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# PENSION SCHEME GOVERNANCE

GOVERNANCE . TRAINING . EMPLOYEE BENEFITS . TECHNOLOGY

# INTRODUCTION TO CORPORATE GOVERNANCE

- **Corporate governance** -> System of rules, practices, and processes by which a company or organization is directed and controlled.
- It involves balancing the interests of various stakeholders, such as shareholders, management, customers, suppliers, regulators, and the community.
- Key Components:
  - **Accountability:** individuals in positions of authority must be answerable for their actions.
  - **Transparency:** Providing clear, honest, and timely information to stakeholders.
  - **Fairness:** Treating all stakeholders with respect and ensuring that decisions are made without bias.
  - **Responsibility:** Acting in the best interests of all stakeholders, especially in terms of long-term growth and sustainability.

## Why Corporate Governance is Important for Pension Schemes

- For pension funds, corporate governance ensures that the funds are managed in a way that prioritizes the security of the members' investments and promotes ethical, transparent decision-making.
- It ensures that trustees, investment managers, and other parties involved in managing pension funds act in the best interests of beneficiaries and uphold the principles of accountability and transparency .

## Governance in Defined Contribution(DC) Schemes

- In DC schemes, the responsibility for the retirement savings lies with individual members, making governance even more crucial ensure that their interests are protected and their investments are managed prudently.



## Good Governance in Pension Schemes In Kenya

- Good governance in pension schemes is crucial to ensure that the retirement savings of individuals are managed **effectively, transparently** and **securely**.
- Kenya's pension system has undergone significant reforms focused on enhancing governance structures.
- These reforms are essential for fostering trust among contributors, enhancing the sustainability of pension schemes and ensuring that retirees receive their due benefits.

## PRINCIPLES OF GOOD GOVERNANCE IN PENSION SCHEMES

- The Retirement Benefits Authority in 2018 issued guidelines on good governance practices for pension schemes to adhere to. Some of the main practices outlined in the guidelines include:
  - i. Risk management
  - ii. Code of conduct and ethics
  - iii. Conflict of interest
  - iv. Communication policies
  - v. Data protection and Cyber security
  - vi. Funding policies
  - vii. Internal audit policy
  - viii. Procurement policy
  - ix. Transparency, accountability and disclosure to stakeholders
  - x. Trustee conduct and practices.

## PRINCIPLES OF GOOD GOVERNANCE IN PENSION SCHEMES

- Universally, good governance in pension schemes revolves around several key principles, including
  1. Accountability,
  2. Transparency,
  3. Integrity and
  4. Efficiency.
- These principles ensure that the management of pension funds is conducted in a manner that serves the best interests of the members and their beneficiaries.

# 1. Accountability

- Pension schemes must **have clear lines of responsibility** and **accountability**.
- Trustees and fund managers are accountable to the members of the scheme, and they must act in the best interests of these members.
- Regular audits and reporting are essential in maintaining accountability.



## 2. Transparency

- Transparency in operations and decision-making processes is vital for building trust among scheme members.
- This includes clear communication about investment strategies, fee structures, and the performance of the pension fund.



# 3. Integrity



- The governance of pension schemes must be grounded in ethical conduct and integrity.
- This involves adhering to the highest standards of professional & ethical behavior, avoiding conflicts of interest, and ensuring that decisions are made in an unbiased manner.

## 4. Efficiency

- Efficient management of pension schemes ensures that administrative costs are minimized and investment returns are maximized.
- This requires effective administration, prudent investment strategies, and regular performance evaluations.



# 5. Public Participation



- Citizen involvement in decision-making processes is essential for democratic governance.
- It ensures that policies and decisions reflect the will and needs of the people.

# Challenges in Governance of Pension Schemes

- Despite the regulatory framework and principles in place, Kenyan pension schemes face several challenges that impact governance.
  - 1. Regulatory Compliance:** Ensuring compliance with regulatory requirements can be challenging for some schemes, particularly smaller ones with limited resources. Non-compliance can lead to penalties and erode member trust.
  - 2. Investment Management:** Achieving optimal investment returns while managing risks is a significant challenge. Trustees and fund managers must have the expertise to navigate complex financial markets and make sound investment decisions.

## Challenges in Governance of Pension Schemes

- 3. Transparency and Communication:** While transparency is a cornerstone of good governance, achieving it can be difficult. Pension schemes must ensure that their communication with members is clear, comprehensive, and accessible.
- 4. Conflict of Interest:** Avoiding conflicts of interest is critical for maintaining the integrity of pension schemes. Trustees and managers must act solely in the interest of scheme members, but conflicts can arise, particularly in schemes with ties to sponsoring employers.
- 5. Member Education and Engagement:** Educating scheme members about their rights and the workings of the pension scheme is essential for fostering trust and engagement. However, achieving effective member education can be challenging due to varying levels of financial literacy.

## Measures to Promote Good Governance

- **Strengthening Regulatory Oversight:** The RBA has enhanced its regulatory oversight through regular inspections, audits, and enforcement of compliance standards.
- This helps ensure that pension schemes adhere to best practices and regulatory requirements

# Measures to Promote Good Governance

- **Capacity Building:** Training and capacity-building programs for trustees and fund managers are crucial.
- These programs aim to equip them with the necessary skills and knowledge to manage pension funds effectively and ethically



## Measures to Promote Good Governance

- **Enhanced Transparency:** Efforts to improve transparency include mandating regular disclosures of financial performance, investment strategies, and fees.
- These activities are crucial for building and maintaining trust among scheme members.
- Schemes are encouraged to use technology to facilitate better communication with members.

# Measures to Promote Good Governance

- **Conflict of Interest Policies:** Implementing robust policies to manage conflicts of interest is essential.
- This includes clear guidelines on the roles and responsibilities of trustees, and mechanisms for addressing potential conflicts.



# Measures to Promote Good Governance

- **Member Education Initiatives:** Educational initiatives aimed at improving financial literacy among scheme members are being promoted.
- This includes workshops, seminars, and the provision of educational materials to help members understand their pension benefits and make informed decisions.



# Measures to Promote Good Governance



- **Technological Advancements:** Leveraging technology, such as **mobile apps** and **online portals**, improves administrative efficiency, enhances communication, and provides members with real-time access to their account information and scheme performance.

# Integrating ESG Principles into Governance

- **Environmental, Social, and Governance** (ESG) Integration.
- There is growing emphasis on ESG factors in pension fund investment decisions... especially when transitioning to alternative investment.
- Trustees' role in ensuring that investments align with ESG principles.
- ESG integration as a way to enhance long-term fund performance and sustainability.
- Ensuring compliance with evolving ESG regulations.

# Role of Technology

- There is need for Leveraging Technology for Better Governance
  - Use of technology to enhance **transparency** and **reporting**.
  - **Automation** and **data analytics** to improve decision making and risk management.
  - **Online platforms** for member engagement and feedback.
  - The role of **cybersecurity** in protecting member data and fund assets.



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## PENSION SCHEME AUDIT PROCEDURES AND STRATEGIES

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# INTRODUCTION

- Pension plan audits are critical evaluations conducted to ensure **compliance** with regulatory requirements and the proper **management** of funds within a plan, aimed at protecting the financial **security** of participants.
- These audits assess the accuracy and completeness of a plan's financial records and often provide insights into the operation and administration of the plan, which can include assessments of contributions, benefit payments, and participant data.
- Adhering to standards such as the RBA Act is crucial for successful pension plan audits, as it helps maintain transparency and trust in the financial processes of retirement funds.

# Understanding Pension Plan Audits

- Gaining insight into **pension plan audits** is essential for anyone involved in managing or evaluating retirement plans. These audits ensure financial accuracy and **compliance** with various regulations.



# What is a Pension Plan Audit?

- A **pension plan audit** is a thorough examination of a retirement plan's **financial statements** and practices. Conducted by independent auditors, these audits confirm that the plan complies with relevant laws and financial **reporting requirements**.
- Pension plan audits generally assess two main areas:
  - 1. Financial statements:** Auditors verify that financial records accurately represent the plan's financial position.
  - 2. Internal controls:** Auditors evaluate the processes that manage and safeguard the plan's assets.

# Why Are Pension Plan Audits Necessary?

- Pension plan audits play a crucial role in maintaining the **integrity** of retirement plans. They serve several essential purposes:
  1. **Compliance:** Ensures that the plan follows regulations set by regulators.
  2. **Accuracy:** Helps catch errors or discrepancies in financial statements.
  3. **Transparency:** Builds trust among the participants and beneficiaries of the plan.
  4. **Safeguarding assets:** Assists in identifying any weaknesses in the **internal controls** that might expose the plan to fraud or errors.
- The necessity for these audits also stems from specific thresholds. For instance, plans with 100 or more qualified participants often require annual audits.

# Steps in Conducting a Pension Plan Audit

- Conducting a pension plan audit involves several critical steps, each aiming to ensure thorough examination and assessment:
  - 1. Engagement Planning:** The audit begins with **planning**, where auditors determine the scope and objectives.
  - 2. Risk Assessment:** Auditors evaluate potential risks that might affect the plan's accuracy and compliance.
  - 3. Testing Controls:** The internal controls of the plan are tested to ensure they are effective in managing risks.
  - 4. Substantive Testing:** Financial data and transactions are rigorously tested for accuracy.
  - 5. Reporting Findings:** The audit concludes with a report detailing the findings and any necessary **corrective actions**.

# Components of a Pension Plan Audit Report

- The audit report is a key component, providing detailed insights into the plan's financial health and compliance. A typical pension plan audit report includes:

<b>Opinion:</b>	A statement on whether the financial statements are presented fairly.
<b>Observations:</b>	Notes on any discrepancies or issues found during the audit.
<b>Recommendations:</b>	Suggestions for improving financial practices and compliance.
<b>Summary of Testing:</b>	Details on the testing performed and the results.

# Audit Procedures for Pension Plans

- Pension plan audits involve a structured set of procedures to ensure thorough evaluation of the financial statements and adherence to regulations.
- These audits help in identifying discrepancies and ensuring the accuracy of financial practices.



# Initial Planning of Audit Procedures

- The initial planning stages of **audit procedures** are crucial for setting the scope and objectives.
- This involves reviewing the nature and structure of the pension plan.
- During the planning phase, auditors consider the financial statements and operational aspects that will be examined.
  1. Determine the audit's scope.
  2. Set objectives outlining specific goals of the audit.
  3. Review and gather preliminary financial information.
- Planning helps auditors assess the resources required and outline a timeline for completion.

# Testing and Control Assessments

- **Testing and control assessments** focus on actual examination and validation of financial data. These steps are vital for verifying the **integrity** of a pension plan's financial information.
- To evaluate the internal controls, auditors need to:
  - Test the effectiveness of the plan's internal controls.
  - Examine transactions to verify they are authorized, recorded, and reported properly.
- Examples of tests might include:
  - Testing whether participant contributions are accurately tracked and allocated.
  - Verifying that benefit payments align with plan terms.

# Reporting and Evaluating Findings

- The final phase of a pension plan audit involves **reporting and evaluating findings**. Auditors compile their observations into a comprehensive report, offering insights and recommending improvements.
  - **Opinion:** A statement on the fairness of the financial statements.
  - **Recommendations:** Advice for improving financial reporting and internal controls.
  - **Follow-up Actions:** Identified steps to rectify any issues surfaced during audit.
- The ultimate goal of this phase is to enhance transparency and ensure that accurate, trustworthy financial information is available to plan participants and regulators.

# Standard Audit Processes

- The standard audit process for pension plans consists of multiple distinct steps that auditors follow meticulously.
- Understanding these steps sheds light on the thoroughness of pension audits.
  1. **Initial Engagement:** Assess the auditor's understanding of the pension plan structure.
  2. **Planning and Scoping:** Define the audit's scope and objectives.
  3. **Testing Controls:** Evaluate the effectiveness of internal controls.
  4. **Substantive Procedures:** Perform transactions testing.
  5. **Reporting:** Deliver findings and recommendations.

# Advanced Methodologies

- In addition to standard steps, advanced **methodologies** enhance the audit's effectiveness.
- These include **data analytics** and **risk-based auditing** techniques.
  1. **Data Analytics**: Utilizes complex software to analyze patterns in financial data.
  2. **Risk-Based Auditing**: Targets high-risk areas for more intensive scrutiny, allowing auditors to efficiently allocate resources.

# Utilizing Technology in Audits

- Utilizing modern technology enhances the accuracy and efficiency of pension plan audits.
- Tools like **computer-assisted audit techniques (CAATs)** and **enterprise resource planning (ERP)** systems are frequently employed.
  1. **CAATs:** Software programs that help analyze and evaluate the plan's data.
  2. **ERP Systems:** Integrated systems facilitating real-time data access across operational areas.
- An auditor might use CAATs to test the accuracy of transactions recorded over a virtual ledger, ensuring every entry is correctly logged in the pension plan's books.

## How does internal audit fit into best practice governance?

- Using a popular governance model termed **'the three lines of defense'** helps demonstrate how the governance requirements, including internal audit, fit into best practice governance, as illustrated below.



# How does internal audit fit into best practice governance?

Line of Defense Requirements	What does this mean?	Governance Requirements
<p><b>1st Line of Defense</b></p> <p>Day to day processes and related operational controls</p>	<ul style="list-style-type: none"> <li>• Administration</li> <li>• Investment Management</li> <li>• Scheme Accounting</li> </ul>	<ul style="list-style-type: none"> <li>• An effective internal control system which Includes administrative and accounting procedures</li> <li>• An internal control framework</li> <li>• Appropriate reporting arrangements</li> </ul>
<p><b>2nd Line of Defense</b></p> <p>Oversight and monitoring controls</p>	<ul style="list-style-type: none"> <li>• Trustee and pension management reviews</li> <li>• Risk Management Assessments</li> <li>• Integrated Risk Management (DB)</li> <li>• Chair's Statement (DC)</li> </ul>	<ul style="list-style-type: none"> <li>• A risk management function</li> <li>• Own-risk assessment</li> <li>• An internal control framework</li> <li>• Appropriate reporting arrangements</li> </ul>

# How does internal audit fit into best practice governance?

Line of Defense Requirements	What does this mean?	Governance Requirements
<p><b>3rd Line of Defense</b></p> <p>Objective and independent assurance</p>	<ul style="list-style-type: none"> <li>• External audit</li> <li>• Internal audit</li> <li>• Internal control reports from service providers</li> <li>• Ad hoc assurance, for example independent benefit reviews.</li> </ul>	<ul style="list-style-type: none"> <li>• An effective internal audit function</li> <li>• An internal control framework</li> <li>• Appropriate reporting arrangements</li> </ul>

# THANK YOU





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