SPEAKING NOTES BY MR. MOHAMMED NYAOGA, CHAIRMAN, CENTRAL BANK OF KENYA AT THE INSTITUTE OF CERTIFIED PUBLIC SECRETARIES OF KENYA (ICPSK) GOVERNANCE FORUM AT THE SAROVA PANAFRIC HOTEL ON WENESDAY 2ND MARCH 2016

GOOD GOVERNANCE IN THE MANAGEMENT OF PUBLIC FUNDS

1. Good governance is an indispensable facet of management of public funds. Besides money raised by the government through taxes or borrowing and entrusted to government agencies to provide public services, other examples of public funds include:

   - Depositors funds held by commercial banks
   - Shareholders' funds held by listed companies
   - Insurance premiums and funds held by insurance companies
   - Retirement benefit funds held and managed by retirement benefits companies.
   - Funds entrusted to non-governmental organizations for promotion of public good.

2. Managers of public funds are placed in a fiduciary position that requires sound governance practices. Without good governance practices in place, public funds are inevitably lost to the detriment of ordinary citizens and the country at large.

3. Company secretaries have the unenviable role of advising organizations' boards on compliance issues, ensure an organization is compliant with applicable laws and generally to promote good governance.

4. Corporate governance is an evolving discipline, there are universally accepted elements of good corporate governance, which include: well-defined shareholder rights, sound control function and processes, high transparency and accountability, an empowered board of directors, as well as corporate social responsibility. In essence, corporate governance is a commitment to stakeholders and the wider community.

5. There is adequate legal framework in place to ensure good governance in the management of public funds. In Kenya, the policy framework in support of good governance is enshrined in legal regulation, self-regulation by some entities as well as active promotion of a culture of good governance.

6. At the very top, Chapter Six of the Constitution sets out the principles of integrity and leadership that ought to guide public officers in discharging the functions of their offices. Thereafter, each industry has specific laws that espouse good governance, whether banking, insurance, capital markets, parastatals, non-governmental organizations, among others. Specific to the banking sector, there are in place banking laws, regulations and prudential guidelines that amplify the virtues of good governance.

7. Sound and effective corporate governance cannot rely solely on the legislative framework, but rather requires self-discipline and the proper execution of duties by directors and managers of corporate organizations, checks and balances and the promotion of an ethical corporate culture. I believe that "tone at the top" is the key because it drives the behavior of the whole organisation all the way

through from the chairman, the board and down to the front line. Good market conduct is driven by good behaviour, not by rules and regulations. As aptly put by Louis Gerstner, former IBM Chairman and CEO, "the real mechanism for corporate governance is the active involvement of the owners".

8. The Central Bank of Kenya (CBK) on its part as a regulator strives to instill a culture of good corporate governance in banks. For instance, CBK vets shareholders, directors and senior officers of banks before they take up office to ascertain their moral and professional suitability for office. Similarly, the Prudential Guidelines on Corporate Governance, 2013 outlines the expected ethical standards and internal controls required from banks.

9. Industry associations such as the Kenya Bankers Association also have codes of conduct for its members detailing how they are supposed to conduct themselves.

10. Based on international standards and the experience over the years, the Central Bank has prescribed the following corporate governance principles to guide banks in the management of public (customer) funds entrusted to them:

    a. **Ethical Leadership and Integrity** - The board should provide effective leadership based on an ethical foundation.
    b. **Responsibilities of Shareholders** - Shareholders of banking institutions should jointly and severally protect, preserve and actively exercise the supreme authority of the institution in general meetings.
    c. **Overall responsibilities of the Board** - The board has overall responsibility for the bank, including approving and overseeing the implementation of the bank's strategic objectives, risk strategy, corporate governance and corporate values.
    d. **Role and competence of Board members** - Board members should be and remain qualified, including through training and Continuous Professional Development (CPD), for their positions.
    e. **Board's Governance practices** - The board should define appropriate governance practices for its own work and have in place the means to ensure such practices are followed and periodically reviewed for improvement.
    f. **Senior Management** - Under the direction of the board, senior management should ensure that the bank's activities are consistent with the business strategy, risk tolerance/appetite and policies approved by the board.
    g. **Risk Management Framework** - The board must ensure that the banking institution has adequate systems to identify, measure, monitor and manage key risks facing the banking institution and adopt and follow sound policies and objectives which have been fully deliberated.
    h. **Compliance with Laws, Rules, Codes and Standards** - The board should ensure that the institution complies with applicable laws and considers adherence to the institution's rules, codes and standards.
    i. **Internal Control Functions** - The board and senior management should effectively utilize the work conducted by internal audit functions, external auditors and internal control functions.
    j. **Bank's Operational Structure** - The board and senior management should know and understand the bank's operational structure and the risks that it poses (i.e. ‚know-your-structure').

k. **Disclosure Requirements** - The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.

11. These principles have helped a great deal in ensuring corporate governance in banking institutions.

12. Despite the measures in place, it is a reality that public funds are still lost mainly through failure to follow sound governance practices in place as well as outright lack of integrity and ethics on the part of those entrusted with public funds. Good governance therefore not only requires adequate laws and regulations but also ruthless integrity and ethics on the part of those managing public funds. In summary, good governance involves:

    (a) **Focusing on the organizations purpose** – When managing public funds, there must be sharp focus on the organization's purpose, vision and mission to ensure that the users of the organization services such as taxpayers, depositors and ordinary citizens get the services they deserve and value for their money.

    (b) **Effective performance** – Whatever your role is in an organization's hierarchy you must discharge it effectively and efficiently. This means being clear about your responsibilities in the organization and discharging them, without dereliction of duty.

    (c) **Demonstrating good governance values through behavior** - You must put good governance values into practice when carrying out day to day activities.

    (d) **Transparency** – Decisions should be made in an open and transparent manner. In this regard, consultation with all stakeholders before reaching a decision is critical.

    (e) **Upholding the rule of law** – All provisions of law applicable to an organization including procurement laws and provisions of statutes applicable to the organization must be followed to the letter.

    (f) **Actively promoting and cultivating a culture of good governance** in the organization from the top management to the lowest cadre of staff. This can only be achieved if the top organs in organizations such as directors and CEOs demonstrate that public funds are worth safeguarding for the common good. This culture will then trickle down to the entire organization.

    (g) **Having appropriate checks and balances** – The oversight authority, mainly the board of directors should have a clearly defined mandate and be adequately independent in order to perform its oversight role over the organization and ensure that funds are not lost.

13. Ensuring good corporate governance has its own challenges as experience in Kenya has shown. Some of these challenges include:
    i) Pursuit of personal financial interests (self-aggrandisement) at the expense of public good.
    ii) Insider dealings – favouritism, nepotism, tribalism etc which tend to be given priority over merit, competence, professionalism,
    iii) Weak enforcement mechanisms thereby creating an atmosphere of anarchy.

iv) Weak legal framework in some instances thereby creating loopholes for corporate "mis-governance".
v) Inability to get truly independent directors to the boards who are able to provide the necessary unbiased advice and direction.
vi) Political interference.
vii) Appointments without competitive process thereby making the CEOs answerable or susceptible to the appointing authorities.
viii) Boards comprising of cronies of the appointing authorities.
ix) Conflict of interests eg board members doing business directly or through proxy with the company to which he is a board member.
x) Lack of clear board roles/functions which sometimes clash with those of the CEO.
xi) Lack of diversity (skills, relevant knowledge, professionalism, competence, gender, regional balancing, etc) in board composition.
xii) CEO playing the role of chair of the board thereby diminishing the boundary between management role and oversight role.

14. These challenges have a direct negative bearing on how officers entrusted with public funds manage such funds.

15. These challenges can however be overcome through bold steps, some of which might be painful, total commitment of all stakeholders involved in doing the right thing, removing officers who are a liability to the institution or who do not act in the best interest of the institution.

16. Having appreciated the importance of good governance as a tool for ensuring that public funds are not misappropriated, I trust that some of the insights which will be discussed today will go a long way in improving the existing frameworks in our various organizations.

17. Thank you.