An investigation of internal financial reporting in a large financial services company

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ABSTRACT

Against the backdrop of the corporate scandals that have occurred over the last few decades, the demand on companies to bolster their internal financial controls has undoubtedly come under scrutiny. Codes of best practice and regulations have placed a significant burden on the audit committee to provide a statement regarding the effectiveness of the internal financial control environment as a result. This research sought to examine how a large financial services organisation in the South African banking sector designed, implemented and monitored their internal financial controls. The research applied a quantitative approach and gathered information from 100 finance staff using a self-developed, electronic questionnaire in order to achieve the objectives of the study. The data was analysed statically whereafter answers were grouped to investigate: the frameworks and reporting mechanisms to guide the reporting of internal financial controls; the frequency of the internal financial control mechanisms in place and their related content; the degree of representation from risk partners; other functions who are performing financial controls; and the maturity and expectations of the Finance representatives as these relate to the reporting of internal financial controls. The study revealed that there is a robust control environment; however, not all the financial controls have been documented formally. Compliance and Procurement were not perceived as adding value to the internal financial control committee meetings. 'Breaches in segregation of duties' and 'new risks from changes in operating models' should be added as reportable items. Internal and External Audit issues were considered essential items to be reported. Functions outside Finance are not adequately skilled to identify and mitigate financial risks and that not enough emphasis is placed on the automation of internal financial controls. Furthermore, the statement issued to the public to relay comfort that internal financial controls are managed effectively may not be sufficient. The study proposed recommendations in the areas of formal documentation of financial controls, internal financial control forum reporting, upskilling of areas performing financial controls, internal financial control automation and external reporting on internal financial controls. The recommendations were provided to address the identified disparities and improve the internal financial controls of the large financial services organisation.

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LIST OF ABBREVIATIONS

Board	Board of Directors
CFO	Chief Financial Officer
COSO	The Committee of Sponsoring Organizations of the Treadway Commission
IFC	Internal Financial Control
IIA	Institute of Internal Auditors
JSE	Johannesburg Stock Exchange
King III report	King Code on Corporate Governance
King IV report	King Code on Corporate Governance
LFSO	Large Financial Services Organisation
UK	United Kingdom

CHAPTER 1: NATURE AND SCOPE OF STUDY

1.1 Introduction and background

After massive corporate scandals, such as Enron and Worldcom, the financial performance of organisations has come under more scrutiny. Numerous codes of best practice and regulations were introduced to enhance the internal control environment of organisations, with emphasis on the reporting of internal financial controls (IFCs). Further, the responsibility of the audit committee and its mandate to provide a statement regarding the effectiveness of IFCs became mandatory through the enactment of these codes and regulations.

By implementing a robust control environment, an organisation can increase its attractiveness to investors as well as its client confidence. The audit committee issues a statement in the annual integrated report to investors and clients that the IFC system is sufficient. It is therefore critical to understand how organisations have set up their internal structures for reporting IFCs based on the guidance provided by the codes and regulations.

Considering that the large financial services organisation under study (from now on referred to as the LFSO) operates in a highly regulated industry, it is mandatory for the LFSO to abide by various regulations that require the reporting of IFCs. This research identifies the control mechanisms that the LFSO has implemented and management's understanding of the importance and relevance of reporting IFCs.

1.2 Problem statement

According to Gao and Jia (2016:787), companies that can demonstrate strong IFCs can reduce their cost of equity. This supports a statement made by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) that companies who can demonstrate a healthy control environment will attract investors because they see the potential for growth (COSO, 2013:26).

With a greater emphasis on audit committees to design, implement and report on the status of their IFCs, becoming a member of an audit committee is now an extremely onerous responsibility (Naidoo *et al.*, 2016:182). Consider the following statements made by selected banks regarding the status of their IFCs. How do the audit committees support these statements?

> *"Considered, analysed, reviewed and debated information, key judgements and significant matters raised by management, internal audit and the external auditors to ensure the appropriateness of the year-end results."*
> *(Nedbank, 2017:92)*

> ***"**Satisfied itself based on the information and explanations supplied by management and obtained through discussions with the independent external auditor and internal auditors, that the system of internal financial controls is effective and forms a basis for the preparation of reliable financial statements."*
> *(Capitec, 2017:113)*

> *"The audit committee is satisfied with the financial statements, accounting policies and the internal financial controls of the company."*
> *(First Rand Bank, 2017:131)*

PricewaterhouseCoopers (2010) stated that these codes and regulations provide minimal detail on the reporting of the effectiveness of IFCs. Further, the evidence to corroborate the statements made by audit committees is not clear as the codes of best practice and regulations are open to interpretation.

The problem that this research addresses is how the LFSO has established its IFCs and aligned its internal mechanisms as prescribed by the codes of best practice and applicable legislation.

1.3 Research objectives and specific research questions

1.3.1 Primary objective

The main objective of the study is to investigate the effectiveness with which the LFSO has established its IFCs to satisfy the audit committee that the reporting of IFCs is adequate.

1.3.2 Secondary objectives

The secondary objectives are divided into literature objectives and the empirical objectives.

Literature objectives

The literature review investigates the meaning of internal control. It further provides a view of the significant components that form the basis of a sound control environment. The literature review examines the importance and benefit of internal controls and the relevant best practice principles and applicable regulations that guide and prescribe the implementation thereof. The literature review further explores the role of the audit committee over IFCs and the requirements for reporting IFCs.

Empirical objectives

The empirical objectives investigate the following:

- The frameworks and reporting mechanisms established by the LFSO to guide the reporting and monitoring of IFCs.
- The frequency of the IFC reporting and monitoring mechanisms in place and their related content.
- The degree of representation from key IFC risk partners in the established reporting and monitoring control mechanisms.
- Other areas or functions who are performing IFCs and the monitoring thereof.
- The understanding, maturity and expectations of Finance representatives as these relate to the reporting of IFCs.

1.4 Importance and benefits of the proposed study

The research will benefit the LFSO as there could be additional industry-related reporting mechanisms for IFCs that have not been considered as part of the LFSO's current reporting mechanisms. Further, by identifying and reporting on the themes identified from the survey results, the research determines whether the Finance fraternity agrees with the approach to and reporting of key IFCs that require monitoring.

The research further discusses the respective internal controls and the importance thereof. This discussion leads to the corporate failures that gave rise to the enactment of specific legislation as well as the relevant codes of best practice as a result. The research further considers the context around the importance of the reporting and the related content that is required by the stakeholders of the organisation.

1.5 Research methodology

The research methodology consists of a literature and an empirical study.

1.5.1 Literature study

The researcher used the following sources to compile the literature study:

- Peer-reviewed articles in Google Scholar using keywords such as “financial controls”; “reporting of controls”; and “internal financial controls”.
- EBSCOhost with critical terms such as “reporting on internal financial controls”; “reporting on controls”; and “internal control reporting”.
- Acts from South Africa as they relate to the reporting requirements for financial services organisations; for example, the Banks Act (94 of 1990), Financial Markets Act (19 of 2012) and Companies Act (71 of 2008).
- Relevant codes, guidelines and best practice principles that refer to IFCs, such as COSO, King Code on Corporate Governance, Sarbanes-Oxley Act of 2002, Combined Code on Corporate Governance, and the International Standards for the Professional Practice of Internal Auditing.

1.5.2 Empirical study

Research design

The study was conducted using quantitative information. This approach and technique have been chosen as the survey assisted in identifying themes that were interpreted. As a result, conclusions and recommendations could be provided.

Population

The study focused on a specific LFSO. The population was narrowed to focus specifically on how the Finance staff based in the two main Johannesburg offices reported IFCs. A total of 232 Finance staff and executives were identified in the population.

Sample

The sample size of the Finance staff and executives partaking in the survey was 185.

Collection of data

Data was collected using a self-developed survey (see Appendix A), which was conducted through a web-based application constructed in Microsoft Office 365. A link to the survey was sent via email to each respondent.

Analysis of data

The survey data was analysed statistically. The data is presented in Chapter 3 with frequencies, descriptive statistics of each question, and a factor analysis of the responses.

1.6 Delimitations and assumptions

1.6.1 Delimitations (scope)

The study focused on Finance staff and key senior executive Finance staff who are based in the two main Johannesburg offices and their reporting of IFCs. The information obtained from the research contributes to and enhances the knowledge of the reporting of IFCs. It further provides practical solutions based on the outcomes. The following was considered when determining the scope:

- If the research was minimised to the IFC department, the population would not be large enough to perform an adequate analysis. The department only contains approximately 15 staff members, and it is not represented by all the relevant specialist skills (such as finance, risk, control orientated or procurement) that would be necessary for drawing multiple inferences.

- If the scope was increased to all the forums within the LFSO, such as risk committees, their members and other compliance monitoring forums, the study would be too large to manage and collate all the information. The LFSO is a large institution with numerous forums that have been constituted to ensure the effective management thereof. Therefore, if the research were extended to all of these forums, it would result in information that would not be applicable, as their focus is not on IFCs.

- Lastly, if the research was extended to the greater financial services industry, it would have been extremely time-consuming to gather information from at least four or five institutions. Further, the population would have to be focused only on Finance and financial control functions. This would require a vast setup as well as time to create the correct rapport with the institutions, obtain consent, collate the information as well as present it in a mini-dissertation. With the limited time frame available, it was not an option that could be considered.

1.6.2 Assumptions

During this research, it was assumed that the codes and applicable acts have not changed significantly at the time of this research paper . It was further assumed that the Finance staff completing the survey would complete it honestly without any outside influence; that all Finance staff had the same level of understanding of the IFC framework in the LFSO as the selected population of staff are required to ensure that they are aware and understand the relevant IFC controls and frameworks as part of their on-boarding; and that there was a common understanding amongst the Finance fraternity of the importance of reporting IFCs.

1.7 Conclusion

The purpose of this chapter was to provide insight into the overall research document. It offered the problem statement, and the primary and secondary objectives to be addressed. The chapter further imparted insights into the importance and benefits of the proposed study. The chapter indicated how the literature review would be conducted along with some key terms and phrases used. The outline of the empirical study explained the research methodology, provided highlights of the sample size, population, and data collection techniques that would be employed, and discussed how the results would be interpreted. This chapter also dealt with the delimitations as they related to the research and the assumptions made.

Chapter 2 examines the associated literature in more detail.

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

COSO defines internal control as:

> *"… a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance." (COSO, 2013:1)*

Currently, internal controls are essential to organisations that produce reports to the public, such as shareholders. It is also imperative that management understands how to implement controls that will assist the business in achieving its objectives (Arefin & Sakil, 2017:144). Internal controls help to monitor policy adherence, safeguard assets, and ensure the soundness and accuracy of financial reporting (Strombeck, 2016:9). Internal controls are procedures and processes implemented throughout the organisation and practised by all staff. These controls support operations to run efficiently and effectively while having appropriate oversight (Gao & Jia, 2016:785, Strombeck, 2016:9).

In the context of the banking industry, banks operate on the premise of trust (Dahlstrom *et al*., 2014:269). Banks have further become increasingly complex and specialised, which in turn has resulted in additional skilled services being offered at a customer level (Dahlstrom *et al*., 2014:270). Because of the complexity – both internally and at a customer level – there is now a significant dependency on this trust relationship between the bank and its customers (Major, 2017:3). Within the South African construct, legislation requires that banks provide commentary in their annual reports regarding the comfort gained and the IFCs supporting the conclusions.

It is at this point, however, that LFSOs in South Africa adopt different approaches regarding the effectiveness of reporting IFCs. Even though banks are required to be transparent with information, they also need to ensure that the information provided to the public is understandable while maintaining trust (Dahlstrom *et al*., 2014:270).

The myriad of corporate financial failures that shocked the business world was partly to blame for the increased scope and monitoring of internal controls – more so where IFCs are concerned. To provide some context, some examples of public, corporate failures are given with a description of the fraud that occurred:

- WorldCom, 2001. Shortly before Enron, this telecommunications company employed creative accounting practices and committed fraud, which allowed for-profit overstatements of more than $11 billion (Naidoo *et al.*, 2016:454).
- Enron, 2001. Enron was an energy trading company that was riddled with creative accounting and fraud amounting to $70 billion. Its auditors assisted in committing the fraud. The lack of proper board oversight allowed for such practices to continue as the board did not understand the impact thereof (Naidoo *et al.*, 2016:454).
- Parmalat, 2003. The ambitious chief executive officer of an Italian milk producer created a complex company structure and was ultimately aided by auditors to commit fraud. The losses of the business were moved to Bonlat while all the profits were channelled to the family through other entities that were created at the suggestion of its auditors. The total fraud amounted to €4 billion and was described by the SEC as one of the most significant corporate frauds in history (Storelli, 2005:776; Ferrarini & Giudici, *2006:2*).
- Xerox, 2001. The digital printing solutions company employed creative accounting practices and committed fraud. Revenues were overstated by $2 billion (Naidoo *et al.*, 2016:455).
- Toyco, 2001. The manufacturing company committed fraud of approximately $600 million and hid the truth about the inflated revenue and expenses through creative accounting (Naidoo *et al.*, 2016:457).
- Steinhoff, 2017. A multinational retailer of household goods and general merchandise had accounting fraud estimated at R95.4 billion in their accounting records (Styan, 2018:130; Lungisa, 2017:1).

When analysing the above financial failures, some common themes are apparent:

- All the organisations were incredibly large and well established.
- External auditors were appointed.
- All the organisations followed a similar *modus operandi* in the way fraud was committed.

Although the intricacies of the above financial failures will not be dealt with in this research paper, the examples do illustrate the importance of an effective control function and the importance of reporting IFCs.

This chapter provides the theoretical background to the study and enhances the view of why IFCs is such a critical endeavour for management. The chapter further offers an overview of the importance of management adhering to codes of best practice. The context surrounding governments and regulatory bodies imposing more regulation and guidance in the reporting of IFCs is also discussed.

2.2 Five elements of internal control

In order to understand what is meant by internal control, the base needs to be understood in terms of design. To provide this context, the following paragraphs discuss the five elements that COSO conceptualises about internal controls.

2.2.1 Control environment – the first element

The control environment comprises set processes, control standards and structures that provide the foundation for embedding internal control throughout the organisation. Moreover, the board of directors (board) needs to ensure that their ethics and integrity cascade down into the organisation to enhance the need for controls (Sewrathan, 2016:40). By management embodying and reinforcing this culture, the board is delegating their power and responsibility to each individual in the organisation (COSO, 2013:4; Inusah & Abdulai, 2015:53; Scholtz, 2014:26). Delegation is achieved by creating policies, internal control frameworks, behavioural codes for conduct, and effective procedures to ensure that the controls are standardised (Sewrathan, 2016:41; Koutoupis & Pappa, 2018:92). Forming these frameworks and processes creates the foundation for effective control management in the organisation (COSO, 2013:12). There are five principles relating to the control environment (Koutoupis & Pappa, 2018:92):

- Individuals are held accountable for their internal control duties to achieve organisational objectives.
- The board provides supervision for internal control acting independently of management.
- There is a strong dedication to honesty and ethics.
- There are structures, responsibilities and reporting lines implemented by management.
- There is a devotion to attract, develop and retain proficient individuals.

2.2.2 Risk assessment – the second element

A risk is the possibility of an event occurring that could result in the organisation not meeting its goals (IODSA, 2016:16; Scholtz, 2014:25). When an organisation assesses risk, it must ensure that all risks are identified and not just those risks that would result in incorrect reporting of financial results. This view is supported by Inusah and Abdulai (2015:54) as they agree that the risk assessment is all-encompassing of business risks. Organisations must ensure that the risk assessment process is not a once-off event, but that risk is evaluated continuously (COSO, 2013:13). There are four elements relating of the risk assessment (Koutoupis & Pappa, 2018:93):

- Risks can only be recognised and measured when objectives are clearly articulated.
- Once risks are identified and analysed, they are then evaluated in terms of priority to determine how they should be governed.
- The potential for fraud always needs to be considered.
- Any changes to the control environment require a reassessment of the risks to ensure any significant impacts are catered for in the system of internal control.

2.2.3 Control activities – the third element

Controls are the system mechanisms put in place to protect the organisation, including its assets, the reliability of reporting its finances, and how it complies with the applicable regulations (Masrek *et al.*, 2014:256; Group of Thirty, 2012:14). Controls should be implemented to ensure that risk is minimised across the entire organisation (Scholtz, 2014:26). Controls should include but not be limited to the safeguarding of assets, adequate segregation of duties, appropriate levels of review, process verification and proper reconciliations (COSO, 2013:92-93; Al-Zwyalif, 2015:59). The three principles for control activities are (Koutoupis & Pappa, 2018:93):

- The ability to identify and implement controls that mitigate risks within the risk appetite.
- Implementing controls over technology.
- Ensuring controls and their associated activities are implemented as required by policies and procedures.

2.2.4 Information and communication – the fourth element

The information and communication component is the most critical element for an organisation to manage its internal control environment effectively. This statement is supported by Sewrathan (2016:43). Any decision that an organisation makes is dependent on the information that it has at its disposal and the timeliness thereof. Emphasising this element of control leads to better decision-making. It further reduces the need for an organisation to hold a single individual accountable for identifying and preventing fraudulent activities (Inusah & Abdulai, 2015:54). There are three principles associated with Information and communication (Koutoupis & Pappa, 2018:93):

- Producing high-quality information that supports internal control.
- Ensuring there is adequate communication of objectives and responsibilities required to substantiate all the elements of internal control.

- Ensuring there is proper communication of relevant internal control topics to stakeholders.

2.2.5 Monitoring activities – the fifth element

Monitoring is the ongoing review and assessment of internal controls, thereby ensuring that each of the five components of internal controls is embedded and operating as expected (COSO, 2013:124; Sewrathan, 2016:43). Without adequate monitoring, management cannot ensure that the implemented controls are adequate. As a result, supervising the internal control environment becomes more critical to management when reporting on the controls (Inusah & Abdulai, 2015:55). There are two principles regarding monitoring (Koutoupis & Pappa, 2018:93):

- Ensuring there are ongoing evaluations of the internal control environment by multiple individuals or teams within the organisation.
- Ensuring the effective and timely communication of control weaknesses to those responsible for corrective action. This could include management and the board.

Furthermore, business is changing rapidly with the era of technology, and new risks are emerging continuously. Therefore, selecting and implementing appropriate monitoring activities assist management in ensuring that controls remain applicable and being able to identify where change may be necessitated (COSO, 2013:124). The primary purpose of monitoring internal controls is to ensure that management can implement an effective risk-based control environment with the appropriate information and effective communication thereof. However, there is no clear guidance on precisely what management should be reporting.

This sub-section explained the critical elements of reasonable control. The importance and benefits of internal control are discussed in the section that follows.

2.3 The importance and benefits of internal control

The five key elements of internal control provide a basis for conceptualising internal control. This section highlights some of the benefits that an organisation will obtain by implementing and encouraging a robust control environment.

When an organisation chooses to design and implement a robust internal control structure, it indicates to investors that they intend to grow the organisation and drive economic growth (COSO, 2013:26; Group of Thirty, 2012:14). Such an organisation requires capital. By implementing an influential culture of internal controls, financial statements become more reliable, which boosts investor confidence (Feng *et al*., 2015:530; Dickins & Fay, 2016:1). This ultimately leads to investors providing more capital funding (Clinton *et al*., 2014:307; COSO, 2013:26). Additional benefits of enhancing and monitoring the control environment include:

- Standardising processes where possible ultimately speeds up the ability for transactions to be completed more efficiently. It further yields greater process efficiencies and improves the consistency and integrity of information (COSO, 2013:26; Kravet *et al*., 2018:1394).
- For larger organisations, especially those listed on the Johannesburg Stock Exchange (JSE), there is always the risk of insider trading. Large JSE-listed financial services industries are required to embargo employees from divulging price-sensitive information (JSE, 2013). The research found that individuals who are prone to performing insider trading do so by exploiting systems that are not standardised. Therefore, another benefit of standardising processes is that it can reduce the possibility of insider trading (Gao & Jia, 2016:787).
- Providing a stable foundation where management can provide financial performance to its shareholders and stakeholders with greater conviction, which ensures that confidence is maintained (COSO, 2013:27).

When management decides to implement robust controls in their organisation, the aim is to meet their intended objectives (COSO, 2013:26). By establishing appropriate mechanisms for monitoring and reporting internal control failures, a business will be able to grow as it is continuously evaluating whether the right amount of risk is being taken (COSO, 2013:26).

More so, companies have been able to reduce their cost of equity as a result of lowering internal control weaknesses as identified by Gao and Jia (2016:787) in their research into the costs and benefits of internal controls. A study conducted by Li *et al.* (2015:533) regarding the importance of internal controls and the link to better financial results concluded that the presence of IFC-related controls improved the operations and ultimately the financial results of the organisation.

It is also vital that key personnel are adequately trained, have the requisite skills and qualifications to implement internal controls adequately (Guo *et al*., 2016:1170). All staff within the organisation need to support the success of an effective internal control process, as it is not only the executive committee's responsibility (Guo *et al*., 2016:1170)

Therefore, establishing a robust internal control environment should be the biggest drive for management. Furthermore, management is responsible for ensuring that the organisation performs continuously, thus creating value for its shareholders with limited associated risk (Brigham *et al*., 2016:8). Controls are put in place to limit undue risks to investors and customers and to ensure that management can achieve the strategic objectives of the organisation (Strombeck, 2016:11).

The next section emphasises the reporting of IFCs in the banking sector, a subset of internal controls, and the importance thereof as it relates to both the enactment of regulation and globally accepted guidelines.

2.4 Codes and legislation prescribing IFC reporting in the banking sector

Trust in banks is primarily due to the highly regulated industry in which they operate (Dahlstrom *et al*., 2014:269; Group of Thirty, 2012:14). As mentioned earlier, the organisations involved in corporate scandals all demonstrated a weak control environment, particularly regarding IFCs. As a result, governments started drafting regulations that companies had to adopt as part of the usual business activities. Guidance notes written by governance institutions complement these regulations and, in some cases, were even adopted into legislation. The next paragraphs highlight some of these regulations and guidance notes.

2.4.1 Combined Code on Corporate Governance 2003 – United Kingdom

In 2003, the United Kingdom (UK) produced the Combined Code. Although each equally important, the Combined Code originated from six different enacted codes of good governance, namely the Cadbury Code of 1995 along with the Turnbull report of 1999, Higgs Report of 2003 and Smith Report of 2003, amongst others (Gola & Roselli, 2009:165).

The Combined Code prescribes under section 2 that the role and responsibilities of the audit committee are to (FRC, 2003:47):

- Oversee the integrity of the information presented in the financial statements.
- Review the overall risk, internal control and IFC systems in place.

2.4.2 King Codes on Corporate Governance – South Africa

Although the King Code on Corporate Governance was first issued in 1994, more emphasis is placed on the King III, and King IV reports. King III required that the audit committee (PricewaterhouseCoopers, 2010):

- Provides a statement in the annual integrated report regarding the effectiveness of its IFCs.

- Ensures that the status of the IFCs and the effectiveness thereof are provided in the annual integrated report.

- Reinforces any statement regarding IFCs by an annual attestation by Internal Audit about their evaluation of the design, implementation and overall effectiveness of the controls embedded by the organisation.

- Provides reports to the board and relevant stakeholders about material issues that triggered fraud and direct financial losses.

Although King IV has not deviated much from its predecessor, it has a more concise message. King IV provides one statement that outlines the responsibility of the audit committee as it relates to the reporting of IFCs (IODSA, 2016:56):

- The audit committee must give an opinion about the IFC design and its effectiveness and whether any significant weaknesses resulted in financial losses through fraud or significant control breaks resulted in an error.

2.4.3 Sarbanes-Oxley Act of 2002 – United States of America

The Sarbanes-Oxley Act of 2002 was enacted after the Enron and WorldCom financial failures in the United States (Naidoo *et al.*, 2016:454). This Act required in section 404 (107–204 of 2002) that:

- Management is responsible for creating and sustaining a structure of control as it relates to financial reporting.
- Management obtains an opinion of the effectiveness of the established internal control mechanisms and procedures.
- An independent party, such as a registered accounting firm, provides an attestation regarding the assessment of the organisation's opinion.

The above codes and best practices all share a common theme: they require that the audit committee designs, implements and reports on the status of IFCs. What stands out is the fact that an opinion needs to be provided. However, the extent and content thereof are not always defined clearly.

Codes and best practices do not influence organisations significantly as they are generally voluntary. However, the JSE made King IV mandatory, and listed companies have to comply with the codes and offer explanations (JSE, 2013).

Considering that the LFSO operates in a highly regulated industry, the next section elaborates on the applicable legislation specific to the reporting requirements for IFCs.

2.5 Financial services industry-specific requirements for IFC reporting

The section that follows describes the critical pieces of legislation applicable to the financial services industry. These acts ensure that all financial services organisations disclose vital information regarding IFCs.

2.5.1 The Banks Act (94 of 1990)

The Banks Act (94 of 1990) ensures that institutions in the business of receiving funds from deposits do so under the correct supervision and regulation. It offers guidance to the audit committee under section 64(2):

- The audit committee needs to assist the board by providing its opinion regarding the effectiveness of the internal control systems, accounting procedures, information technology and auditing practices performed in the bank.
- The audit committee has to encourage effective internal control systems, accounting procedures, information technology and auditing practices through proper communication.
- The audit committee must initiate appropriate mechanisms that will improve the integrity and fairness of the financials.

2.5.2 The Companies Act (71 of 2008)

The Companies Act (71 of 2008) regulates the formation and proper management of companies and outlines the relationships that companies should instil between their shareholders and directors. Further, the Act ensures that companies create a standard for financial reporting and that they maintain relevant financial records. The Act obliges companies to manage their businesses effectively within appropriate regulations. An organisation should act as a responsible person because once a company is formed, it is seen as a separate legal person, which is referred to as the legal personality concept (Naidoo *et al*., 2014:55).

Section 94 states under points 7(f), (g) and (h), which relate to financial control reporting, that audit committees have a duty to:

- Provide commentary regarding the committee’s comfort about the integrity of the financial results, accounting practices and policies, and internal controls of the organisation.
- Address and manage the Internal Audit function and accounting procedures.

- Address and manage the information contained in the financial results or the effectiveness of the auditor responsible for auditing the financials.
- Address the IFCs of the organisation.
- Address any other specific issues.
- Provide a statement to the board regarding its assessment of the organisation's systems of financial controls, accounting practices and reporting.

2.5.3 Financial Markets Act (19 of 2012)

The Financial Markets Act (19 of 2012) aims to regulate those organisations that trade in financial markets. It further regulates and controls securities trading. The Act requires under Chapter VI, section 55(f) that all trade repositories ensure that effective accounting practices, systems of internal controls, processes of risk assessments and mechanisms are established to ensure the integrity of technology.

Although this research paper does not review all the regulations, it is evident that the banking sector is highly regulated and that much attention is paid to a robust internal control system. Furthermore, there is a strong emphasis on the audit committee and their involvement in the reporting of IFCs. However, does the audit committee being more involved create a stronger control environment? The audit committee is responsible for offering commentary to the shareholders that they have gained control of the IFCs of the organisation.

Section 2.7 gives examples of how each bank has interpreted the regulations and guidance regarding the reporting of IFCs. The section highlights that none of the regulations and guidance discussed above specifies exactly which required elements of IFCs should be reported. The next section discusses the role and responsibilities of the audit committee in IFC reporting.

2.6 Audit Committees and IFC

Audit committee membership has become rather formidable through the institutionalisation of codes of best practice and legislative requirements, a view which is shared by Naidoo *et al*. (2016:180). However, when considering the major financial failures of the last two decades, it should be asked whether IFC systems are effective.

Many studies emphasise that the audit committee should opine about the design, implementation and monitoring of IFCs (PricewaterhouseCoopers, 2010). Clinton *et al*. (2014:307) identified that organisations with effective IFCs have an increased likelihood of being profitable. As a result, analysts can provide more accurate forecasting. Therefore, based on the detail described in the preceding paragraphs, it can be deduced that not having proper IFCs in place and not monitoring the IFCs effectively can result in financial statements being unreliable. In contrast, by concentrating on the effective design, implementation and reporting of IFCs, an organisation can ensure that its financial reporting becomes more reliable.

As discussed in earlier sections, the audit committee plays an essential role in the reliability of the system of internal controls and, more particularly, the controls over financial reporting. After the enactment of the Companies Act (71 of 2008), the audit committee became a mandatory committee for listed organisations (Naidoo *et al.*, 2016:180). Therefore, the correct composition is essential for the audit committee to meet the demanding requirements of the codes (as mentioned above) and legislation. King IV prescribes the following composition for audit committees (IODSA, 2016:56):

- A minimum of three independent non-executive members.
- Members with financial savvy and the appropriate skills to perform their roles adequately.
- An independent non-executive chairperson, who may not be the chair of the board.

For the audit committee to discharge its responsibility regarding IFCs effectively, it requires supporting evidence from Internal Audit. Internal Audit is an independent function that is best positioned to assure an entity’s system of controls (IIA, 2017:2; ECIIA, 2014:6). The standards governing Internal Audit activity have two further particular standards that Internal Audit needs to perform as part of its duties (IIA, 2017:13), namely:

- Assess the effectiveness of risk management processes relating to the governance, risk and control processes of the organisation. Consideration must include the fairness and integrity of the financials.
- Assess the effectiveness of controls implemented by the organisation relating to the governance, risk and control processes of the organisation. Consideration must include the fairness and integrity of the financials.

Through the establishment of the audit committee, it is now clear that independence is also important. Therefore, through its mandate to provide a statement regarding IFCs, the audit committee can now delegate this responsibility to Internal Audit. Internal Audit is an independent function that can present its assessment of the effectiveness of controls that are in place to mitigate risk for the organisation (Lewis, 2014:28). Therefore, by delegating the assessment of the IFC environment to Internal Audit, the audit committee can meet its obligations of reporting on the status of IFCs (Lewis, 2014:28). Although Internal Audit is a critical stakeholder in the effective monitoring of internal control, the specific detail of their role will not be discussed in this research

Now that the guidance notes and regulatory elements of the importance of IFC establishment and monitoring have been discussed, it is also essential to understand how and why this information needs to be presented and reported. This discussion follows in the next section.

2.7 External reporting on IFCs

As mentioned above, an organisation needs to report on the design, implementation and effectiveness of its internal controls, and more particularly, its financial controls. The requirements of the Banks Act, Companies Act and Financial Markets Act have to be disclosed as part of an organisation's annual integrated reporting to shareholders. The board, which remains ultimately responsible, drives this task through the audit committee (Naidoo *et al.*, 2016:180).

When reporting on the IFCs, the audit committee needs to understand that there are some limitations related to internal controls. Internal controls cannot be the only mitigating factor that organisations consider in their implementation efforts (COSO, 2013:136). Some limitations include (COSO, 2013:137; Sewrathan, 2016:44):

- Corporate culture plays a vital role in driving the risk-aligned mindset. Managers need to make decisions to drive business, which are usually made using the information that is available at the time and the relevant individual's awareness and insights. In some cases, these decisions could be wrong or result in errors being made.
- Controls can break down because staff either misunderstand or misinterpret what is specifically required of them.
- Higher-level management can override controls.
- Collusion amongst staff to intentionally alter financial information to circumvent the system of controls.

The above points are illustrated by using the integrated reports of four major banks for 2017 and 2018. The following is noted regarding the audit committees' statements:

Nedbank 2017

> *"Considered, analysed, reviewed and debated information, key judgements and significant matters raised by management, internal audit and the external auditors to ensure the appropriateness of the year-end results."*
>
> *"Reviewed and discussed information from management, Internal Audit and external auditors and considered the effectiveness."*
> *(Nedbank, 2017:92)*

Nedbank 2018

> *"Considered, analysed, reviewed and debated information, key judgements and significant matters raised by management, Internal Audit and external auditors to ensure the appropriateness of the 2018 year-end results, the evaluation of ETI's performance, the implementation of IFRS [International Financial Reporting Standards] 9 and IFRS 15 and the conclusion accounting matters relating to managed separation."*

"Reviewed and discussed information from management, Internal Audit and external auditors and considered the effectiveness of the internal controls of the group in all material respects throughout the year under review."
(Nedbank, 2018:69)

Capitec 2017

"Satisfied itself based on the information and explanations supplied by management and obtained through discussions with the independent external auditor and internal auditors, that the system of internal financial controls is effective and forms a basis for the preparation of reliable financial statements."
(Capitec, 2017:113)

Capitec 2018

"Satisfied itself, based on the information and explanations supplied by management and obtained through discussions with the independent external auditor and internal auditors, that the system of internal financial controls is effective and forms a basis for the preparation of reliable financial statements."
(Capitec, 2018:168)

First Rand Bank 2017

"During the year, the committee received regular reports from group internal audit on any weaknesses in controls that were identified, including financial controls, and considered corrective actions to be implemented by management."

"The committee can confirm that the financial and risk management information contained in the annual integrated report accurately reflects information reported to the committee by management and has no reason to believe that the existing internal controls, including internal financial controls, do not form a sound basis for the preparation of reliable financial statements. The committee's opinion is supported by the reports received from the risk, capital management and compliance committee, external audit, internal audit and executive management."

"During the year, the committee received regular reports from group internal audit on any weaknesses in controls that were identified, including financial controls, and considered corrective actions to be implemented by management."
(First Rand Bank, 2017:116-117)

First Rand Bank 2018

“During the year, the committee received regular reports from group internal audit on any weaknesses in controls that were identified, including financial controls, and considered corrective actions to be implemented by management.”

“The committee can confirm that the financial and risk management information contained in the annual integrated report accurately reflects information reported to the committee by management and has no reason to believe that the existing internal controls, including internal financial controls, do not form a sound basis for the preparation of reliable financial statements. The committee’s opinion is supported by the reports received from the risk, capital management and compliance committee, external audit, internal audit and executive management.”

“Reviewed quarterly activity reports from internal audit which covered audit plan progress, insights and optimisation opportunities, cumulative view on internal financial controls and risk management process maturity, and a summary of audit observations with respective status updates on remediation effort.”

“During the year, the committee received regular reports from group internal audit on any weaknesses in controls that were identified, including financial controls, and considered corrective actions to be implemented by management.”
(First Rand Bank, 2018:120-122)

Standard bank 2017

“Reviewed internal audit’s annual report, which summarised the results and themes observed as part of internal audit’s activities for the prior year. The report concluded with internal audit’s assurance statement that the control environment was effective to ensure that the degree of risk taken by the group was at an acceptable level and that internal financial controls were adequate and effective in ensuring the integrity of material financial information. In addition, the committee confirmed the organisational independence of the internal audit activity.”

“On a quarterly basis, reviewed a report on internal financial control activities, as overseen by the group’s internal financial control committee.”

“Reviewed proposed amendments to the group’s delegation of authority framework and recommended revised financial limits to the board for approval.”
(Standard Bank, 2017:35).

Standard bank 2018

“Reviewed internal audit’s annual report, which summarised the results and themes observed as part of internal audit’s activities for the prior year. The report concluded with internal audit’s assurance statement that the control environment was effective to ensure that the degree of risk taken by the group was at an acceptable level and that internal financial controls were adequate and effective in ensuring the integrity of material financial information. In addition, the committee confirmed the organisational independence of the internal audit activity.”

“On a quarterly basis, reviewed a report on internal financial control activities, as overseen by the group’s internal financial control committee.”

“Reviewed proposed amendments to the group’s delegation of authority framework and recommended revised financial limits to the board for approval.”
(Standard Bank, 2018:26-27)

ABSA 2017

“IA [Internal Audit] continues to review the Group’s systems of internal control and risk management on an ongoing basis. Based on the performed as part of the approved audit plan for the current reporting period, IA confirmed that sound risk management and a robust framework of internal control is in place over financial, operational and compliance issues which supports the validity, accuracy and completeness of the financial information. Where areas of improvement were identified by IA, management has completed corrective actions or is in the process of implementing corrections. Progress is tracked to completion by IA, and it actively encourages completion of ongoing remediation initiatives and embedment of controls, and the principles of the ERMF [enterprise risk management framework], to ensure that the improved control environment rating is not only maintained, but also strengthened.”
(Barkleys, 2017:3)

ABSA 2018

> *"Engaged with Internal Audit on the soundness of risk management, and the robustness of the internal control framework over financial, operational and compliance issues which support the validity, accuracy and completeness of financial information. Where areas of improvement were identified, management has completed corrective actions or is in the process of implementing corrective action, and progress is tracked by Internal Audit."*
>
> *"The Committee is responsible for ensuring that the Group's financial reporting information is valid, accurate and complete and that the interim financial results and annual financial statements fairly present the financial position of the Group and comply, in all material respects, with the relevant provisions of the Companies Act, IFRS [International Financial Reporting Standards] and Interpretations of IFRS, and the SAICA [South African Institute of Chartered Accountants Reporting Guides]. During the reporting period, the Committee:*
>
> - *Satisfied itself on the appropriateness of the going concern assumption as the basis of preparation of the interim and annual financial statements.*
> - *Confirmed, through consultation with Internal Audit, that the Group's internal controls support the preparation of consolidated financial reporting information."*
>
> *(ABSA, 2018:2-4)*

All the above reports show that the only information that audit committees provide is a statement that the IFCs have been assessed. Each statement is reported differently. However, what informs the reporting? What were those internally created reporting structures and rules that each of the banks used to report IFCs? COSO particularly mentions the key control elements and activities that need to be considered in the control environment. However, none is mentioned in the integrated reports of the respective banks.

The preceding sections provided context on the origin of what constitutes a strong control environment with a particular focus on IFCs. The sections further gave the reader an insight into the regulatory environment in which banks operate. Finally, it highlighted that reporting of IFCs is crucial.

The next section describes the current IFC structures that are in place in the LFSO, where the research was conducted.

2.8 Current IFCs in the LFSO

While conducting the research, the current structures of the organisation under study had to be assessed against regulations and guidelines. While the structure has been adapted, the fundamental elements thereof are discussed below:

2.8.1 Framework

The LFSO has a framework in place that covers the following:

- Financial controls on new products.
- Documented policies.
- Intercompany processes.
- Controls over non-routine transactions.
- Segregation of duties.
- Budget management.
- Financial control over financial statements.
- Financial staff skills management.
- Balance sheet controls.
- Consolidation controls.
- Delegation of authority.
- Master data controls.
- Journal management.
- Month-end controls.
- Other general considerations.

The above elements are in line with COSO's statement that establishing frameworks and policies ensures that the standardisation of controls forms the basis for effective control management for the organisation.

2.8.2 Internal monitoring committees

Figure 2-1 provides a holistic view of the current structure in place to monitor the IFCs within the LFSO effectively.

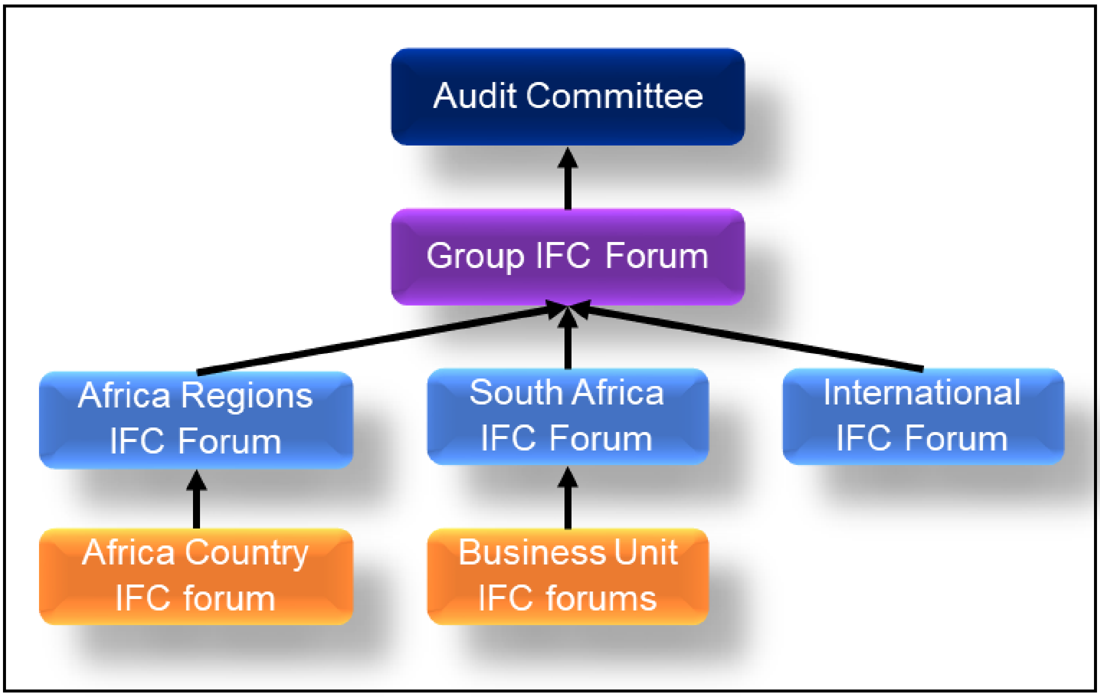

Figure 2-1: IFC reporting structure (Adapted)

The LFSO has a reporting structure in place to ensure that IFCs are monitored and reviewed continuously. These forums meet monthly to address matters such as:

- Segmentation of customers.
- Procurement-related issues.
- Operational risk items.
- Internal Audit matters.
- External Audit matters.
- Results of the month-end reconciliation process at a business unit level.
- Any issues that need to be escalated to the group IFC forum.

This structure is in line with COSO's perception that the fourth element, namely information and communication, is possibly the most critical element for managing an organisation's internal control environment effectively.

2.8.3 Internal audit reporting

Internal Audit performs an assessment based on the coverage obtained during the year from their audits. This attestation provides the following information to the audit committee:

- Audit coverage of IFCs across the LFSO.
- Significant themes identified through the reviews.
- Overall opinion of the IFC environment.

This verification agrees with the requirements of the King Codes of Corporate Governance, which propose that the assessment can be delegated to Internal Audit; however, the responsibility remains with the audit committee.

2.8.4 External audit reporting

External Audit is responsible for auditing the financials and providing their findings to management to address any concerns regarding the financial controls. Management will discuss the tracking and closure of the issues at the IFC forums. While the above information has been amended, it is representative of the information that is provided to the audit committee, which allows for an overall statement to be made in the report to the public on IFCs.

2.9 Conclusion

Organisations are continuously driving to grow their businesses by taking risks that are aligned with their strategy. However, in the absence of an adequately designed internal control environment, they run the risk of exposing themselves to fraud and internal manipulation of systems. By understanding what is meant by internal control and the benefits that it can yield, organisations can still to take risks but in a more structured manner.

Considering those corporate scandals that shocked the world and lost investors billions, organisations need to create an influential culture centred around designing, implementing and reporting on controls, with emphasis on IFCs. If this culture of stricter controls is combined with the duties that are now required from audit committees, including reporting on the effectiveness of the IFCs, the organisation will yield the benefits and reduce their overall exposure to financial misstatement.

The next chapter discusses the research design and analysis of the collected data.

CHAPTER 3: RESEARCH DESIGN AND ANALYSIS

3.1 Introduction

This chapter outlines the research design and techniques that were applied to obtain the required data to conduct the research. It also discusses the population, the sampling techniques and data collection instruments that were used, and the data analysis that was applied to interpret the results.

3.2 Research design

The study focused on investigating IFCs in the LFSO. The study was aimed predominantly at the Finance fraternity within the organisation. The information was obtained through a quantitative approach using a self-designed quantitative survey that was sent to the attendees of the relevant IFC forums (Bryman *et al*., 2017). A quantitative approach was chosen as it allowed for the measurement of the responses to be counted using frequencies (Lune & Berg, 2016:12).

The information gathered was interpreted to identify and categorise certain patterns to make a clear and concise argument. This approach was further used to produce a theory about what would be seen as fit for purpose regarding the implementation, understanding and reporting of IFCs to the relevant stakeholders, i.e. the chief financial officer (CFO) and the group audit committee (Bryman *et al.*, 2017).

The research was conducted during 2019 and was considered cross-sectional as the survey was conducted at a particular point in time and not over the entire year (Trochim & Donnelly, 2007).

3.2.1 Population of the study

A population is the full collection of objects or people regarding which the researcher wants to obtain a conclusion (Saah, 2017). Due to time and financial constraints, the study focused on a specific LFSO, which has been narrowed further to focus on how the Finance staff based in the two main Johannesburg offices understand, implement and report IFCs (Bryman *et al*., 2017; IODSA, 2016). A total of 232 Finance staff members were identified in the population using the IFC forum's attendee lists.

These LFSO staff members included the respective Finance product senior executives, heads, senior managers and product managers who report on IFCs.

3.2.2 Sampling techniques

Sampling is a process for identifying specific aspects of the population to be researched and tested (Bryman *et al*., 2017). Sampling is further defined as a subset of the full population, and one of the determinants of quality research is an appropriate sampling technique (Saah, 2017).

For this research study, systematic sampling was the best-suited sampling technique for data collection because (Saunders *et al*., 2009):

- The unit of analysis was defined, and all units in the population could be identified.
- It could fit any sample size.
- It was not limited to the specific data collection method chosen.
- It did not carry a substantial cost to perform.

The sample size for the Finance staff and executives to partake in the survey was 185. An 80% response rate for the completed surveys was considered significant enough for drawing a meaningful inference to the generalisations made because the research was limited to representatives in the IFC forums. Further, the large sample size would lower the risk that the generalisations made of the population would be erroneous but would also tend toward a normal distribution (Saunders *et al*., 2009).

The survey was intended to identify and establish:

- The expectations that each representative of a particular area in Finance has as it relates to IFCs (IODSA, 2016:56).
- The level of each individual’s understanding of the reporting of financial controls.
- Their level of maturity across each business unit of financial risk.
- Whether there are established frameworks in place to guide the implementation, understanding and reporting of IFCs.

3.2.3 Data collection instruments

The data for this research was collected using a self-developed survey. A survey was considered a rational and more accessible approach for obtaining insight from respondents as it allowed for flexibility and was deemed reliable. The survey consisted of close-ended questions, which allowed for better statistical analysis. The questions were coupled with a five-point Likert scale using a rating that ranged from ‘strongly agree’ to ‘strongly disagree’ as it was easier for the respondents to complete and allowed for better analysis (Saah, 2017).

The self-developed survey was conducted through Microsoft Forms, which is a web-based application in Microsoft Office 365. A link to the survey was sent to each respondent via email, which was beneficial as the appearance of the survey could be modified to the researcher’s needs. Further, the responses were automatically collated into an Excel spreadsheet and required no additional coding, thereby enhancing the accuracy of the data collected.

This particular survey approach was chosen as Microsoft Office 365 can be accessed anywhere as long as there is an internet connection, which made it convenient for respondents. Further, the survey was created in a secure private environment (Bryman *et al.*, 2017:292-294). The possibility of incorrect email addresses was eliminated as only staff who were employed within the LFSO were selected.

This research was intended specifically for the LFSO. Therefore, using an online survey did not bias anyone in the population. The link to the survey was issued via the CFO’s office to solicit responses; therefore, increasing the likelihood of a higher response rate (Bryman *et al.*, 2017:292-293). A copy of the survey is attached as Appendix A: Survey.

3.3 Data analysis

Bryman *et al*. (2017) define data collection as “the process of gathering the required information that the researcher will use to draw conclusions from”. The required data needed for this research was collected by distributing a self-developed questionnaire in the form of an electronic survey.

This section describes the data analysis of the obtained survey information, including the analysis methods, system, assumptions, research ethics and overall analysis of the results.

3.3.1 Survey

The survey used two different types of variables to answer the questions in the two sections (see Appendix A). A survey yields quantitative data, and as a result, the following was considered when analysing the data:

The questions could be answered using a combination of two-variable answers and a five-point Likert scale rating. This allowed for dichotomous variables such as ‘yes’ and ‘no’ as well as a Likert scale rating, yielding interval variables, in which respondents could choose between a range of answers from ‘strongly agree’ to ‘strongly disagree’” on a five-point scale. Missing data was catered for by allocating a zero (0) to ensure the values were not counted in the analysis.

The survey results were analysed using the statistical system SPSS Version 25. This allowed for the dichotomous variables and interval variables to be analysed statistically and any errors in the calculation of the results to be removed.

3.4 Assumptions

The following assumptions were made during the research:

- The codes and applicable acts have not changed significantly at the time of this research paper.
- Finance staff completing the survey did so honestly without any outside influence.
- All Finance staff have the same level of understanding of the IFC framework and appropriate controls in place in the LFSO. The selected population of staff are required to ensure that they are aware and understand the relevant IFC controls and frameworks as part of their on-boarding.
- That there is a common understanding amongst the Finance fraternity of the importance of reporting IFCs.

3.5 Research ethics

Before performing the research in the LFSO, permission was obtained from the organisation. Further, informed consent was obtained from each survey respondent.

3.6 Results

From the 185 surveys sent a total of 100 completed anonymous responses were received, and no surveys were disregarded as all survey questions were answered. Question 1 was ignored in the analysis as its purpose was to obtain consent to partake in the survey.

The survey responses to Questions 2–18 were subject to the frequency and descriptive analyses based on the response rate for each question. The responses are summarised in Table 3-1 to Table 3-13.

A factor analysis was performed on Questions 10–17. Cronbach alphas were used to ensure that the questions measured their respective intended elements and that the questionnaire was a reliable instrument for performing research. The responses are summarised in Table 3-14.

3.6.1 Frequency and descriptive statistics

The final set of responses consisted of 100 respondents. The responses were split into relevant sections applicable to the research. Question 1 was ignored as its purpose was to obtain informed consent from the respondents: all 100 respondents agreed to take part in the survey. The aim of Question 2 and Question 3 was to obtain specifics regarding the financial service experience and management level of respondents.

Table 3-1 clearly illustrates that 86% of the Finance staff had been in the financial services industry for at least 5 years. In terms of distribution, the majority of respondents had either between 5 and 10 years' experience or between 10 and 20 years' experience, with both groups representing 33% of the sample. The management level was more represented by middle managers (26%) and senior managers (39%) than respondents from the other two categories, namely heads of department (15%) and executives (20%).

Table 3-1: Frequency table of experience and management level

	< 5 years	5–10 years	10–20 years	> 20 years
2 Please indicate your experience in the financial services industry (or in general in the bank).	14%	33%	33%	20%
3 Please indicate your management level:	**Middle manager**	**Senior manager**	**Head of department**	**Executive**
	26%	39%	15%	20%

Questions 4–6 were designed to identify whether there are an established IFC function and framework in place. These questions related to the IFCs within the LFSO. As evidenced in Table 3-2,100% of the respondents were aware of the IFC function, and 99% were aware of the IFC framework. Of the respondents, 65% indicated that key financial controls are mapped and documented formally.

Table 3-2: Frequency table for establishing IFC function and internal reporting metrics

	No	Yes	Maybe
4 Is there an established IFC function in your institution?	0%	100%	–
5 Is there a defined IFC framework in place in the large financial services organisation that you work for?	1%	99%	–
6 Have all key financial controls been mapped and documented formally?	13%	65%	22%

Questions 7–9 were designed to identify the frequency of IFC mechanisms being reported. The respondents' answers to Questions 7–9 show that Internal Audit issues (66%), External Audit issues (41%) and material issues (83%) are mostly reported monthly.

Table 3-3: Frequencies of reportable items

	Monthly	Quarterly	Bi-annually	Yearly	Never
7 How often are Internal Audit issues reported?	66%	13%	4%	16%	1%
8 How often are External Audit issues reported?	41%	14%	21%	24%	0%
9 How often are material issues reported?	83%	9%	1%	4%	3%

Questions 10–18 aimed to obtain the expectations, level of understanding of the reporting of IFCs, as well as the level of maturity of the Finance fraternity. The results are represented from Table 3-4 to Table 3-12. The 'strongly disagree' and 'disagree' columns were added together to allow for ease of understanding of the dispersion of the results for these categories. The same principle was applied to the 'agree' and 'strongly agree' columns. Each set of questions is represented with a frequency table followed directly by a descriptive statistics table to allow for more significant interpretation of the results obtained.

The aim of Question 10 was to understand which areas that are represented in the IFC forum add value. Table 3-4 shows that the vast majority of respondents felt that all identified areas present in the IFC committees do add value, with IFC (83%) and Finance (89%) receiving the highest ratings. However, Compliance (55%), Procurement (67%) and Business Unit Management (73%) received the lowest ratings.

Table 3-4: Frequencies of areas that add value in the IFC committee meeting

10 Do the following areas represented in the IFC committee add value?							
	Strongly disagree	**Disagree**	**Sum SD & D**	**Neutral**	**Agree**	**Strongly agree**	**Sum SA & A**
Operational Risk	4%	5%	**9%**	15%	55%	21%	**76%**
Internal Audit	4%	4%	**8%**	17%	51%	24%	**75%**
Business Unit Management	5%	7%	**12%**	15%	54%	19%	**73%**
Finance	3%	3%	**6%**	5%	45%	44%	**89%**
Compliance	7%	10%	**17%**	28%	39%	16%	**55%**
Internal Financial Control	3%	6%	**9%**	8%	38%	45%	**83%**
Procurement	5%	8%	**13%**	20%	43%	24%	**67%**

SD: Strongly disagree; D: Disagree; SA: Strongly agree; A: Agree

Table 3-5 identifies that Finance and IFC added the most value with means of 4.24 and 4,16, respectively. Compliance and Procurement yielded the lowest means with 3.47 and 3.73, respectively. The standard deviation ranged from 0.911 to 1.072. The results correlate with the outcome in Table 3-4.

The results of Question 10 identified that Compliance, Procurement and Business Unit Management was not ranked as highly as the other areas represented in the IFC forum. This is an interesting result considering the critical role that each area contributes toward the control environment.

Table 3-5: Descriptive statistics for areas that add value in the IFC committee meeting

10 Do the following areas represented in the IFC committee add value?		
	Mean	**Std. Deviation**
Operational Risk	3.84	0.950
Internal Audit	3.87	0.960
Business Unit Management	3.75	1.009
Finance	4.24	0.911
Compliance	3.47	1.096
Internal Financial Control	4.16	1.012
Procurement	3.73	1.072

The objective of Question 11 was to gain insight into whether the reported items in the IFC forum are seen as essential to Finance. Table 3-6 indicates that respondents felt strongly that all identified themes should be reported at the IFC forums. The highest scores were obtained for Internal Audit issues (96%); External Audit issues (96%); and themes arising from External Audit findings (96%), which were followed by balance sheet errors (95%). The areas that received the lowest responses were Procurement (81%) and 'considered accounting changes' (83%).

Table 3-6: Current themes reported at the IFC committee meeting

11 Should the following be reported and discussed in the group IFC forums?							
	Strongly disagree	**Disagree**	**Sum SD & D**	**Neutral**	**Agree**	**Strongly agree**	**Sum SA & A**
Risk incidents	–	3%	**3%**	**5%**	47%	45%	**92%**
Internal Audit issues	–	2%	**2%**	**2%**	50%	46%	**96%**
Balance sheet errors	–	3%	**3%**	**2%**	39%	56%	**95%**
Fraud incidents	–	3%	**3%**	**4%**	43%	50%	**93%**
External Audit issues	–	1%	**1%**	**3%**	46%	50%	**96%**
Intercompany breaks	–	2%	**2%**	**10%**	46%	42%	**88%**

11 Should the following be reported and discussed in the group IFC forums?							
	Strongly disagree	**Disagree**	**Sum SD & D**	**Neutral**	**Agree**	**Strongly agree**	**Sum SA & A**
Procurement	–	5%	**5%**	**14%**	48%	33%	**81%**
Themes arising from External Audit findings	–	1%	**1%**	**3%**	48%	48%	**96%**
Considered accounting changes	–	3%	**3%**	**14%**	48%	35%	**83%**

SD: Strongly disagree; D: Disagree; SA: Strongly agree; A: Agree

As it relates to Question 11, the highest mean that was obtained was 4.48 for balance sheet errors, and the lowest mean realised was 4.09 for Procurement. This question yielded a standard deviation range between 0.607 and 0.770.

Table 3-7: Descriptive statistics for the current themes reported at the IFC committee meeting

11 Should the following be reported and discussed in the group IFC forums?		
	Mean	**Std. Deviation**
Risk incidents	4.34	0.714
Internal Audit issues	4.40	0.636
Balance sheet errors	4.48	0.689
Fraud incidents	4.40	0.711
External Audit issues	4.45	0.609
Intercompany breaks	4.28	0.726
Procurement	4.09	0.818
Themes arising from external audit findings	4.43	0.607
Considered accounting changes	4.15	0.770

Question 11 yielded a thought-provoking result as it was noted that the items reported at the IFC forum were from independent assurance providers. Internal Audit and External Audit are generally invitees to the forums; therefore, they do not have any impact on the quorum or voting rights. However, the IFC attendees feel that their input into the meetings is seen as the most important. This result also alludes to the high maturity of the Finance fraternity, which is assessed further in Questions 12–16 in Table 3-8. These questions were aimed at understanding whether:

- Assessing IFCs adds value.
- The IFC forum is effective in monitoring IFCs and whether it meets that mandate.
- The key financial controls are being tracked and reported, which is an essential element in the proper governance of IFCs.
- Those functions who are performing financial controls can identify and mitigate financial risk adequately.
- There is an effort being placed on automating financial controls.

When asked whether assessing the maturity of IFC added value, 75% of respondents agreed (Question 12). Furthermore, there was a strong impression that the IFC forum is effective in carrying out its mandate with 80% of respondents agreeing with Question 13, as noted in Table 3-8.

When answering Question 14, 77% agreed strongly that key financial controls are being tracked adequately. However, it is noted that Finance personnel felt that functions outside their area are not sufficiently skilled to identify and mitigate financial risks, with only 49% agreeing and 20% disagreeing with the statement made in Question 15.

There seemed to be a mixed response to Question 16, which enquired whether enough emphasis is being placed on automating financial controls. Only 57% of respondents agreed with the statement.

Table 3-8: Maturity metrics for additional IFC understanding

	Strongly disagree	Disagree	Sum SD & D	Neutral	Agree	Strongly agree	Sum SA & A
12 Does the assessment of the maturity of IFC add value?	3%	7%	**10%**	15%	52%	23%	**75%**
13 Please rate whether the IFC forum is effective in carrying out its mandate to effectively monitor IFCs for the organisation.	1%	9%	**10%**	10%	55%	25%	**80%**
14 Are key financial controls tracked and reported adequately?	1%	11%	**12%**	11%	58%	19%	**77%**

	Strongly disagree	Disagree	Sum SD & D	Neutral	Agree	Strongly agree	Sum SA & A
15 Please indicate if functions outside Finance, who are performing financial controls, are adequately skilled to identify and mitigate financial risks.	5%	15%	**20%**	31%	43%	6%	**49%**
16 Is enough emphasis being placed on automating financial controls?	6%	17%	**23%**	20%	41%	16%	**57%**

SD: Strongly disagree; D: Disagree; SA: Strongly agree; A: Agree

Table 3-9 shows the descriptive statistics for Questions 12–16. Question 13 had the highest mean of 3.94 for the most substantial level of agreement on whether the IFC forum is effective in carrying out its mandate, with a standard deviation of 0.897. However, for this range of questions, the lowest mean of 3.30 was noted for Question 15, which asked the Finance fraternity whether they felt that functions outside Finance are adequately skilled to identify and mitigate financial risks. The standard deviation for Questions 12–16 ranged between 0.897 and 1.131.

Overall, Questions 12–16 did show that the control understanding and maturity metrics of the IFC were all positive in their responses, except for functions outside Finance. This further indicates that there is a certain level of maturity across the Finance fraternity in their understanding of the IFC environment.

Table 3-9: Descriptive statistics for additional IFC understanding and maturity metrics

	Mean	Std. Deviation
12 Does the assessment of the maturity of IFCs add value?	3.85	0.957
13 Please rate whether the IFC forum is effective in carrying out its mandate to effectively monitor IFCs for the organisation.	3.94	0.897
14 Are key financial controls tracked and reported adequately?	3.83	0.900
15 Please indicate if functions outside Finance, performing financial controls, adequately skilled to identify and mitigate financial risks.	3.30	0.969
16 Is enough emphasis being placed on automating financial controls?	3.44	1.131

Question 17 was asked to understand which additional items respondents felt could potentially be reported at the IFC forum. There was an intense concentration for 'new risks from new or changes to operating models' (92%) and 'breaches of segregation of duties' (91%) as indicated in Table 3-10.

Table 3-10: Additional items to be reported at the IFC committee meeting

17 Please indicate which of the following should also form part of the reporting of financial controls forum meetings:							
	Strongly disagree	**Disagree**	**Sum SD & D**	**Neutral**	**Agree**	**Strongly agree**	**Sum SA & A**
Internal audits to be conducted for the period.	1%	5%	**6%**	21%	48%	25%	**73%**
External audits to be conducted for the period.	2%	5%	**7%**	23%	50%	20%	**70%**
Breaches of segregation of duties that impact financial controls.	1%	–	**1%**	8%	50%	41%	**91%**
New risks from new or changes to operating models.	1%	–	**1%**	7%	47%	45%	**92%**
Finance initiatives.	1%	4%	**5%**	14%	61%	20%	**81%**
Combined assurance coverage.	1%	3%	**4%**	23%	56%	17%	**73%**

Regarding Question 17, the highest mean attained was 4.35, which was noted for 'new risks or changes to operating models', whereas the lowest agreement was 3.81, which was obtained for 'external audits to be conducted for the period'. The standard deviation ranged between 0.702 and 0.866.

Table 3-11: Descriptive statistics for additional items to be reported at the IFC committee meeting

17 Please indicate which of the following should also form part of the reporting of financial controls forum meetings:		
	Mean	**Std. Deviation**
Internal audits to be conducted for the period.	3.91	0.866
External audits to be conducted for the period.	3.81	0.884
Breaches of segregation of duties that impact financial controls.	4.30	0.704
New risks from new or changes to operating models.	4.35	0.702
Finance initiatives.	3.95	0.770

17 Please indicate which of the following should also form part of the reporting of financial controls forum meetings:		
	Mean	**Std. Deviation**
Combined assurance coverage.	3.85	0.770

Question 17 yielded interesting insights into the additional items to be reported at the IFC forum with both Table 3-10 and Table 3-11 highlighting that ‘segregation of duties’ and ‘new risks or changes to operating models’ need to be considered as part of the IFC forum.

Lastly, Question 18 was asked explicitly to allow respondents to provide their view regarding whether the statement, as contained in the governance and remuneration report to investors and the public, is sufficient for the public to gain comfort that the IFCs are managed effectively. Table 3-12 yielded the most surprising result – only 50% of respondents agreed with the statement. The second-largest response frequency was neutral, with 44%.

Table 3-12: Effectiveness of the IFC statement in the governance and remuneration report to the public

	Strongly disagree	Disagree	Sum SD & D	Neutral	Agree	Strongly agree	Sum SA & A
18 Please indicate if the statement in the governance and remuneration report is sufficient for the public to gain comfort that IFCs are managed effectively.	1%	5%	**6%**	44%	40%	10%	**50%**

Question 18 shows a mean of 3.53 and a standard deviation of 0.784.

Table 3-13: Descriptive statistics for the effectiveness of the IFC statement in the governance and remuneration report

	Mean	Std. Deviation
18 Please indicate if the statement in the governance and remuneration report is sufficient for the public to gain comfort that IFCs are managed effectively.	3.53	0.784

When interpreting and combining the view of both Table 3-12 and Table 3-13, it is evident that there is a slight but definite lean towards an agreement with a 3.53 mean of the responses, which is still an interesting result.

Questions 10 to 18 (from Table 3-4 to Table 3-13) were grouped as these questions were specifically designed to obtain an understanding of:

- The expectations each representative of a particular area in Finance has as it relates to IFCs.
- The level of each individual's understanding of the reporting of financial controls.
- The level of maturity across each business unit of financial risk.

The next section provides the factor analysis related to the understanding of the IFC environment in the LFSO.

3.6.2 Factor analysis and reliability

Cronbach's alpha values are used to determine the internal reliability of coefficients (Bryman *et al*., 2017). Table 3-14 illustrates the Cronbach alpha values for Questions 10 to 17 as well as the factor analysis performed on the variables. The Cronbach alpha values were calculated to ensure that the results, which were based on a five-point Likert scale from 'strongly disagree' to 'strongly agree', could be combined to provide confidence that the responses all related to the questions asked. The values of the Cronbach's alphas shown in Table 3-14 are all above 0.70, which indicates that the study is reliable for Questions 10 to 17.

Table 3-14: Factor analysis and reliability of Questions 10–17

Question 10			
Kaiser-Meyer-Olkin measure of sampling adequacy	**Number of factors extracted**	**Variance on number of factors explained**	**Cronbach's alpha**
0.868	1	67.053	0.915
Component matrix[a]			
	Factor		
	1		
Operational Risk	0.877		
Internal Audit	0.874		
Internal Financial Control	0.867		

Finance	0.832
Procurement	0.776
Business Unit Management	0.768
Compliance	0.725

Question 11

Kaiser-Meyer-Olkin Measure of sampling adequacy	Number of factors extracted	Variance on number of factors explained	Cronbach's alpha
0.907	1	64.650	0.926

Component matrix[a]

	Factor
	1
External Audit issues	0.872
Themes arising from External Audit findings	0.869
Internal Audit issues	0.867
Risk incidents	0.845
Fraud incidents	0.828
Balance sheet errors	0.808
Intercompany breaks	0.757
Considered accounting changes	0.687
Procurement	0.674

Question 12 to Question 16

Kaiser-Meyer-Olkin Measure of sampling adequacy	Number of factors extracted	Variance on number of factors explained	Cronbach's alpha
0.771	1	59.802	0.818

Component matrix[a]

	Factor
	1
Please rate whether the IFC forum is effective in carrying out its mandate to monitor IFCs effectively for the organisation.	0.886
Are key financial controls adequately tracked and reported?	0.879
Is there enough emphasis being placed on automating financial controls?	0.796

Does the assessment of the maturity of IFCs add value?	0.706	
Please indicate if functions outside Finance, who are performing financial controls, are adequately skilled to identify and mitigate financial risks.	0.549	

Question 17			
Kaiser-Meyer-Olkin Measure of sampling adequacy	**Number of factors extracted**	**Variance on number of factors explained**	**Cronbach's alpha**
0.695	1	53.192	0.818
	2	73.581	0.784
Component matrix[a]			
	Factor		
	1	2	
Internal audits to be conducted for the period	0.764		
External audits to be conducted for the period	0.759		
Finance initiatives		0.728	
New risks from new or changes to operating models		0.710	
Combined assurance coverage	0.710		
Breaches of segregation of duties that impact financial controls		0.702	

3.7 Conclusion

This chapter discussed the research design and the applicable techniques that were used to perform this study. A quantitative approach was employed during the study. The research population comprised all Finance staff who attend the IFC forums. A systematic sampling approach was used to select a sample of intended respondents.

A self-developed questionnaire with close-ended questions was applied as a data collection technique. The data was analysed statistically using SPSS Version 25 to inform the conclusions made. This allowed for descriptive statistics and factor analysis to be used in the interpretation of the data. The study's reliability was improved by using Cronbach's alpha values. Further, certain assumptions related to the answering of the survey were made. To ensure that the research was conducted in line with appropriate consideration of the sensitivity of the research topic, the relevant ethical issues were considered, and permissions were obtained.

The next chapter summarises the findings, makes recommendations and gives a concluding remark.

CHAPTER 4: RECOMMENDATIONS AND CONCLUSION

4.1 Introduction

The numerous codes of best practice and regulations that govern listed financial institutions call for stringent financial controls. While all JSE-listed organisations are required to make a statement regarding the effectiveness of their IFCs, it just as important to understand how an organisation has established its internal structures to monitor the effectiveness of their IFCs.

Further, listed financial institutions endeavour to ensure that their share price is maintained, and by doing so, attract investors. The audit committee has an onerous task under its mandate to opine about the state of the IFC environment within their organisation. It is, however, clear that each listed financial services organisation has its interpretation regarding the requirements of the codes of best practice and regulations. Therefore, it should be a top priority for the management of any listed organisation to ensure that strong and effective IFCs are in place – more so for LFSOs who are safeguarding customers' money.

This chapter presents an overview of each of the previous chapters. It concludes the study and makes recommendations based on the findings identified in Chapter 3. It discusses a structured approach to link the research objectives of the study to the main findings. The chapter provides recommendations that are aimed at enhancing the IFC environment of the LFSO. Limitations and future research suggestions are also provided.

The next section gives an overview of the study and briefly describes each chapter.

4.2 Overview of the study

To provide context and establish the focus of the research, Chapter 1 provided the background to the research by discussing the problem statement. The chapter further discussed the primary and secondary research objectives. To satisfy the group audit committee that the reporting of IFCs is adequate, the primary objective of this research was to investigate how effectively IFCs have been established in the LFSO (see Section 1.3.1). By doing so, the researcher was able to gain a better understanding of the ability of the IFC environment to mitigate financial control weaknesses properly. Furthermore, the study determined the communication of IFCs throughout the Finance fraternity.

To accomplish the primary objective, secondary objectives were also investigated to provide the researcher guidance with crafting the research questions and objectives (see Section 1.3.2). Chapter 1 highlighted the importance and benefits of the study. Lastly, the chapter discussed the research approach, including the delimitations and assumptions that were made.

Chapter 2 discussed the literature review, which provided a theoretical background to IFCs and explained the reason for IFCs being a critical component to management. The chapter described the codes of best practice and the regulatory context in which governments and regulatory bodies started imposing more regulation and guidance over IFCs.

Chapter 3 explained the research design, data analysis, assumptions and research ethics. The research results of the questionnaire and the specific elements of the statistical analysis were presented.

Chapter 4 is a concluding chapter that summarises the chapters briefly. It further makes recommendations to the LFSO to improve its IFCs.

The next section discusses the findings identified in this research. It briefly describes the literature that is applicable and provides detail of the findings.

4.3 Research findings

This section discusses the findings observed after data collection and data analysis in conjunction with the literature review.

4.3.1 Control environment

COSO ensures the standardisation of controls by creating internal control frameworks and policies, which form the basis of an organisation's effective control management. The research identified that the LFSO has an established IFC function, noted in Table 3-2 with 100% of respondents indicating such, and a defined IFC framework also noted in Table 3-2 with 99% of respondents indicating their awareness thereof.

As indicated in Table 3-8, the IFC forum is successful in carrying out its mandate of monitoring the LFSO's IFCs effectively with 80% of the respondents agreeing. These findings align with COSO's first element, which stipulates that a control environment must be established to ensure that risks are mitigated adequately.

It was, however, found that not all financial controls have been documented formally with only 65% of respondents agreeing per Table 3-2, which poses a risk to the LFSO as there could be risks that have not been identified. Thus, there are not adequate controls in place to mitigate these risks. This relates to COSO's first element of internal control, namely that adequate procedures and standardised controls, such as the documentation of all financial controls, must be in place.

While the controls may not have been documented adequately, it is assuring that there is a framework in place for management to ensure that the documentation process will be standardised.

4.3.2 Information and communication

COSO describes the fourth element of internal control, namely information and communication, as possibly the most critical element for managing an organisation's internal control environment effectively. Entrenched in the LFSO are numerous IFC committees that meet at least monthly. These committees represent specific areas in the LFSO that perform financial control monitoring. It was on this basis that the research was designed to identify whether the areas represented are adding value in the IFC forums. The research concluded that almost all areas attending the committee do add value except for Compliance and Procurement. These areas were noted to add the least value to the IFC committees as indicated in Table 3-4, only receiving 55% and 67% agreement respectively.

As discussed in Section 2.4, the banking sector is a highly regulated industry. Compliance needs to demonstrate that their attendance at the IFC forum adds value.

Compliance has a significant role to play to ensure that the LFSO meets of all the required regulations in South Africa and all other countries where it operates.

Although the literature review was not specific to Procurement, it is, however, a division that has a significant role to play in the maintenance of IFCs in the LFSO. Procurement is a significant expense for any organisation and, as such, effective monitoring of spend is a vital financial control element.

Per Table 3-10, it was also identified that ‘breaches in the segregation of duties’ and ‘new risks from changes in operating models’ should also be reported at the IFC forums, with 91% and 92% agreement respectively. The literature supports this because ‘segregation of duties’ and ‘new risks from changes’ are vital elements of the COSO framework. These elements are further required by the Companies Act to address any other specific issues.

4.3.3 Codes and regulatory reporting

The King Codes on Corporate Governance prescribes that any material issues that trigger fraud and direct financial losses must be reported to the board and relevant stakeholders. In order for the board to report on these items, effective monitoring and reporting mechanisms need to be established. It is noted that there are established IFC forums in the LFSO that report on the following specific elements:

- Risk incidents
- Internal Audit issues
- Balance sheet errors
- Fraud incidents
- External Audit issues
- Intercompany breaks
- Procurement
- Themes arising from External Audit findings
- Considered accounting changes

While all of these items are critical, the study revealed that Procurement received the lowest response rate regarding whether they should be reporting at the IFC forum. While the result in Section 4.3.2 revealed that respondents felt that their information does not add value, this result now questions whether their actual reporting at the IFC forum is required.

The study further revealed, per Table 3-6 with 83% agreement, that ‘considered accounting changes’ are not necessarily considered as an area that should be reported at the IFC forum. This department is vital in ensuring that the financials are presented in line with the prescribed accounting standards and forms part of a compliance mechanism. However, section 94, points 7(f), (g) and (h) of the Companies Act state explicitly that accounting procedures need to be considered as part of the audit committee’s mandate.

The results did identify that Internal Audit and External Audit issues were considered essential items to be reported at the IFC forum, as indicated in Table 3-6 with 96% agreement for both. The King Code on Corporate Governance requires Internal Audit to provide an annual attestation of their evaluation of the design, implementation and overall effectiveness of the controls embedded in the organisation. Therefore, Internal Audit’s attendance and reporting of IFCs are also supported by the research. Further, the Companies Act requires that matters raised by the audit responsible for auditing the financials must be addressed and managed.

External Audit is not present in the IFC forums. However, based on the current matters that are discussed as part of the monthly meetings, the research confirmed that the matters discussed were important.

4.3.4 Maturity of IFCs

COSO’s third element of control relates to the embedment of control activities throughout the entire organisation to ensure that risks are minimised. It was found that 49% (Table 3-8) of the finance staff felt that the functions outside Finance, who perform financial controls, are not adequately skilled to identify and mitigate financial risks.

Although there is an embedded IFC framework, it appears as if management still needs to ensure that the framework is understood adequately. The overall maturity can also be enhanced.

4.3.5 Continuous improvement and risk assessment

With a new era of automation in organisations becoming a vital element, the research identified that the automation of IFCs is not being emphasised sufficiently. This outcome is noted in Table 3-8 with only 57% of finance staff agreeing to the statement. While automation was not necessarily considered in the literature analysis, it can still be identified under COSO's second element of risk assessment as it is a continuous process of identifying new and emerging risks.

4.3.6 External reporting on the IFCs

The Banks Act, Companies Act, Financial Markets Act and the King Code on Corporate Governance for listed entities require an overall disclosure statement in the annual integrated reporting to shareholders regarding the design, implementation and effectiveness of IFCs. While this is a task carried out by management, the audit committee remains ultimately responsible. The research found, per Table 3-12, that only 50% of respondents agree that the statement issued to the public to gain comfort that IFCs are managed effectively, may not be sufficient.

Based on the above outcomes, the analysis of the survey, and codes of best practice and regulations, the next section makes recommendations to the LFSO.

4.4 Final recommendations

Based on the findings identified in the research, the following recommendations are proposed:

4.4.1 Formal documentation of financial controls

Although there is an embedded IFC framework, the LFSO should ensure that they drive consistency throughout the organisation by having formally documented financial controls. This ensures that financial controls are managed effectively and that risks are mitigated. In response to the finding discussed in Section 4.3.1, it is therefore recommended that the LFSO should develop a template for all Finance teams to document their financial controls formally. The template should include:

- Control owners.

- Process (e.g. journal loading, journal releasing as examples).
- Systems involved.
- Evidence storage location.
- Segregation of duty elements (the loader and releaser).
- Control frequency.
- Frequency of updating.
- Formal sign-off and alignment to the IFC framework elements.

To ensure that the process is performed effectively, key stakeholders and risk specialists should be included in the process for all related control and risk items to be considered adequately. These roles include Internal Audit, Operational Risk and External Audit.

Considering the size of the LFSO, a period of six months should be considered sufficient for each respective Finance function to document their controls using the recommended template and to ensure that their documents are stored electronically.

It is also recommended that the IFC function should maintain a cloud-based storage solution in a central location for each functional finance area. As a result, they will be able to maintain a record of who has completed the process of documenting their controls and will be able to ensure that annual reviews of process documentation are performed.

4.4.2 IFC forum reporting

The IFC Forum was established to ensure that the monitoring of controls is performed in a structured manner with the relevant areas contributing to the effective monitoring of IFCs. However, there are some areas of improvement that should be considered. Recommendations are provided in response to the findings identified in Section 4.3.2 and Section 4.3.3:

- The IFC function of Procurement and Compliance should be assessed to determine the reason for committee members feeling that they do not add value. This vital feedback and commentary from committee members regarding their input and involvement in the IFC forums will allow for a more detailed analysis to be performed.

- The IFC forum should include the department responsible for monitoring and controlling segregation of duties in the IT system used by the LFSO.
- Operational risk should be proactive in their approach of providing new and emerging risks from changes in operating models.
- Considered accounting changes from the IFRS technical department should be considered an agenda item. Alternatively, it should be discussed when specific accounting changes need to be adopted or reconsidered.
- External Audit should be included in the group IFC forum every quarter. Being included will give External Audit valuable insights into the financial control environment. Furthermore, there will be potential cost savings for the LFSO as External Audit could use the insights from the forum to focus their audit effort.

All of the above points should be considered at the next annual IFC mandate update. Attendees should be given a week to provide their inputs for consideration and debate in the IFC forum.

4.4.3 Upskilling of areas performing financial controls

An essential element of an effective control environment is ensuring that controls are understood and embedded throughout the organisation. The following recommendations are therefore provided in response to Section 4.3.4:

- The IFC department should create training material and establish training programmes for functions who are performing financial controls to upskill them.
- Competency assessments and standardised procedures (see Section 4.4.1) should be developed and maintained to ensure that the functions outside Finance have been provided with the necessary means to perform their functions appropriately.
- This initiative should be developed and rolled out over 12 months by the IFC department, along with the Finance fraternity, to assist in upskilling all the downstream functions performing IFC.

4.4.4 IFC automation

The LFSO has an established IFC function. Considering the finding raised in Section 4.3.5, the following recommendations are proposed:

- The IFC department should develop a schedule of all considered IFCs that are going to be automated along with their expected timelines for implementation. Each automated IFC should be accompanied by a detailed risk assessment and documented description of the automation to take place.
- This schedule should be presented at the group IFC for visibility and overall progress being made against the set timelines.

The implementation of the schedule should be considered in the next financial period, and the involvement of operational risk should be continuous throughout the process.

4.4.5 External reporting on IFCs

The LFSO should consider potentially increasing the relevant detail in its annual report to the public. This is recommended based on the finding in Section 4.3.6, which should include:

- A description of the IFC framework that has been established and a brief description of all the elements that form the basis of its design.
- The current construct of its internal monitoring activities such as the committee structures, the matters addressed and the involvement of Internal Audit and External Audit in these forums.
- All the elements that are provided to the audit committee and by which area it is receiving the information from.

4.4.6 Summary of recommendations

The recommendations above are only provided to further enhance the already strong control environment that the LFSO has established. Organisations need to ensure that their IFC environment is supported with adequately documented controls and healthy monitoring controls that add value.

Regarding the areas outside Finance that are performing financial controls, the LFSO should roll out adequately documented, standardised controls, and conduct training interventions to bolster the financial controls.

Lastly, if the LFSO chooses to provide further detail in its annual report to the public regarding its external reporting on IFCs, it could increase investor confidence and satisfy the group audit committee that the reporting of IFCs is adequate.

Overall, the research confirmed that the LFSO had established a robust control environment that is adequate to satisfy the group audit committee that IFCs are managed, monitored and reported adequately.

The next section provides a link between the research objectives and the findings of the research.

4.5 Evaluation of the study

This section discusses the link between the primary and secondary objectives and the findings of the research.

4.5.1 Primary objective

The primary objective of this research was to investigate the effectiveness of IFCs in the LFSO to satisfy the group audit committee that the reporting of IFCs is adequate. The primary objective was achieved by designing a survey linked to literary-based research to identify the elements of a healthy control environment with a specific focus on IFCs. All the survey questions were designed to examine:

- The frameworks and reporting mechanisms established by the LFSO to guide the reporting of IFCs.
- The frequency of the IFC mechanisms in place and the understanding of the content being reported.
- Areas in the LFSO that form part of the IFCs.

- Other functions who are controlling IFCs and the monitoring thereof.
- The awareness, maturity and expectations of Finance representatives as these relate to the reporting of IFCs.

All these elements form the structure of a sound control environment. The research findings did not identify any significant outliers in terms of significant control issues faced by the LFSO. Therefore, based on the outcomes of the findings obtained and the analysis performed, it can be concluded that the primary objective has been met.

4.5.2 Secondary objectives

The secondary objectives for this research were broken down into literature objectives and empirical objectives.

Literature review

The literature provided a clear outline of internal control. It presented a view of the significant components of a sound control environment. The literature review further discussed the importance and benefits of internal controls and gave details regarding the required critical best practice principles and applicable regulations for effective implementation. The review explored the audit committee’s importance and responsibility as it relates to the reporting of IFCs.

Empirical objectives

The empirical objectives were designed to identify the following based on a structured research approach and methodology adopted by the researcher:

- The frameworks and reporting mechanisms established by the LFSO to guide the reporting of IFCs.
- The frequency of the IFC mechanisms in place and their related content.
- The degree of representation from key IFC risk partners in the control mechanisms.
- Other functions who are controlling IFCs and the monitoring thereof.

- The understanding, maturity and expectations of Finance representatives as it relates to the reporting of IFCs.

The survey incorporated elements of each of the above points, as shown in Table 4-1:

Table 4-1: Link between empirical objectives and survey questions

Empirical objective	Survey questions	Reference
The frameworks and reporting mechanisms established by the LFSO to guide the reporting of IFCs.	4–6	Table 3-2
The frequency of the IFC mechanisms in place and their related content.	7–9, 11	Table 3-3, Table 3-6
The degree of representation from key IFC risk partners in the control mechanisms.	10, 17	Table 3-4, Table 3-10
Which other functions are controlling IFCs and how they are monitored.	15	Table 3-8
The understanding, maturity and expectations of Finance representatives as it relates to the reporting of IFCs.	12–14, 16, 18	Table 3-8, Table 3-12

Based on the literature review performed and the empirical research conducted, it can be concluded that the secondary objectives have been addressed.

4.6 Limitations of the study

The following aspects formed some of the limitations of this study:

- Limited local research has been conducted on IFCs and the reporting thereof in the banking sector. Therefore, the researcher had to rely on international best practice guidelines and information from other industries. Although these guidelines apply to any industry, they were adapted for this research.

- The time taken for respondents to complete the survey caused delays in the overall time taken to complete the research. Numerous follow-ups were sent to ensure an adequate sample was obtained for data analysis.

- Due to time and monetary constraints, the research was focused on a single bank and was not extended to the other top banks in South Africa. Had there been more time and the financial means to do so, the research could have been extended to the other large banks in South Africa. An increased sample would allow for comparable results across the banking sector.

- Due to the nature of the financial services industry and the reluctance to have information made public, proprietary information has been edited and amended for the research. This was done to protect the identity of the LFSO, where the study was conducted.

- The possibility that respondents may not have provided honest opinions on the survey is indeterminate. While not noted in the overall results, the possibility has to be considered.

Considering the above limitations, the next section makes some suggestions that could be considered for further research.

4.7 Suggestions for Further Research

The following suggestions for future research can be considered:

- Perform the research as a comparative study across all the major listed banks in South Africa to determine the overall IFC environment.

- Do a qualitative study to identify whether greater disclosure of the internal processes and governance structures of financial controls would result in heightened investor confidence.

- Where banks have operations in foreign countries, extend the research to obtain different regulations and their associated impacts on group reporting and the mechanisms used to overcome these barriers.

- Conduct a comparative research study across multiple business sectors listed on the JSE to determine how each sector has adopted the governance recommendations and regulatory requirements of IFCs.

- Perform a qualitative study on group audit committees to determine whether they gain comfort about the information provided to them to be able to opine about the IFC environment.
- Use the survey developed in this study in future studies and across different sectors to test its consistency and application.
- Determine the role of Internal Audit in providing a monitoring mechanism for IFCs and their ability to assure that the design, implementation and monitoring of IFCs are adequate.

4.8 Overall Conclusion

Against the backdrop of global corporate scandals that have destabilised major organisations, IFCs was legislated as part of the reporting requirements for listed entities. For a listed entity, attracting investors is a significant part of their ability to create more capital. Therefore, by establishing a robust control environment, they would undoubtedly be able to attract more significant investment.

It has become an onerous responsibility to be a member of an audit committee. There are numerous acts prescribing member responsibilities, with the most critical being that members have to report on the state of the IFCs of their organisations. Once members have given their opinions regarding the design, implementation and monitoring of IFCs, the codes of best practice and regulations are open to interpretation. Considering this research focused on the financial services industry and banks in particular, this interpretation could be ascertained as all members provided their respective statements without similar structures or content.

The research problem was derived in the interpretation of the codes of best practice and regulations. This research was intended to identify how a specific LFSO established its IFCs and aligned its internal mechanisms as prescribed by codes of best practice and applicable legislation.

This document was split into the constructive components required of a research study by identifying the primary and secondary objectives to be achieved. These elements provided the base for constructing the research approach. Evidence was obtained from a literature review, and an empirical study was done to meet the intended objective. The importance and benefits of the study were determined, and this research will be presented to the LFSO where it was conducted.

The research critically analysed the relevant literature to determine the theoretical construct of the design, as well as the implementation and reporting of a healthy control environment. This included the COSO framework, which has five elements of control that comprise an embedded control environment. The importance and benefits of internal controls were provided to illustrate the benefits an organisation would obtain by implementing and encouraging a robust control environment.

The most relevant codes and legislation prescribing the reporting of IFCs in the banking sector provided the context of the highly regulated industry in which banks operate. The codes included the Combined Code on Corporate Governance 2003, King Codes on Corporate Governance, and the Sarbanes-Oxley Act of 2002. The critical legislation that applies to the financial services industry were discussed, including the Banks Act (94 of 1990), Companies Act (71 of 2008) and Financial Markets Act (19 of 2012).

The research further discussed the importance of audit committees and their responsibility to opine about the design, implementation and monitoring of IFCs. The external reporting of IFCs was discussed to illustrate the importance thereof as prescribed by the Banks Act, Companies Act and Financial Markets. The research further compared four major South African banks and the statements they provided in their integrated reports.

The current structures of the LFSO under the study were assessed against the regulations and guidelines. Chapter 3 described the research design of the study, including the population, sampling methods used and the data collection techniques that were adopted. It further discussed the system that was used to perform the data analysis and gave assumptions that were made in the study. The applicable research ethics were considered.

The survey results were analysed critically and presented in tabular formats. The tables included frequency and descriptive statistics, factor analysis and reliability of the research results. These results were used to identify specific themes and findings that will be presented to the LFSO.

The final chapter provided a high-level overview of the study. It discussed the relevant research findings and proposed recommendations in detail. The chapter gauged how the study met the primary and secondary objectives to allow for easy comparison between the survey results and the secondary objectives. Specific limitations to the study were considered, and suggestions for future research were provided.

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APPENDIX A: SURVEY

		Yes	No
1	Do you consent to complete the survey and agree to the informed consent form?		
2	Please indicate your experience a. Less than 5 years b. 5 to 10 years c. 10–20 years d. 20 years +		
3	Please indicate your management level • Middle Manager • Senior Manager • Head • Executive		
4	Is there an established Internal Financial Control Function in your institution?		
5	Is there a defined Internal Financial Control framework in place in the large financial services organisation that you work for?		
6	Have all key financial controls been mapped and formally documented?		

		Monthly	Quarterly	Bi-annually	Yearly	Never
7	How often are Internal Audit issues reported on? **(Mark one)**					
8	How often are External Audit issues reported on? **(Mark one)**					
9	How often are material issues reported: A material issue is any issue that would give rise to a significant write-off; major control break; exposure to liability claims; customer impact; representational risk etc. **(Mark one)**					

		Strongly Disagree	Disagree	Neither Disagree nor Agree	Agree	Strongly Agree
10	Do the following areas represented in the Internal Financial Control committee add value?					
	Operational Risk					
	Internal Audit					
	Business Unit Management					
	Finance					
	Compliance					
	Internal Financial Control					
	Procurement					
11	Should the following be reported and discussed in the Group Internal Financial Controls forums?					
	Risk incidents					
	Internal Audit issues					
	Balance sheet errors					
	Fraud incidents					
	External Audit issues					
	Intercompany breaks					
	Procurement					
	Themes arising from external audit findings					
	Themes arising from external audit findings					
	Considered accounting changes					
12	Does the assessment of the maturity of internal financial controls add value?					
13	Please rate whether the IFC forum is effective in carrying out its mandate to effectively monitor IFCs for the organisation.					
14	Are key financial controls tracked and reported adequately?					
15	Please indicate if functions outside Finance, performing financial controls, adequately skilled to identify and mitigate financial risks.					
16	Is enough emphasis being placed on automating financial controls?					

		Strongly Disagree	Disagree	Neither Disagree nor Agree	Agree	Strongly Agree
17	Please indicate which of the following should also form part of the reporting of financial controls: Internal audits to be conducted for the period only on Internal Financial Controls.					
	Internal audits to be conducted for the period.					
	External audits to be conducted for the period.					
	Breaches of segregation of duties that impact financial controls.					
	New risks from new or changes to operating models.					
	Finance initiatives.					
	Combined assurance coverage.					
18	Please indicate if the statement in the governance and remuneration report is sufficient for the public to gain comfort that IFCs are managed effectively.					