composition of Audit Committees
- ☐ Weak Vs Effective Audit Committees
- ☐ Challenges Facing the County Audit Committees
- ☐ Way Forward for Audit Committees
- ☐ Conclusions

Introduction



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

IIA Corporate Governance Model



Definition of Audit Committees



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

Why Audit Committees in Public Sector?



- ❑ Act as a forum for dialogue between the Audit Committee/Board, Executive management and Internal and External auditors
- ❑ Promote integrity and quality of internal and external audit reporting by providing high level assurance and check.
- ❑ Foster and promote a more effective and efficient audit process by providing independent review of the internal audit annual work plan and reports

Why Audit Committees in Public Sector?



- ❑ Provide “no surprises” environment in an entity in regard to identification of risks and threats to organizations.
- ❑ Provide a depth of knowledge that assist management discharge its responsibilities in the most effective and efficient manner.

Legislative Requirements of Audit Committees in the Public Sector



- ❖ The Constitution of Kenya, 2010 (Article 10 on National Values and principles of Governance & Article 225 & 226) ***providing principles of public service that ensure economic, efficient, effective use of public resources.***
- ❖ Treasury Circular No. 16/2005-”***Establishment & Operationalization of Audit Committees in the Public Service.***
- ❖ Kenya Gazette Notice 2690. Vol CXVII No 40. of 15th April 2016- ***Audit Committee Guidelines for National & County Governments.***

Legislative Requirements of Audit Committees in the Public Sector.....



- ❖ The PFM Act, 2012 was enacted to infuse the constitutional spirit on good governance, accountability, transparency in Government.
- ❖ Public Finance Management (PFM) Act, 2012 Sections 73 (5) and Section 155(5) of PFM Act- ***establishes Audit Committees for National Government entities and County Government entities*** whose composition and functions are prescribed by the Regulations.
- ❖ 174(4) A minimum of three members, excluding a person who shall be appointed from National Treasury in each audit committee and a maximum of five.

AC Composition & Qualifications according to the Regulations



- All members of the County AC shall have a good understanding of county government operations, financial reporting and auditing.
- Have a good understanding of the objects, principles and functions of the County Government & County Assemblies
- Chairperson should be independent of the entity, be knowledgeable of the entity, have requisite business and leadership skills and not be a political office holder.

County Assembly AC Composition



- ☐ The County Assembly shall competitively source for 3 members of its Audit Committee from suitably qualified persons, one of whom shall be the chair.
- ☐ The Audit Committee shall report to the County Assembly through the County Assembly Clerk.
- ☐ The County Speaker shall nominate one senior officer to sit in the Audit Committee.

County Executive Audit Committees



- The County Executive shall competitively source for 4 members of its Audit Committee from suitably qualified persons ,one of whom shall be the Chair.
- The County Governor shall nominate one senior officer to sit in the Audit Committee
- The Audit Committee shall report to the Governor.

Key Attributes of Audit Committee Members as per PFMR, 2015



- Independent of the Entity
- Have a good understanding of the objects, principles and functions of the entity to which they are to be appointed
- Have requisite business & leadership skills
- Have a good understanding of government operation, financial reporting or auditing integrity.
- Relevant experience

Role of the Audit Committees



- Support the Accounting Officers (*Governor & Clerk of the County Assembly*) with regards to their responsibilities on issues of risk management, control and governance and associated assurance-
Main Function.
- Provide an independent review of an entity's reporting functions to ensure the integrity of financial reports.
- Monitor the effectiveness of the entity's performance management and performance information - *Strategic Plans/Budget.*

Role of the Audit Committees



- Provide effective liaison and facilitate communication between management and external audit
- Provide oversight of the implementation of accepted audit recommendations-from both *Internal & External Auditors*.
- The AC should approve the appointment and/or termination of appointment of the Head of Internal Audit.
- The Performance Assessment of the Head of Internal Audit should be driven by the AC and should not be left at the discretion of the Executive Management.

Role of Audit Committees.....



The Audit Committee should monitor and review the effectiveness of the entity's internal audit function:-

- ☐ Internal Audit Charter
- ☐ Internal Audit Strategic plan
- ☐ Risk-Based Annual Work Plan
- ☐ Internal Audit Reports
- ☐ Positioning, Staffing and Facilitation of Internal Audit Function;



Role of Audit Committees.....



- ❑ As part of the on-going monitoring process, the AC should review the ***management letter***. The AC should review and monitor management's responsiveness to the external auditor's findings and recommendations.
- ❑ Ensure the entity effectively monitors compliance with legislative and regulatory requirements and promotes a culture committed to lawful and ethical behavior.

Role of Audit Committee according to the Guidelines

1. Financial Reporting

2. Risk Management and Internal Control

3. Oversight Over Internal Audit

4. Oversight over External Audit

5. Regulatory, Compliance and Ethical Matters

6. Maintaining and Measuring Effectiveness

7. Communication and Reporting

Audit Committee- Areas of Focus

Financial reporting

- Appropriateness of accounting policies
- Disclosure requirements
- Fairness and balance of MD&A/
operating review
- GAAP conversion

Risk management & internal control

- Understanding of key risk areas
- Effectiveness of controls
- Fraud risk

Audit committees: Areas of focus

External audit

- Appointment and remuneration
- Scope of work
- Independence requirements
- Significant audit findings/recommendations
- Reviewing the performance of external auditors

Internal audit

- Charter, authority and resources
- Scope of work
- Internal audit effectiveness
- Responses to internal audit
recommendations

Maintaining & measuring effectiveness

- Training needs
- Maintaining financial literacy
- Annual performance evaluation
of audit committee

Communicating & reporting

- Relations with management
- Updates and recommendations
to the full board
- Reports to the board and
shareholders

Regulatory, compliance & ethical matters

- Effectiveness of system for
ensuring compliance with laws
and regulations
- Code of conduct/ethics
- Whistleblowing

Characteristics of Ineffective Audit Committees



- Rubber-Stamp Audit Committees
- AC with conflicts of interest
- AC with undefined roles & mandate.
- Idle AC with no value addition
- Mistrust & suspicion
- Lack of commitment
- Fear & despondency
- Sabotage & undercuts
- Lack of collective responsibility

Characteristics of Effective Audit Committees



- They know their Role & Mandate
- Demand accountability from Management
- Ensure all the all audit issues both internal & external are closed out as per their recommendations
- They ask the 'Right, probing but difficult Questions
- There is induction of new members and continuous capacity building for members.
- Persons of integrity with no Conflict of Interest

Characteristics of Effective Internal Audit Function to support AC



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

Challenges Facing Audit Committees in the County Governments



- ☐ Political Patronage
- ☐ Lack of understanding of their Role & Mandate.
- ☐ Lack of appropriate mix and skills
- ☐ Lack of commitment and quorum
- ☐ Conflict of Interest.
- ☐ Inappropriate reporting structure for the County Executive and County Assembly Audit Committees.
- ☐ Poor Incentive & Remuneration structure for AC members
- ☐ Inability to raise relevant questions on audit reports and pursue them with Management

Challenges Facing Audit Committees in the County Governments



- ☐ Limited time available for the agenda items & discussions
- ☐ Being influenced by Management views.
- ☐ Domineering Governors/Clerks vis-à-vis Audi Committees
- ☐ Poor relationship with External Auditors, Internal Auditors & Executive Management
- ☐ Inadequate critical information from Management.
- ☐ Expiry of Terms of Service/Rotation of AC members
- ☐ Weak Accounting & Internal Control Environment
- ☐ Inadequate Legal and Legislative Framework

Way Forward for ACs in CG.....



- ❑ Review the reporting structure for ACs within the AC Guidelines to ensure they are truly independent
- ❑ Undertake training & continuous capacity building for ACs
- ❑ Strengthen the Internal Audit Functions within Counties
- ❑ Develop and firm-up Audit Committee & Internal Audit Charters.
- ❑ AC to develop an Annual work plan to guide its activities/meetings
- ❑ Leverage on IT for both Internal Audit & ACs operations (***Usage of Data Analytics, Audit Mgt Systems and E-Board technologies***).

Way Forward for ACs in CG.....



- ☐ Undertake training on Enterprise Risk Management (ERM) to allow for ERM policy framework development and implementation.
- ☐ Undertake Performance Evaluation of AC, its members and IAF.
- ☐ Pursue the issue of Incentives & Remuneration with SRC.
- ☐ Strengthen the Secretarial Function to have adequate staff and right skill mix.
- ☐ Undertake root cause analysis of Auditor General audit reports with a view of closing recurring audit issues.

Way Forward for ACs in CG.....



- ☐ Periodically rotate Audit Committee members including the Chairperson and focus on financial expertise-for chairs position
- ☐ Position the Head of Internal Audit to a level where he/she is able to influence strategic decisions.
- ☐ ACs must have full access to Internal & External Auditors and Executive Managers including external advisors if necessary.
- ☐ Hold Executive (private) Sessions with Internal, External Auditors and other Assurance Providers & Executive Management.

Take Home- Effective Audit Committees

- Doing the right things:-spelt out in the AC charter.
- Having the right people:-Skills sets
- Having the necessary industry experience.
- Managing critical relationships; Governor/Clerk, Mgt, Internal & External Auditors, Assurance Providers etc.
- Asking the right probing questions.
- Doing the right things right-strong leadership.
- Striving for continuous improvement;

Conclusion



- ☐ Cowardice asks the question-***is it safe?***
- ☐ Expediency asks the question-***is it politic?***
- ☐ Vanity asks the question-***is it popular?***
- ☐ But conscience asks the question-***is it right?***

And there comes a time when one must take a position that is neither safe, nor politic, nor popular; but one must take it because it is RIGHT."

Conclusion



‘I have in mind a person with the intelligence, experience and understanding to know the right questions to ask of management or the auditors and the forcefulness and tenacity to ask a direct question and insist on a straight answer. Ideally, all audit committee members should have these qualities’ –

US SEC Commissioner, February 2003

Questions & Answers





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