

King's Counsel*

Internal financial controls



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The King Committee on Governance issued the *King Report on Governance for South Africa – 2009 (the “Report”)* and the *King Code of Governance Principles – 2009* (the “Code”), together referred to as “King III” on 1 September 2009.

The issuance of King III was necessitated by the new Companies Act of South Africa and changes in international governance trends since the release of the second *King Report on Corporate Governance for South Africa* (King II) in 2002.

King III states that the audit committee is vital to ensuring the integrity of integrated reporting and internal financial controls (IFCs). In addition, the audit committee should have oversight of financial reporting risks. In order to align recommendations with global best practice principles, King III recommends:

- A statement from the board on the effectiveness of internal controls to be included in the integrated report;
- A statement from the audit committee, also included in the integrated report, on the effectiveness of IFCs. No external attestation is required to be made on the audit committee’s statement on IFCs;
- The statement made by the audit committee should be supported by a formally documented annual review of the design, implementation and effectiveness of the company’s system of IFCs following suitable testing performed by internal audit or any body to which authority is assigned by the audit committee;
- The audit committee should evaluate the nature and extent of the formal documented review of IFCs; and
- The nature and extent of weaknesses in financial control that are considered material and that resulted in actual material financial loss, fraud or material errors, should be reported to the board and stakeholders.

Meeting the internal financial control requirements of King III and putting its principles into practice requires a number of practical interventions. The purpose of this paper is to highlight those areas of King III that apply to an organisation’s assessment of its IFCs and to offer our professional insights into how entities can practically implement and apply these recommendations, including the seven key questions we believe the audit committee should be asking:

- Is there a control framework (e.g. COSO) governing financial reporting in the organisation?
- Have all the risks to the preparation of the financial statements in accordance with the applicable financial reporting framework (such as International Financial Reporting Standards), including where relevant, their fair presentation been identified and documented?
- Are there controls (manual and automated) in place to address these risks and are they adequately designed to prevent or detect material misstatements in the financial statement results and disclosures?
- Do the controls identified operate as they are supposed to and are they appropriately evidenced?
- Has internal audit tested the controls identified above and reported the results to the audit committee completely and accurately?
- Is the audit committee’s assertion appropriately evidenced (including internal audit’s assessment)?
- Is a process in place to ensure that the framework remains relevant over time and is embedded as part of the company’s financial reporting procedures?

The approach to IFCs should ensure that a sensible balance is maintained between the costs of implementing and monitoring the framework and the benefits of such a framework.

1. What are the key concepts and best practices relevant to internal financial controls under King III?

King III requires the audit committee to oversee a formal process to assess and report on the effectiveness of IFCs on an annual basis.

What constitutes effective internal financial controls?

To adequately apply the King III recommendations, a control or combination of controls can be considered effective if the risk of material misstatement in the financial statements is adequately reduced and, as a result, the controls provide a basis for the preparation of reliable financial statements.

The most widely used benchmark that companies have used globally to assess internal controls is the COSO framework. COSO, which stands for the Committee of Sponsoring Organisations (of the Treadway Commission) was originally formed in 1985 to study factors leading to fraudulent financial reporting and to develop recommendations for public companies and their independent auditors, for various regulators, and for educational institutions. The organisation published an internal control framework that set out critical elements of effective internal control. These elements are described in more detail below.

What constitutes an evaluation of internal financial controls?

In order for the audit committee, internal audit, or an appropriately assigned authority to report on the effectiveness of IFCs, an evaluation is required of the organisation's IFC framework.

The overall objective of such a control framework, which should be documented, is that it achieves the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant, their fair presentation.

The controls included in the framework should be those IFCs that collectively mitigate the risk of material misstatement in the financial statements and disclosures – each individual control is often referred to as a “key” control.

The framework of controls evaluated for reporting on IFCs should not have to include all controls that management relies on for complete and accurate reporting, but should be limited to those “key” controls that mitigate the risk of material misstatement in the financial statements.

How does an organisation conduct an assessment of internal financial controls?

There are three steps that should underlie the assessment:

- i. Identifying the risks of material misstatement in the financial statements and identifying controls that address them;
- ii. Evaluating the adequacy of controls and evidence supporting the performance of the controls; and
- iii. Concluding on the results of testing and reporting to stakeholders by the audit committee.

i. Identifying risks of material misstatement and identifying controls that address them

A risk-based approach should be followed to identify likely sources of material misstatements in the financial statements and disclosures. These risks should then be mitigated by controls that are adequately designed and are operating effectively to ensure the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation. From the start, it is important to understand the controls currently in place within the business that contribute to achieving the objectives recommended by King III.

The risk of financial statement misstatement may arise from internal or external risk factors that impact on the business, both quantitative and qualitative. Risks may also manifest in the initiation, authorisation, processing and recording of transactions and other adjustments that are reflected in financial information. Consideration should also be given to immaterial suspense/control accounts where large numbers of transactions are recorded, reconciled and cleared. In order to determine the relevance of the risks identified, management should consider both the likelihood (probability) and impact (value) of error.

Mapping the appropriate controls or combination of controls to the risk assessment is important as the risk of material misstatement may be addressed by a control that operates in isolation, or a combination of controls that together mitigate the risk of material misstatement. Judgment should be used to identify the nature and extent of controls required to mitigate the risk of misstatement.

In our experience...

A good starting point for the risk assessment is an evaluation of all significant account balances or disclosures in the financial statements and the underlying processes and/or locations that generate them.

The identification of significant accounts and disclosures

Consider the inherent risk of material misstatement in “significant account balances and disclosures”. The starting point for making these judgments is quantitative. Quantitative assessments are likely to be tied to financial statement materiality, however determined by the entity’s management. It is important to note that qualitative considerations are also an important part of the risk assessment process. For example, all notes to the financial statements are likely to be judged significant by virtue of the fact that they are included in the financial statements. Once management has identified the significant account balances and disclosures within the scope of its assessment, the risks associated with relevant financial statement assertions will further determine the nature and extent of controls to be evaluated.

Determining relevant assertions and risks

Financial statement assertions are those representations by management, explicit or otherwise, that are embodied in the financial statements and used by internal audit to consider the different types of potential misstatements that may occur.

Assertions fall into the following categories:

Assertions about classes of transactions and events for the period include:

- Occurrence: transactions and events that have been recorded have occurred and pertain to the entity;
- Completeness: all transactions and events that should have been recorded have been recorded;
- Accuracy: amounts and other data relating to recorded transactions and events have been recorded accurately;
- Cut-off: transactions and events have been recorded in the correct accounting period; and
- Classification: transactions and events have been recorded in the proper accounts

Assertions about account balances at the period end include:

- Existence: assets, liabilities and equity interests exist;
- Rights and obligations: the entity holds or controls the rights to assets and liabilities that are the obligations of the entity;
- Completeness: all assets, liabilities and equity interests that should have been recorded, have been recorded; and

- Valuation and allocation: assets, liabilities and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

Assertions about presentation and disclosure include:

- Occurrence and rights and obligations: disclosed events, transactions, and other matters have occurred and pertain to the entity;
- Completeness: all disclosures that should have been included in the financial statements have been included;
- Classification and understandability: financial information is appropriately presented and described and disclosures are clearly expressed; and
- Accuracy and valuation: financial and other information are disclosed fairly and at appropriate amounts.

Only controls over relevant assertions need to be included in the scope of the assessment.

Determining significant processes and locations

In order to establish exactly where the risk of material misstatement manifests, the assessors will have to gain an understanding of the processes that give rise to the significant account balances and disclosures and identify which locations are individually significant or present a higher risk of material misstatement to the financial statements. This is an important step that will enable the assessors to identify exactly which “key” controls or combination of controls address the risk of material misstatement and consequently form part of the evaluation. Individual locations might also present specific risks based on unique aspects of business in certain locations. Alternatively, a “centres of excellence” approach to implementing controls over the recognised risks can be documented and tested. Other locations may be significant in aggregate, and governed by “entity” controls which are documented and tested.

Determining “key” internal financial controls

The “key” IFCs are those controls that form part of the IFC framework that are subject to the assessment and are essentially those controls that mitigate the risk of material misstatement in the financial statements. The controls can be performed within a transactional process, embedded in IT system controls, performed as part of the financial reporting process or as part of management’s review and monitoring or governance functions.

ii. Evaluating the adequacy of controls and evidence supporting the performance of the controls

Controls identified in the previous section are evaluated to determine whether they are adequately designed, implemented and are operating effectively by conducting suitable validation and/or testing procedures.

Design effectiveness

Controls are evaluated to ensure that they are adequately designed to detect/prevent material misstatements in the financial statements. Relevant assertions and control objectives are sufficiently addressed for all significant accounts and disclosures.

Operating effectiveness

Assuming that controls are effectively designed, testing occurs to ensure that they are also operating effectively. This requires the development and implementation of testing plans, consideration of exceptions, remediation decisions and testing of remediated controls.

Controls that require remediation, either because they are not adequately designed to mitigate the risks identified or because they are not operating effectively, are identified, prioritised and recorded, on a remediation plan.

The extent of the evidence required to address the recommendations of King III is subject to management and internal audit's discretion (ultimately the audit committee should satisfy itself that the process followed is acceptable). Management and internal audit should determine the nature and extent of support required to substantiate the examination and to support conclusions on the design, implementation and operational effectiveness of internal financial controls.

What is considered appropriate evidence to support internal audit's report to the audit committee?

Internal audit is responsible for maintaining reasonable support for its assessment. The extent of support required will vary based on the financial reporting risks identified and other factors, such as the size and complexity of the entity. Internal audit, together with management, should decide what the nature and extent of support required to validate its decision is. However, the support should, at a minimum, include documentation supporting:

- The design of the controls identified to address material financial reporting risks;
- How evidence was gathered and evaluated to support conclusions drawn; and
- The basis for determining whether a control was effective or not.

In principle, the evidence gathered to support internal audit's conclusions should be aligned with the risk to reliable financial reporting. Controls that mitigate a high risk to reliable financial reporting should be evidenced with greater rigour than controls that mitigate a lower risk.

Evidence supporting the performance of controls can take many forms (for example, paper documents, electronic documents, system descriptions and e-mails). The documentation can also be presented in a number of ways (for example, policy manuals, process models, flowcharts, job descriptions, internal memorandums and checklists).

The nature, timing and extent of validation/testing procedures performed should also be aligned with the risk to reliable financial reporting.

Areas that pose a high risk to reliable financial reporting can be more robustly validated/tested by internal audit, while self assessments by management may be considered acceptable evidence for those areas considered lower in risk.

In our experience...

- Evaluations that begin with identifying controls embedded in transaction-level processes generally end up with too many "non-key" controls as part of the IFC framework. This approach is commonly known as a "bottom-up" approach and cannot be sustained. Where possible, a top-down approach should be implemented.
- Many concepts may be foreign to key "non-accountant" members of the project team. As a result, education may be needed to ensure that concepts such as financial statement assertions are fully understood.
- Most companies are adequately controlled. However, the majority do not have appropriate documentation or evidence of the operation of those controls and this is usually the most labour and time-intensive aspect of the IFC project.
- Documentation is often not at the required level of detail. For example, a control may be described as "unusual matters are followed up and resolved". The documentation must clearly set out what is "unusual" and what constitutes "resolved" in order for these aspects of the control to be tested.
- The determination of significant locations is an involved process and many companies have not adequately scoped their projects because of a failure to properly identify significant locations. A location is not necessarily a legal entity or even a separate unit within the company. In essence, a location is anywhere that a control is executed.

- Responsibility for systems controls, both within business units and within internal audit, is usually segregated from responsibility for manual controls. It is important to the success of the IFC project that consideration of these controls is integrated. For example, where a key manual control is the reconciliation of two reports, consideration must be given to the systems controls that ensure the reports are reliable and accurate, not just the manual reconciliation process. Failure to address these controls on an integrated basis may render the IFC project less efficient and/or less effective.
- There are some areas that will require the co-operation of entities outside the scope of control of the entity. In particular, entities to which controls have been outsourced, such as payroll providers, custodians and clearing houses, must be consulted as to the degree of reliance that can be placed on these organisations and the extent to which the basis for this reliance can be substantiated. These discussions should be held earlier rather than later.

iii. Concluding on the results of testing and reporting to stakeholders by the audit committee

This step involves determining the potential and actual financial statement impact of control deficiencies identified and reporting results to the appropriate stakeholders.

Control deficiencies can result from controls that are inadequately designed, implemented or controls that are not operating effectively. The impact of control deficiencies on the financial statements should be evaluated both on an individual basis as well as in combination with other control deficiencies to determine the impact they may have on the accurate presentation of the financial statements.

Control deficiencies that are considered to have a significant impact on the financial statements should be reported by internal audit or another assigned authority to the audit committee (a threshold could be set out by the company in excess of 20% of financial statement materiality). Deficiencies in financial controls, whether from design, implementation or execution, that are considered material (individually or in combination with other deficiencies), and that resulted in actual material financial loss, fraud or material errors, should be reported by the audit committee to the board and stakeholders.

The framework must remain relevant over time by taking into consideration any changes to both internal and external factors impacting the entity.

In our experience...

An effective approach is to centralise the assessment process around the identification of significant or material control deficiencies as part of the company's IFC framework. This helps ensure the consistent application of the company's methodology regarding the assessment of the likelihood of control deficiencies and any resultant financial quantification of potential misstatement, were the deficiency deemed to be reasonably possible rather than a remote control deficiency.

Guidance as to whether the statement on IFCs should be in the form of a positive or negative expression of opinion by the audit committee is expected to be provided by the King Committee. An example of wording may either be "the company's internal financial controls are effective" or "nothing has come to our attention to indicate that the company's internal financial controls are not effective".

2. What structure and approach can management and internal audit use to facilitate the assessment of internal financial controls?

Developing and supporting management's assessment of controls over financial reporting can be a substantial undertaking. The COSO framework sets out five elements of internal control:

- Control activities;
- Control environment;
- Risk assessment;
- Information and communication; and
- Monitoring of controls.

While projects must cover all elements of the COSO framework, most projects begin with a study of control activities. Control activities are the “boiler room” of internal control. They include the day-to-day limits, approval, reconciliations, confirmations and other activities that management and staff perform in safeguarding the assets and recording the activity of the enterprise. Two common ways of documenting control activities have emerged:

- **The top-down approach**

In this approach, management identifies those financial statement account balances and disclosures that are deemed quantitatively and qualitatively significant, and works back from those account balances to the processes that contribute to the transactions being recorded, accumulated and disclosed.

- **The bottom-up approach**

Here, management starts by identifying everything that employees do on a day-to-day basis. Within these activities, which are usually grouped into processes, controls are identified. Ultimately, these controls are then mapped to financial statement accounts.

The best practice guidance embraces the top-down approach. This approach begins with identifying the most significant risks to complete and accurate financial reporting. Controls that address these risks are then identified, starting with entity-level controls (generally covered by the four COSO elements noted above, other than control activities), including controls that are embedded in the financial reporting processes.

Without adequate entity-level controls, it is unlikely that control activities taken as a whole can be effective. The use of this approach ensures that only those controls that are considered key (related to all significant accounts and disclosures) are documented and tested.

In addition, rather than inventorying all controls and processes, this approach limits the scope of the project to only relevant processes and key controls within those processes that address material misstatement.

In our experience...

Best practice suggests that the attestation process focuses on entity-level controls. Many IFC projects have started with control activities and left entity-level controls to the end. By taking this approach management often identifies too many controls and focuses on transaction-level controls that do not address material misstatement.

Many companies have inappropriately adopted the bottom-up approach. This has facilitated faster and more decentralised implementation of the IFC project. However, this approach makes it more difficult to focus on priorities and has also led to much larger projects, delayed conclusions and made conclusions more difficult to reach. The certification is based on significant accounts and disclosures and, hence, opinions cannot be formed until the body of processes and controls is documented and mapped against the financial statements.

3. What project management protocols have been established to facilitate an efficient and effective assessment?

IFC projects can result in a significant investment of time and resources. The implementation of formal protocols is essential. Consider the following:

- The project should be sponsored by a senior member of the executive team and care must be taken to demonstrate that it is a key priority for the company;
- A dedicated project manager with sufficient seniority should be allocated to the IFC project on a full-time basis; and
- Regular status reporting to key stakeholders, including executives, the audit committee and external audit, against a detailed list of milestones is crucial to ensuring the timely identification of slippage.

In our experience...

Companies doing this will have clear and continuous communications regarding the project's importance. The executive sponsor steps in on a timely basis to eliminate barriers to success.

In some cases, project management has provided conceptual guidance but has left detailed decisions as to the format of reporting, scope of the project and materiality deliberations to the working groups. In these cases, submissions to the central teams have been inconsistent in content, format and quality. As a result, considerable efforts are required by the central project management team to ensure consistency on an entity-wide basis.

Projects generally run more smoothly when key decisions are communicated to the working groups on a regular basis. This allows for timely identification and resolution of any differences and ensures that the working groups do not raise issues that require re-work to be performed.

4. How will the “softer side” of COSO be addressed?

As stated earlier, there are five elements to the COSO framework, and much of the IFC project effort to date has generally been directed at control activities.

COSO contends that control activities cannot be effective without an appropriate entity-wide framework within which controls are seen as a priority, and which would provide sufficient scope for monitoring of controls so as to ensure ongoing effectiveness. These control elements are sometimes referred to as the “softer side” of the COSO framework and include:

- **Control environment**

What is the overall “tone” of the organisation and how is it demonstrated, communicated and enforced? Are integrity, ethics, competence and accountability priorities of the company and do senior executives “live” these values? This is the foundation for all other components of internal controls.

- **Risk assessment**

What functions exist to identify and assess risks (including fraud risk)? What mechanisms are in place to identify emerging risks? How are these controls being tested and how is effectiveness measured?

- **Information and communication**

How is pertinent information identified, captured and communicated? How clearly are roles and responsibilities for financial reporting defined and understood?

- **Monitoring of controls**

What processes are in place to monitor control effectiveness, identify breakdowns and take corrective action.

5. How does the evaluation of internal financial controls address the risk of fraud and controls to address fraud?

In the past, fraud in relation to material misstatement of the financials statements was most commonly thought of in terms of misappropriation of assets. More recently, manipulation of financial reporting has been the more common fraud. The risk of fraud must be considered by internal management as part of the IFC project. Key considerations include:

- Explicit assessment of fraud risk and identification of relevant controls;
- Controls that safeguard assets;
- The existence and proliferation of a strong and clear code of ethics;
- The adequacy of the internal audit activity; and
- The existence of an effective complaint gathering and handling process (including a whistle-blower programme).

Directors should expect that management has identified the specific controls that address each of these broad expectations and has developed an approach to testing those controls.

In our experience...

- Audit committees have sometimes taken a “no news is good news” approach to fraud. The audit committee expects to be informed of events as they occur and the actions taken in relation to them. The committee is expected to understand what fraud is and what areas within the business are most susceptible to fraud. Further, the audit committee should have an understanding of key factors that might contribute to fraud risk, such as:
 - Dominating personalities in the executive suite;
 - Potential for manual intervention in the preparation of records, particularly at the corporate level;
 - Strong focus on results and share value, whether driven by compensation plans or other factors; and
 - The complexity of business and heavy reliance on judgments and estimates.
- Audit committees should engage in discussion with both the internal and external auditors about assessments of the risk of fraud and responses in the respective audit plans to deal with these risks. They should also understand controls implemented by management and establish formal protocols for reporting all incidents. The whistle-blower programme is a critical part of fraud controls.

6. What can the audit committee expect from the results of the evaluation?

As the IFC implementation project progresses, the audit committee should expect to receive regular reports on progress towards reaching milestones and issues, both in relation to controls and effectiveness.

The audit committee will have all significant control and material deficiencies reported to it. Control deficiencies that do not rise to the level of significant or material, will be discussed with management but will most likely not be reported to the audit committee.

In our experience...

The audit committee's first inclination may be to have all control deficiencies reported to it at least for the first year. It is important to balance the volume of reporting from management to avoid the risk of overloading the audit committee and to avoid adding an extra layer of judgment onto decisions about significance.

Excessive audit committee involvement with relatively minor control deficiencies could compromise the "learning" that management may benefit from in the first year and may well result in an inefficient use of the audit committee's time and resources.

Directors should ensure that they are engaged in a dialogue about "themes" emerging on the control deficiency list that may cause individually insignificant control deficiencies to aggregate into significant control or material deficiencies for a particular significant account or disclosure, or for a particular component of the COSO framework.

There are very high reputational stakes attached to the IFC project, particularly as it relates to the risk of control deficiencies in the process. We strongly encourage audit committees to seek regular reporting on project progress. Milestones should be set and some form of project dashboard should be developed to report on progress, risks and known problems within the IFC project itself.

7. How will control deficiencies be evaluated and reported?

Once the IFC project is complete, management and internal audit will need to review the control deficiencies identified and their significance. While this is one of the last steps in the IFC project, it is also one of the most difficult, and early planning and the development of frameworks to help management as it considers issues is extremely beneficial. Both quantitative and qualitative factors are considered in making the determination.

The quantitative guidance is relatively straightforward, with most project teams applying the following categories:

- The control deficiency reflects an inappropriate or inadequately communicated or enforced "tone at the top";
- The control deficiency involves management override or other central, enterprise-wide controls;
- The control deficiency affects an item subject to precise measurement or an estimate;
- The control deficiency affects compliance with regulatory requirements;
- The control deficiency affects compliance with loan covenants or other contractual requirements;
- The control deficiency has the effect of increasing management's compensation – for example, by satisfying requirements for the awarding of bonuses; and
- The control deficiency involves concealment of an unlawful transaction.

Circumstances that result in a significant control deficiency and are strong indicators of a material deficiency include:

- Restatement of previously issued financial statements due to error;
- Identification by the auditors of a material misstatement in the financial statements;
- Ineffective oversight of the company's external financial reporting and internal control over financial reporting by the audit committee;
- Ineffective internal audit risk assessment function, particularly in more complex entities;
- Ineffective regulatory compliance function for complex entities in highly-regulated industries;
- Ineffective control environment;
- Identification of fraud of any magnitude on the part of senior management; and
- Significant control deficiencies communicated to management and the audit committee that remain uncorrected after a reasonable period of time.

In our experience...

- It is difficult to provide guidance and have that guidance consistently applied for qualitative judgments. It is more effective to have these decisions made by a small core of senior individuals for the company as a whole.
- The cumulative impact of control deficiencies must be considered, whether derived from a single significant control deficiency or from the combined impact of a number of control deficiencies. Many line items and disclosures reflect activities in a number of business units and, as such, judgments about cumulative impact can only be made at the corporate level. Where the project is being managed on a decentralised basis, units must report all control deficiencies in order to allow decisions about cumulative impact to be made in the appropriate context by the central team.
- Consistency of assessment between the IFC work and other monitoring groups within the organisation is crucial. A process should be implemented to ensure that all internal audit points have been identified in the IFC process. A similar process should be considered for compliance or other quality monitoring groups.

Common sources of a control deficiency:

- Account reconciliations;
- Journal entries;
- Anti-fraud controls;
- Estimates and areas of judgment, such as income taxes;
- Significant non-recurring transactions;
- Suspense and intercompany accounts;
- Financial statement year-end close period process (i.e. consolidation, purchase accounting, transaction of minorities, etc.);
- Controls around significant contracts and the accounting treatment thereof;
- Complex spreadsheets and other manual controls;
- Complex derivative financial instruments;

- Authority and capability of process owners;
- Accounting policies and procedures;
- Segregation of duties;
- IT general computer controls; and
- Training and skills of staff resources in key financial reporting areas.

8. How does the audit committee know if its oversight is appropriate?

The evaluation of the audit committee should be performed every year.

In addition, audit committee effectiveness is under the microscope with regulators, standards setters and the investing community. Increasing expectations have led to a variety of expectations around audit committee independence, identification of a financial expert (where necessary) and the development of a formal audit committee charter. With these higher expectations come increased responsibility and it is understandably important to directors that they have assurance that they are meeting these expectations. It is difficult to establish a single measure of audit committee effectiveness or the effectiveness of individual members. Some considerations might include:

- **The audit committee**

The board of directors is required to evaluate the effectiveness of the audit committee and areas for scrutiny should include:

- Authority and mandate: is it known; do agendas cover it; is it regularly reviewed; and do members understand it?
- Membership: is the mix appropriate and are members capable and independent?
- Agendas: is an annual formal task list prepared and adhered to; are topics appropriate and discussed in a rigorous manner; and do members attend?
- Internal financial control, financial reporting, compliance with laws and regulations: are structured reports received in respect of each; are discussions risk-focused; and are steps taken to ensure all requirements are met?
- Internal and external audit: is appropriate direction given by the audit committee; are activities reviewed in depth; and is each evaluated against agreed goals and expectations?

- **Audit committee members**

- Members should be evaluated by the chairperson based on their:
 - Business knowledge;
 - Specific areas of expertise (look for complementary skills);
 - Demonstrated independence and objectivity;
 - Understanding of the duties and responsibilities of the board of directors;
 - Demonstrated willingness to prepare for meetings and discussions; and
 - Attendance at meetings.

In our experience...

Expectations of the audit committee are evolving. Given the importance of the control environment to achieving effective controls overall, it may be beneficial to establish protocols that will identify gaps in the control environment early and report them to the board of directors, as these may be the most difficult to remediate.

Common focus areas for companies

- Learn from the experience of other companies in the execution phase;
- Ensure project office instructions are communicated and fully understood by business units;
- Templates must be followed and submitted timeously and complete;
- Take steps to ensure added complexities are considered where necessary – joint ventures, multiple locations etc;
- Identify and address non-standard IT applications and outsourced functions;
- Focus on the significant or key controls for evaluation of design effectiveness and testing of operating effectiveness;
- Many exceptions in testing arise from a lack of evidence that the control was performed; and
- Remediation takes longer than expected, so planning and prioritisation are important considerations.

How we can help you

Organisations should make an informed decision as to how to adopt the principles of King III with regard to internal financial controls. We can help you to achieve this by advising and assisting you on the implementation of a framework tailored to your business that will support internal audit's assessment of internal financial controls. This approach takes into account the design of a framework that is flexible to the needs of your business and the cost and associated benefits envisaged to achieve the desired result.

The methodology we apply in helping our clients is principles based and is approached from management's perspective.

Management best understands the risks that impact financial reporting. Our methodology is based on management's experience and takes into consideration the relative size and complexity of the business. The result of this is that companies are able to maximise the benefits and minimise the effort of applying the principles of King III.

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