



Board Audit Committee Masterclass
Effective Performance Review processes
for the Audit Committee Members & Chair

by:

CPA Erick Audi

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Sarova Whitesands Beach Resort & Spa, Mombasa

Uphold public interest

Credibility

Professionalism

Accountability

Profile

- CPA, CIA Erick Audi
- MBA-UON (Finance), B. Comm. -University of Nairobi (UON), Accounting Option
- CPA, Certified Internal Auditor (CIA), CISA Certifications
- Certified ISO Lead Auditor; ISO 9001:2015
- Member of ICPAK, ISACA, IIA & KIM
- Over 16 years working experience from private & public sector institutions including (Audit Firm, KRA, KeRRA, Ketraco & KenGen)
- Passion for Governance, Risk Management & Control Advisory Services.
- Seasoned Facilitator/Trainer on Internal Audit, Controls, Risk Management and Governance processes for Audit Committee & Boards.
- Currently, works at KenGen as the Internal Audit & Risk Manager

Presentation Agenda



- ☐ Introduction
- ☐ Legal & Administrative Framework
- ☐ Key considerations in Audit Committee Evaluations
- ☐ Assessment Criteria
- ☐ Selecting a methodology
- ☐ Feedback/corrective Action
- ☐ Common pitfalls

Introduction



- ❑ **Board Evaluation is the** process through which performance of the Board, its committees and individual members of the Board is assessed against an established benchmark.
- ❑ The primary benefit of carrying out evaluation is to improve the performance of the Board & its Committee and in so doing, improve the organization's performance.
- ❑ AC evaluation is the most effective way to ensure the members understand their duties and adopts effective good governance practices.
- ❑ To be effective, appraisals need to ***have specific, clearly defined steps and practices, and a special commitment from the Board.***

Legal & Administrative Framework



- ❑ ***CMA Code of Governance for Practices for Issuers of Securities to the Public, 2015*** - The Board shall develop a Board Evaluation and determine and agree on its annual evaluation toolkit & the parameters to be used in the annual evaluation process
- ❑ ***Mwongozo Code of Governance*** -The evaluation should cover the Board as a whole, its Committees, individual members, the chairperson, the CEO and the Corporation Secretary.

Legal & Administrative.....



- ❑ **UK Governance Code section B.6** states: “The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors”
- ❑ **King IV, Principle No.9-** “the Governing Body should ensure that the evaluation of its own performance and that of its committees, its chair and its individual members, support continued improvement in its performance and effectiveness.

Annual AC Review & Assessment



- ❑ The Committee should conduct an annual review and assessment of its performance, including a review of its compliance with the Charter, in accordance with the evaluation process approved by the Board.
- ❑ Areas for self-assessment should include the AC's understanding, communication and oversight responsibilities in regard to the financial statements, risk management, internal controls, compliance, ethics management, internal auditing, external auditing, resources and special assignments and investigations.
- ❑ The Committee should also assess its composition, training, meetings, charter and performance.

Key considerations in Audit Committee Evaluations



- ❑ Must be driven by the Committee “Buy in”
- ❑ There must be an agreement on why the exercise-Objective?
- ❑ There must be an agreement on the process?
- ❑ The tool must be appropriate “no one size fits it all”?
- ❑ The Committee must discuss the results, own them and agree on the next steps.

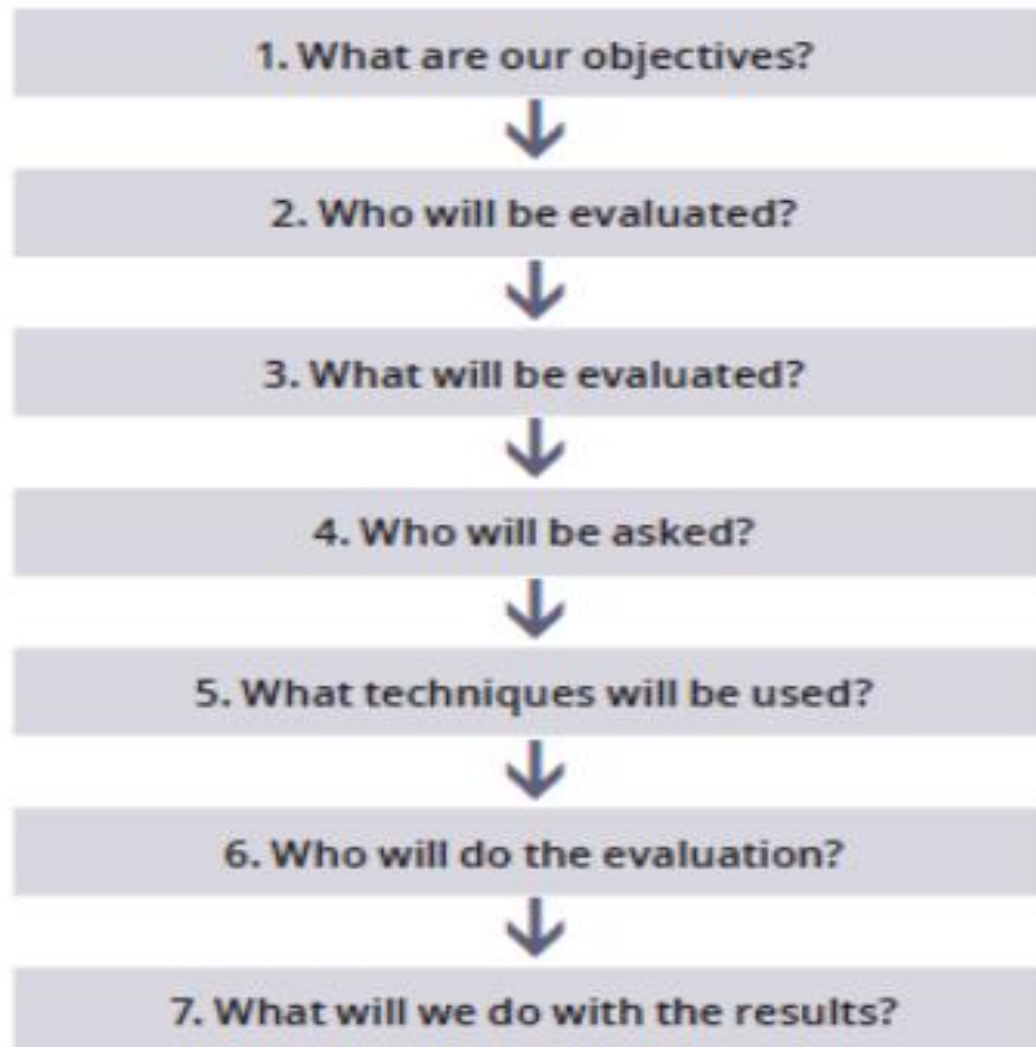
All these can be defined within the Entity’s Corporate Governance Manual or Board/AC Charter/Manual.

Ways to evaluate Audit Committees



- ❑ **Compare Committee's activities against its charter-** Assists the Committee it has properly completed the full scope of its responsibilities during the year. Allows the Committee to take remedial steps in the event an item was missed.
- ❑ **Compare Committee's activities against leading best practices-** benchmarking against leading practice is another effective way to improve committee performance and considers practices that go beyond the basic rules.

Framework for Audit Committee Evaluation



Assessment Criteria



- ☐ Appropriate composition, diversity of skill and experience
- ☐ Appropriate discharge of roles and responsibilities
- ☐ Effective Chairman
- ☐ Charter & Mandate
- ☐ Effectiveness of meetings
- ☐ Format of reporting
- ☐ Annual Work Plan
- ☐ Relationship with other Board Committees
- ☐ Reporting requirements to the Board and Shareholders

Types of Assessment



Audit Committee evaluations consist of three types of assessment:

- ☐ An Audit Committee assessment which details the effectiveness of the overall performance of the committee.
- ☐ An individual committee member self-assessment, which focuses on each individual member's perspective and its overall performance.
- ☐ Committee member peer evaluation, in which each committee member evaluates the performance of each of their peers within the committee.

Selecting a Methodology



Key considerations for individual committee members :

- Members must ensure that they understand survey/interview questions
- Members must answer survey/interview questions honestly
- Members should not be afraid to include commentary regarding the effectiveness of the committee or individual committee members
- Members must ensure they understand the process of the assessment
- Members should ensure that they have a clear understanding of the type of methodology used during the assessment.

Assessment



- ❑ A variety of methodologies exist when performing an Audit Committee Evaluation
- ❑ These methodologies include the application of surveys, interviews and focus groups



Common Pitfalls



Description	Action plan
Selecting one methodology of assessment, e.g., the application of surveys as the only form of assessment.	Implement a combination of assessment methodology tools such as surveys, interviews and focus groups to ensure all audit committee and members concerns are analyzed and addressed.
Carrying out the evaluation with the sole reliance of an "in house specialist"	Enhance the creditability of the organization and committee by selecting an independent third party to conduct the evaluation.
Beginning with a 50-question formal assessment, in which committee members feel bombarded with information and feel intimidated by the assessment process.	Start briefly with the evaluation process e.g., an hour open ended audit committee discussion on the years progress and future plans.

Common Pitfalls



Description	Action plan
Committee members not answering assessment questions honestly and openly	Emphasize the importance of the evaluation to address concerns to ensure an effective and high performing audit committee results
Committee members having little understanding on the methodology adopted and the assessment process	Ensure all committee members are briefed on the evaluation process and have an understanding of the methodology adopted
Audit committee not following through on feedback and action plans to address improvement areas or key concerns	To ensure an audit committee “gets it right”, it is critical that action plans are implemented and monitored on a regular basis.

Feedback/Corrective Action for Board/AC Evaluation



- **Analysis**
- Feedback from surveys/interviews or focus groups are analyzed around key themes that surfaced from the assessment to aid in determining:
 - ✓ Strengths of the Audit Committee
 - ✓ Areas for potential improvement
- **Discussion**
- Schedule at least 2 hours (preferably half a day for the audit committee to discuss the results of the assessment)
- Discuss the top 2-5 areas for improvement and develop strategies to effectively address these concerns
- Create and action plan(2-5 items)

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Barriers to AC Performance Review



- The process is self-administered
- Over-complex process
- Cost implications
- The AC Chairman is the problem and is leading the process
- Lack of confidentiality
- Intrusions by investors or other stakeholders
- Lack of objectivity

Barriers to AC Performance Review.....



- Wrong approach – too much too soon
- Feedback skills
- Time pressures and poor planning
- The evaluation method being used leans towards a box-ticking exercise
- The issues of behaviour and attitude are overlooked in the evaluation process;
- Action plans are not part of the Audit Committee's agenda once the evaluation process is completed.

Leading Practices on AC/AC Chair Performance Review



- ❑ The AC members must possess the skills and attributes necessary for them to undertake their roles and responsibilities. **At least one member with relevant financial experience-Hold Accountancy Qualification**
- ❑ Their must be an effective Internal Audit Function properly structured and staffed to provide the interface between Senior Management, External Auditors and the AC/Board.
- ❑ The AC members must be properly inducted into the entity's business mandate through a structured induction and orientation program.

Leading Practices.....



- ☐ Consider the use of third-party reviewer for objectivity & confidentiality purposes.
- ☐ Identify a point person on the AC who is accountable for managing the AC evaluation process and following through on the recommendations/action plan.
- ☐ Conduct a well-planned, skillful interviews as part of the evaluation process to elicit more valuable, detailed, sensitive and candid director feedback as compared to questionnaires.
- ☐ Provide evaluation feedback to the individual AC Members.

Leading Practices.....



- ☐ Incorporate new perspectives on the AC's effectiveness by seeking inputs from other stakeholders e.g., Internal & External Auditors, Finance Director, Company Secretary who are regular invitees to the Committee meetings.
- ☐ Develop and implement a policy on Board Evaluation Process over and above what is contained within the Entity's Board Charter.
- ☐ AC can benchmark against other high-performing ACs in the same industry segment or against best practices in a specific area.
- ☐ Voluntarily provide additional disclosures including the results of the AC evaluation, action taken on the basis of the evaluation, current status, etc. through Annual Report/Website.

Leading Practices.....



- ❑ Increase the frequency of AC evaluation and ensure its a continuous process e.g., members can give regular feedback during meetings whether oral or written and this complements the annual evaluation process.
- ❑ Regular review of the evaluation process and the AC evaluation toolkit to ensure the objectives are being met.
- ❑ Preserve confidentiality by having an internal documents retention policy and using trusted parties to carefully handle and report on the data from the Committee Evaluations.
- ❑ Deploy a more-broad range of assessment measures beyond the compliance approach quite often adopted.

Conclusion



- ☐ There are many variables and elements to consider and implement-choose what is right for you
- ☐ Clearly define what is meant by “success” – a framework
- ☐ It is essential that the audit committee regularly monitors it's performance to ensure an on-going continuous improvement process results.



**Role of the Audit Committee in implementing
the HIA's Recruitment, Remuneration, Performance
Review, Termination & Professional Development.**



Presentation Outline

- ✓ **Case Study**
- ✓ **Discussion**

CASE STUDY – RHINO LTD

Recruitment of the Chief Audit Executive



- ❑ In today's business environment, where there is increasing focus on governance, risk management, and control thus appointing a CAE is a critical undertaking for any organization.
- ❑ **This imperative activity is one of the key responsibilities of the organization's Board/Audit Committee.** The CAE will have a high degree of interaction with Senior Management and the Board and thus needs to demonstrate the right attributes and skills for the position.
- ❑ The CAE's unique role in the organization requires independence and objectivity while also demonstrating an ability to partner within the Mgt.

Recruitment of the Chief Audit Executive



- Independence & objectivity are fundamental to the CAE's role because the individual must be willing to raise difficult issues with both Senior Management and the Board, even if that proves unpopular.
- To maintain credibility, CAEs must demonstrate the ability to escalate difficult issues to an appropriate level to ensure they are adequately addressed.
- The CAE must exhibit the attributes of integrity, intellectual curiosity, and a focus on audit quality. ***Key skill categories for a CAE include technical, business, communication, and people management skills.***

Recruitment of the Chief Audit Executive



In many instances, the process for choosing a new CAE, including establishing job qualifications, salary and benefits, are all determined by management, who then presents finalists or worst yet a single candidate to the Board for approval. Too many Boards or ACs already overworked by growing responsibilities, regulatory pressures, and commitments outside the organization, are all too eager to rubber stamp management's choice.

Richard Chambers, Former President & CEO, IIA-Global

Recruitment of the Chief Audit Executive (CAE)



- ❑ It is strongly encouraged that all CAEs, either before appointment or within a reasonable time period after appointment, should demonstrate a strong understanding of the roles and responsibilities of internal audit, the IPPF, and audit technical **skills through attainment of the Certified Internal Auditor® (CIA®) designation.**
- ❑ The key professional & personal attributes should be detailed in the job description for the position and will generally make clear the reporting relationships with the Board and Senior management.
- ❑ The Board may request to meet with the CAE candidates before making a final hiring decision.

Termination of the Chief Audit Executive



- ☐ The termination of the services of the CAE may be voluntary by the CAE or involuntary.
- ☐ The CAE may wish to resign for a range of reasons, and the employer, through the AC may have in place a process, such as an exit meeting and/or a questionnaire, to identify the reasons for the CAE's resignation and determine whether there are any issues that require further attention.
- ☐ When a contract agreement exists and the term expires but is not renewed, the AC *may desire assurance that non-renewal of the contract is appropriate.*

Questions the AC might Ask:



- ☐ *Did the CAE resign due to inappropriate limitations placed on the scope of his or her role and activities by senior management?*
- ☐ *Did the CAE resign due to remuneration/bonus issues, which management controlled?*
- ☐ *Did the CAE receive adequate support from the Board/AC and management to enable conformance with the Standards?*
- ☐ *Did the CAE have adequate resources to fulfill the requirements of the Internal Audit Function?*
- ☐ *Are there opportunities for future improvement that the CAE would recommend?*

When the CAE is terminated by the Employer



- ❑ The AC should oversee the termination of a CAE.
- ❑ AC will want to determine if termination is justified and appropriate. Identifying sensitive issues or wrongdoing by management are not reasons the AC would generally consider for termination of a CAE.
- ❑ Termination that is *either voluntary or due to poor performance* would be *considered acceptable*.
- ❑ ***The AC will most likely want to ensure the termination is not voluntary in appearance only but is genuinely voluntary.***

Termination by the Audit Committee

Consider terminating CAE's services when there is adequate evidence that:

- Stipulated professional performance requirements were not met.
- A material breach of either The Institute of Internal Auditors' (IIA's) Code of Ethics or the organization's internal code of conduct was committed.
- Material non-conformance with the IPPF's Standards exists.
- **When an involuntary termination is considered, the CAE needs to be prepared for the AC to:**
 - Review the documentation related to the performance issue(s).
 - Meet with the member(s) of senior management responsible for the recommendation for termination.
 - Meet privately with the CAE to confirm/discuss the performance issue(s).

The benefits of separate functional and administrative reporting lines are quickly mitigated when Boards and Audit Committees fail to support and nurture that separation, and nowhere is that more evident than when Boards or Audit Committees “sit on their hands” when it comes to hiring & firing the CAE.

**Richard Chambers,
Former President & CEO-IIA-Global**

Performance Review of the CAE



- ❑ The Chair of the AC should be accountable for setting the objectives of the CAE and appraising his/her performance at least annually.
- ❑ It would be expected that the objectives and appraisal would take into account the views of the Chief Executive. This appraisal should consider the independence, objectivity and tenure of the CAE.
- ❑ The performance assessment of the Head of Internal Audit should be driven by the Audit Committee and should **NOT** be left at the discretion of the management.

Source: National Treasury Guidelines on Audit Committees in the National Government

Performance Evaluation of the CAE



- An effective internal audit function will likely include the Board and senior management having in place a formal evaluation of the CAE's performance on a regular (at least annual) basis.
- This evaluation could include criteria pertaining to the CAE's required attributes and skills.
- The CAE may be required to review the criteria through a **scorecard**, which can be tied back to the internal audit charter and the CAE's job description.

Performance Evaluation Criteria for CAE



Specific Attributes- Independent, Objective, and Ethical.

Intellectually Curious-The CAE monitors the organization and its surroundings regularly, and provides proactive audit responses to changes in the risk environment

Quality Focused.-The CAE ensures that work is performed in accordance with all elements of the IPPF

Skills-Solid Business, Technical, and Process-These competencies are further described in the IIA Global's Internal Audit Competency Framework.

Performance Evaluation Criteria for CAE



- ❑ **Knowledge**-Adequate audit coverage is aligned with organizational goals and documented in annual and long-term internal audit plans.
- ❑ **Communication & Listening**-The CAE requests regular, concise communications with the AC (through formal meetings, executive sessions, and access to AC members for private conversations).
- ❑ **People Management**-The CAE maintains adequate resources to discharge responsibilities and manages turnover to appropriate levels.

Role in the Compensation of CAE



- ❑ CAEs should be remunerated according to the general principles (Salary & Benefits) of the organization in which they work. Thus, where there are variable as well as fixed components to remuneration, consideration should be given to the CAE receiving a comparable package to roles at the same level, based on appropriate criteria.
- ❑ Any variable remuneration component for the CAE should be decided on a basis that does not compromise internal audit's independence or objectivity.
- ❑ The AC should decide on a structure that does not undermine internal audit's willingness or ability to advise on risk or make judgements based on promoting long-term sustainability.

Role in the Compensation of CAE



- ☐ The level of remuneration of the CAE should reflect the level at which he/she is required to operate in the organization. Where variable remuneration is the norm, CAEs need not be excluded. **However, appropriate criteria should be chosen that do not undermine the CAE's independence and objectivity.**

- ☐ In considering the level of remuneration for the CAE, AC should have regard to the level at which the CAE is required to operate in relation to others in the organization. It should not be set lower than those in equivalent functions, notably in senior executive management. This will be particularly sensitive if the CAE position is staffed from within the organization.

Conclusion



The AC must review and concur in the appointment, annual compensation, annual performance review, replacement, re-assignment, or dismissal of the Chief Audit Executive (CAE) or outsourced internal audit function.

Summary



- The AC should take charge of the hiring process to ensure the CAE not only reports to them, ***but also has the qualifications and independent mind-set necessary for the role.***
- AC must be heavily involved in any effort to fire or move the CAE into a different role within the organization. They must assure that such moves are truly in the best interest of the organization and not just for the convenience of management.
- ACs serve an essential role in good governance by providing direction and oversight on risk management, governance and internal control. Performing this critical role includes selecting and appointing the CAE, and this role should **NEVER** be delegated to Management.



Independence & Resourcing of Audit Function & its Relationship with Management and the AC

Independence of the Internal Audit Function



Ideally, the Internal Audit function should report;

- ☐ Functionally to the Audit Committee
- ☐ Administratively to the CEO/Executive director of the organization

Threats to the Independence of the Internal Audit Function:



- ❖ Actions or persuasion designed to influence the conduct, scope of an audit, or the content of an audit report;
- ❖ Previous employment in area being audited, unless a suitable period (at least one year) has elapsed since the auditor's involvement;
- ❖ Personal relationships, particularly with the staff of the process being audited;
- ❖ Personal bias against top management/other officer whether due to ideological differences, personality conflict
- ❖ Financial interest by the auditor personally or indirectly through family members.

Threats to the



- ❖ The IA unit is organizationally located under an operational department e.g., Finance;
- ❖ The reports of the IA are subject to the prior approval of management before being released;
- ❖ The IA serves the audited entity in management or operational capacity;
- ❖ The IA's recruitment, performance appraisal, promotion and dismissal is influenced by top management.
- ❖ The IA is not readily accessible to those charged with governance;
- ❖ The IA is unable to conduct audits & report findings, opinions & conclusions objectively without fear of reprisal.

Measures to ensure the independence of the Internal Audit Function:



- ❑ The HIA should meet privately with the Board/Audit Committee without the presence of the management.
- ❑ The AC should have final authority to review and approve the annual audit plan and all major changes to the Audit work plan.
- ❑ The AC should review the performance of the HIA and overall IAF at least once a year, as well approve the compensation levels for the HIA.
- ❑ The AC should receive and review reports on Internal Audit engagements and monitor the performance and independence of the IAF.

Measures to ensure the.....



- ☐ The IA Charter should clearly articulate both functional and administrative reporting lines for the IA function.
- ☐ The reporting line should facilitate open & direct communications with CEO, senior executive group & line management.
- ☐ The Internal Auditors should have unrestricted access to information
- ☐ Budgetary controls and considerations imposed by the administrative reporting line should not impede internal audit in accomplishing its objective.

Resourcing the Internal Audit Function



- ☐ **In-house:** Provided exclusively or predominately by inhouse staff or managed in-house by an employee of the organization.
- ☐ **Co-Sourced:** Conducted by a combination of in-house staff and a sole service provider or a panel of service providers and managed in-house by an employee of the organization.
- ☐ **Outsourced with in-house management:** Provided by a sole service provider or a panel of service providers contracted to the organization for this purpose, with internal audit actively managed in-house by an employee with knowledge and experience of internal auditing.

Resourcing the Internal Audit.....



- ❑ **Outsourced:** Conducted by service providers contracted to the organization, with the service provider also managing the internal audit function. Management of the service provider's contract is conducted in-house by an employee of the organization who is unlikely to have knowledge and experience of internal auditing.

- ❑ ***In cases where total outsourcing is selected as the method for obtaining internal audit services, oversight and responsibility for the internal audit activity cannot be outsourced.***

Considerations for Outsourcing the Internal Audit Function



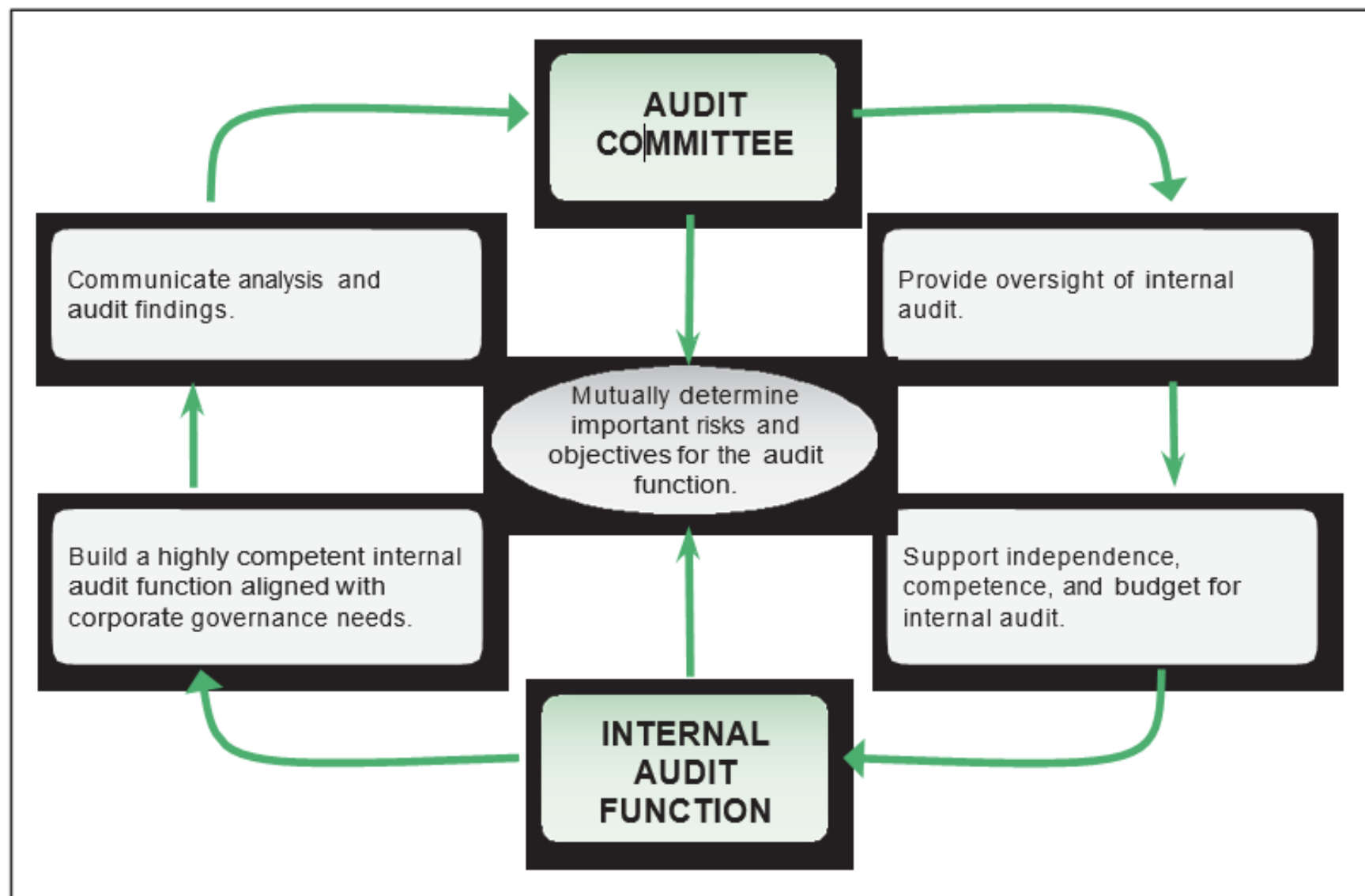
- ☐ Available resources and cost considerations
- ☐ Size of the organization
- ☐ Law, statute or regulations governing internal audits
- ☐ Independence of the external service providers
- ☐ Allegiance of in-house resources versus that of external service provider.

Considerations for Outsourcing the Internal Audit Function



- ☐ Professional standards followed by the external service provider
- ☐ Qualifications of the outsourced service provider
- ☐ Staffing – training, turnover, rotation of staff, management
- ☐ Flexibility in staffing resources to meet engagement needs or special requests
- ☐ Retention of institutional knowledge for future assignments

Exhibit 1 The Mutual Relationship Between the Audit Committee and the Internal Audit Function



Internal Audit Relationship with the Senior Management



- ❑ IAs look at the risks that stem from strategic and business objectives.
By looking at the risks that affect strategic business objectives, they are able to determine more effectively what information is most relevant to senior management.
- ❑ Internal Audit need to work with Management focusing mainly on management's response to audit findings and implementation of audit recommendations. They also work with management to ensure that unacceptable risks are properly mitigated and any unacceptable risk are reported to the AC for mutual determination.

List of References



- ☐ IIA Position Paper: ***The Role of Internal Auditing in Resourcing the Internal Audit Activity***
- ☐ Practise Guide: ***Chief Audit Executive's Appointment, Performance Evaluation, & Termination***, May 2010.
- ☐ IIA Research Foundation, ***Audit Committee Effectiveness***, What works Best, 3rd Edition.
- ☐ IPPF Practise Guide: ***Independence & Objectivity***, October 2011
- ☐ ***Chairing the Board***: A practical guide to activities and responsibilities, by John Harper.

Conclusions

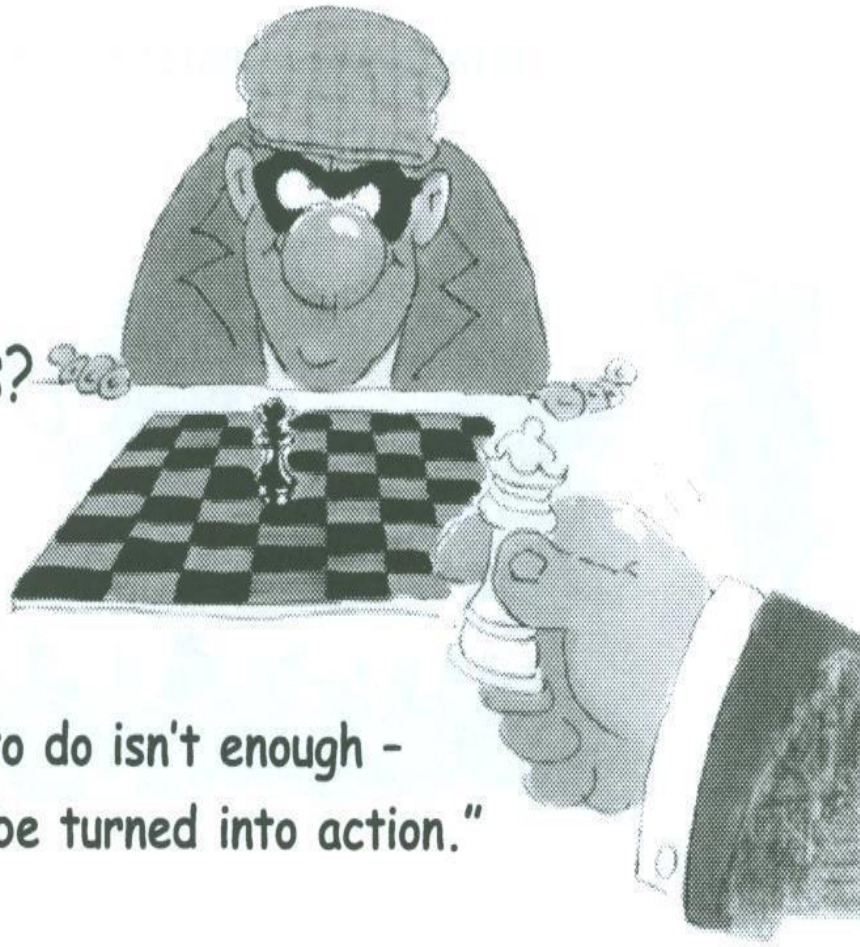


“Internal audit is the primary resource of the Audit Committee in carrying its duties and responsibilities. With those responsibilities increasing and continued pressure from the regulators for financial reporting integrity, a functioning partnership of the audit committee and internal audit is vital”

BellSouth Corporation

YOUR MOVE...

Questions?
Comments?
Observations?



"Knowing 'what' to do isn't enough -
knowledge must be turned into action."

