

# **THE BOARD AUDIT COMMITTEE MASTERCLASS**

## **INDEPENDENCE AND RESOURCING OF AUDIT FUNCTION & ITS RELATIONSHIP WITH MANAGEMENT AND THE AUDIT COMMITTEE**

- Managing Partner, Nelson and Francis LLP ,Chairman Audit Committee Baringo County
- CPA Nelson Korir
- 24 Feb 2021

# OUTLINE



1. BACKGROUND
2. BUDGET MAKING PUZZLE
3. PUSH FOR FINANCIAL LAWS TO  
STRENGTHENED FINANCIAL STEWARDSHIP
4. REVENUE DISTRIBUTION-SCENARIO
5. PENDING BILLS PANDEMIC
6. VEERING OFF COURSE IN FINANCIAL STEWARSHIP
7. REVENUE DISTRIBUTION AT A  
GLANCE IN COUNTIES
8. INDEPENDENCE & OBJECTIVITY
9. RESOURCES AND FATAL ISSUES
10. HURDLES TO RESOURCING OF INTERNAL AUDIT  
DIVISION
11. THREATS TO INDEPENDENCE
12. ATTEMPTS TO IMPROVE EFFECTIVENESS of  
INTERNAL AUDIT

# BACKGROUND

- Internal audit is a key function of organizations serving as financial security organ outfit, division engaging in oversight of businesses,
- Focus being on risk management, governance practices internal controls, budget review, validation of policies, review of entity financials on regular basis and other performance parameters.
- Traditionally, internal audit function has been under the belt of finance department headed by finance manager.
- Over time reporting line changed, reporting to entity chief executive officer.
- With independence and resourcing among other drawbacks and threats still a concern.
- Aim was to make internal audit function effective.
- Still on traditional audit function it is apparent firms were investing in IT infrastructure, meaning clients data sits on electronic platform with minimum investment in audit software, exposing further organization data to enormous risk. Low investment in audit software still a challenge.

# Push for financial laws to strengthened financial stewardship

- There has been a push to improve reporting model culminating in the establishment of audit committee in Financial Management Act 2012 and Rules 2015 with the oversight organ reporting to entity chief executive officer.
- The operationalization of the audit committee under Kenya Gazette No 2690 of 15<sup>th</sup> April, 2016.
- Audit Committee provided support layer to internal audit.
- Dwells on facilitation and resourcing
- Induction is a non-negotiable event
- Changes geared to making internal audit function and audit committee independent free from interference from those in the executive suite.

# BUDGET MAKING PUZZLE

- Entities prepare balanced budget to comply with financial laws and regulations
- Unvalidated payroll chews significant portion of exchequer releases, as high as 60% in some counties
- This impacts negatively on the quality of services in the entities, including provision of oversight services.
- From this scenario a mere 10% -15% is available OM.Tragic!
- Wage bill rationalization is envisaged to bring down this obesity to around 30% in the long run. Through strategic reforms.
- Policy leaves about 30% ring fenced for development
- Small portion is left to provide service and initiate the much needed reforms to lighten burden on wage bill.
- This state of affairs has eroded independence of audit function, organization oversight function.



# Revenue Distribution-SCENARIO

- Entities releases from exchequer represent close to 95% of devolved units` cash needs
- Payroll chews say 55%,
- Development 30%
- Basic services(OM) 15%
- Collections from local sources is on decline, oscillating at 3%-5% of resources available.
- Delay in exchequer releases coupled with falling revenue from local sources put counties on cash crisis as a permanent feature since 2014.
- Entities should craft AND VALIDATE policies that spur growth and development through newly establish Audit Committee

# Pending bills pandemic

- Pending bills are spontaneous credits obtained from business partners interest free
- Troubled entities carry off balance sheet transactions
- Common in firms operating single entry accounting system.
- They exacerbating cash woes in the entities ,
- They are settled on selective basis.
- No separate budget for spontaneous credit.
- It erodes entity tight budget.
- There are no validated policies to curb this menace that was flagged out by former Head of State HE Mwai Kibaki in his first term of office.

# VEERING OFF COURSE

- Many institutions have veered off course on financial stewardship
- 45 counties not on clean status.
- On Rider of oversight agencies
- Low investment in lobby body activities has affected independence of internal audit function.



# REVENUE DISTRIBUTION AT A GLANCE IN COUNTIES

- CRA provides platform for revenue distribution
- Approved by law makers
- Distribution approval runs for 5 years
- Share of funds anchored in constitution at 15%
- Glamour to increase to 35% under BBI
- Division of Revenue Act (DoRA) is passed to pave way for the release of funds to devolved units
- Amount stands at sh316.5billion
- Planning unhindered seamlessly for 5 years

Revenue distribution is relevant and affects independence and resourcing of independence of audit function

Resources poured to counties to cater for the following:

Lead	Model 1	Model 2	Model 3	Model 4	Model 5
Wage Bill	55%	50%	45%	40%	30%
Development	30%	30%	30%	30%	30%
Office Maintenance	15%	20%	25%	30%	40%
Total	100%	100%	100%	100%	100%

# Independence & Objectivity

- *Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.*
- The internal audit activity must be independent,
- Internal auditors must be objective in performing their work.
- *Internal audit Head has direct and unrestricted access to senior management and the board.*
- *This can be achieved through a dual-reporting relationship.*
- *Threats to independence must be managed at the individual auditor, engagement, functional, and organizational levels.*

# Organizational Independence

- The chief audit executive must report to a level within the organization
- That position 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.

# Requirement of Audit Committee

## Guideline no 2690 of 15<sup>th</sup> april, 2016

- *Fortifies facilitation and demystification. of oversight body*
- *Facilitation is placed on the door steps of accounting officer.*
- *.Internal audit Head reports to Audit Committee*
- *Audit Committee reports to Chief executive officer., appointing authority*



# Objectivity

- *Objectivity is an unbiased mental attitude*
- *It allows internal auditors to perform engagements and believe in their work product*
- *No quality compromises are made*
- *No subordination of judgement on audit matters to others.*

# *IMPAIRMENT OF ORGANIZATIONAL INDEPENDENCE AND INDIVIDUAL OBJECTIVITY*



*Impairment of organizational independence and individual objectivity may include, but is not limited to,*

- personal conflict of interest, scope limitations, restrictions on access to records, personnel, and properties, and resource limitations, such as funding*

- The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results
- Individual Objectivity  
Internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest

# RESOURCES

Audit Committee guideline is very rich on facilitation of the lobby body and internal audit function.

Watching perhaps over sh5billion plus spending requires pouring of resources to secure exchequer funds to the delight of public.

# FATAL ISSUES

- Ring fenced budget.
- Adequate secure office space
- Skilled personnel
- Lap tops(pen & pad)
- Audit software licenses for teammate
- Capacity building
- Empowered secretariat.



# HURDLES TO RESOURCING OF INTERNAL AUDIT DIVISION

- Flawed budgeting
- Entity Budget not being validated by internal audit
- Planning and budgetary control instrument not validated by internal audit division
- Failure to develop policies that spur growth and development
- Failure to attack payroll obesity chewing almost 60% of available resources through reform agenda
- Failure to adhere to Audit Committee guideline.
- Budget lumped with treasury budget, access is a challenge
- Management believes audit Committee sits at least 4 times a year,
- Audit Committee sittings guided by mandate anchored in law.
- Sittings bungled through poor facilitations, besides limited resources allocated to internal audit function.

# Threats to independence

- Failure to validate key planning and budget tools.
- Process anchored in Public Audit Act 2015
- Failure to validate payroll that chews close to 60% of entity resources.
- Lack of support from management-defiance in response to audit queries
- Restricted access to payroll system, records
- Restricted access to IFMIS
- Shuffling of audit staff without following established protocol
- Micro managing work of internal audit including allocation of errands outside audit work plan.
- Failure to ring fence budget
- Failure to perform induction-Demystification of role of internal audit function and internal audit committee
- Inappropriate inauguration process, low keyed
- Inappropriate Reporting model
- Limiting meetings running foul with internal audit committee mandate.
- Lack of credible policies to implement audit reports.
- Audit software is too expensive for the devolved units reeling in cash crunch
- Opaque direction on what happens when reports arrive at the door steps of appointing authority. Tuck in archives?

# ATTEMPTS TO IMPROVE EFFECTIVENESS of INTERNAL AUDIT



- Proper resourcing.
- Capacity building key stakeholders including internal audit Committee
- Timely demystification of internal audit reports through workshops and strategy reviews
- Timely demystification of supreme auditor reports
- Use of audit software, long overdue
- 
- Formation of task force under executive order to review oversight agencies reports and recommend appropriate action. This assists appointing authority to discharge his/her mandate effectively.
- Internal audit function to get involved in the validation of budgets and planning instruments and policies
- Submission of Audit Committee annual report within timeline provided in AC guideline and financial regulations
- Upgrade internal auditor to the level of Chief officer
- Internal audit committee to be vetted following upgrading of auditor to the level of Chief Officer
- Tenure of internal audit committee to run 8 years nonrenewable just for CoB and Supreme Auditor
- Those entities with low rating should embark on urgent reforms(holistic review)
- Anchor lobby body budget in Division of Revenue Act (DoRA) at 0.5%.
- ON LONG TERM BASIS, Remove internal audit function from National Treasury.

A decorative blue wave graphic with a white outline and a light blue gradient fill, curving from the top right towards the center of the slide.

**HOW COME MINISTRIES  
Departments, directorates  
are not subjected TO  
rigorous reporting as we  
in audit committee?  
Q & A**