

Written Assessment Of Internal Financial Controls



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Foreword

Principle 7.3. of the King III Code on Corporate Governance requires that Internal Audit should provide a written assessment on the effectiveness of the company's system of internal controls and risk management. This will give substance to the endorsement by the directors of the effectiveness of internal controls in a company in the integrated report.

In applying principle 7.3, King III recommends the following:

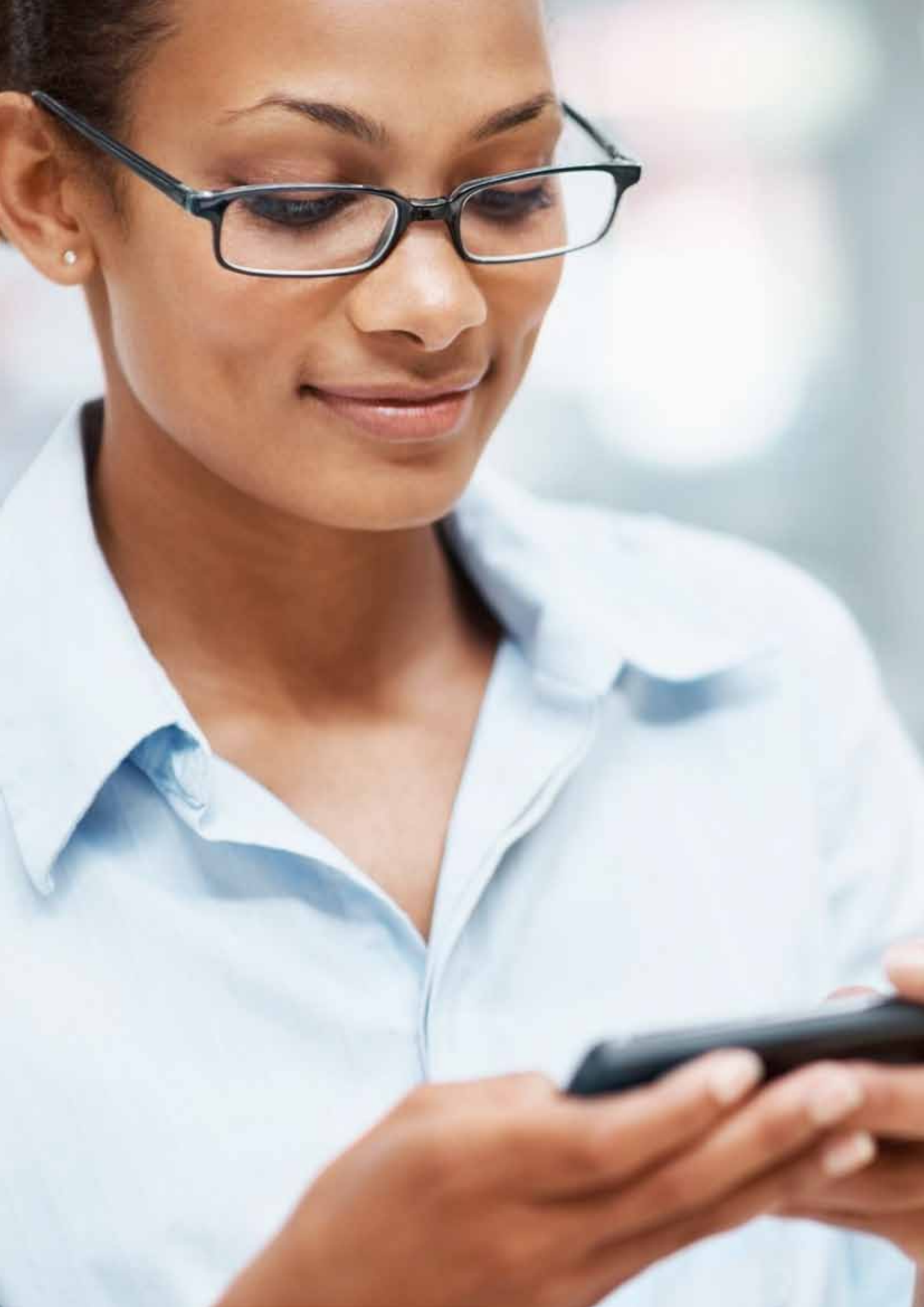
- Internal audit should form an integral part of the combined assurance model as internal assurance provider.
- Internal controls should be established not only over financial matters, but also operational, compliance and sustainability issues.
- Companies should maintain an effective governance, risk management and internal control framework.
- Management should specify the elements of the control framework.
- Internal audit should provide a written assessment of the system of internal controls and risk management to the board.
- Internal audit should provide a written assessment of internal financial controls to the audit committee.

Companies Act, 2008, also requires that the audit committee must conclude and report annually to the stakeholders and the board on the effectiveness of the company's internal financial controls. The audit committee should holistically consider all information brought to its attention from all sources, including the documented assessment of the internal financial controls by internal audit and external audit information, before concluding and reporting annually to the stakeholders and the board on the effectiveness of the company's internal financial controls.

The audit committee should report any weaknesses in financial control, whether from a design, implementation or operation, that are considered material (individually or in combination with other weaknesses) and that resulted in actual material financial loss, fraud or material errors, to the board and the stakeholders as part of the integrated report.

How Are The Internal Financial Controls Assessed?





How Does The Audit Committee Achieve The Level Of Assurance?

The audit committee should consider the following:

- Is there a control framework governing financial reporting in the company?
- Have all the risks that pertain to the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework been identified and documented?
- Are there controls (manual and automated) in place to address these risks and are they adequately designed to prevent or detect material misstatements in the financial statements and disclosures?
- Do the controls identified operate as they are supposed to and are they appropriately evidenced?
- Has internal audit tested the controls identified above and reported the results to the audit committee completely and accurately?
- Is the audit committee's assertion appropriately evidenced (including internal audit's assessment)?
- Is there a process in place to ensure that the framework remains relevant over time and is embedded as part of the company's financial reporting procedures?
- Internal audit should use its knowledge of the organisation's structures, operations and processes to identify risks to reliable financial reporting.

Assessment Versus Opinion

King III requires an assessment from internal audit and does not require internal audit to issue a review and/or audit opinion over the internal financial controls.

This recommendation also implies that the assessment over the system of internal control does not relate to a particular financial year, although the audit committee's obligation to annually report in the integrated report may require an annual review of the internal financial controls.

The supporting audit evidence will be built up over a period of time and based on the results of several periods of testing, work performed by others and informal evidence.

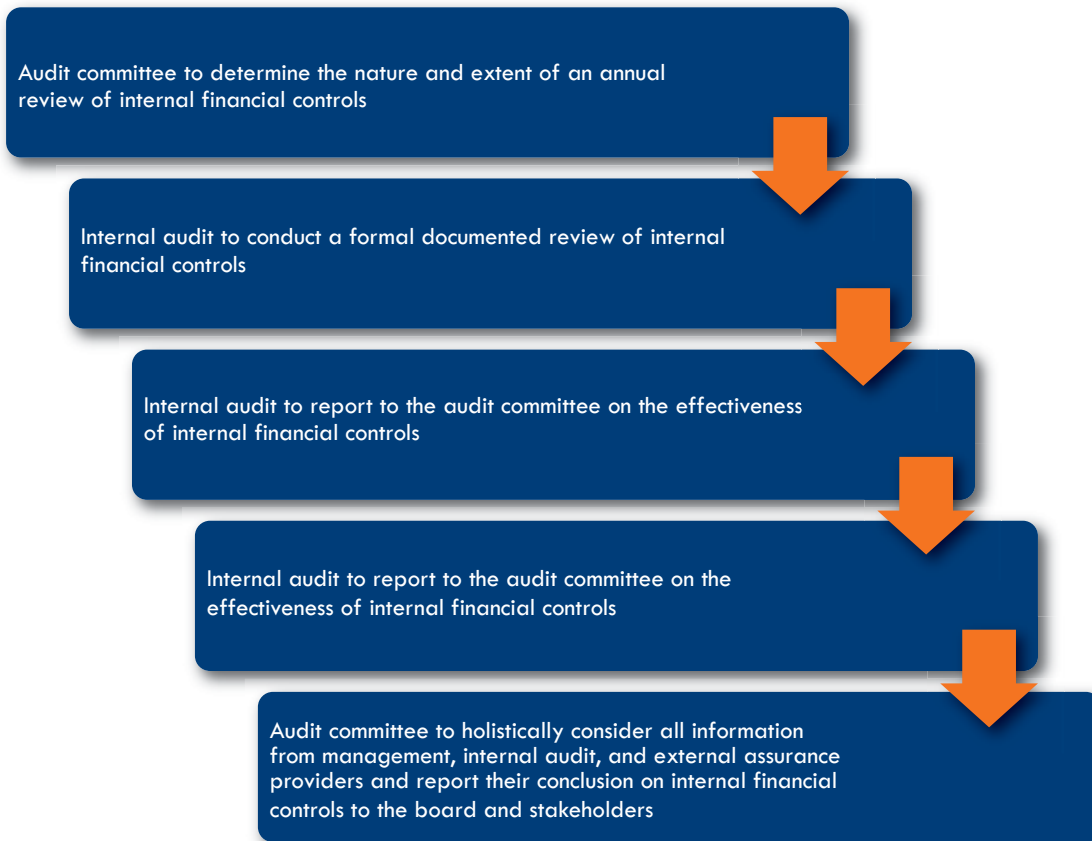
On the other hand, there is a widespread interpretation that internal audit activities are being asked by the board, management, and other stakeholders to provide opinions as part of each individual audit report as well as on the overall adequacy of governance, risk management, and control within the organization. These requests may be for an assurance or opinion at a broad level for the organization as a whole (macro-level opinion) or on individual components of the organization's operations (micro-level opinion).

Examples of macro and micro opinions include:

- An opinion on the organization's overall system of internal control over financial reporting (macro)
- An opinion on the organization's controls and procedures for compliance with applicable laws and regulations, such as health and safety, when those controls and procedures are performed in multiple countries or subsidiaries (macro).
- An opinion on the effectiveness of controls such as budgeting and performance management, when such controls are performed in multiple subsidiaries and coverage comprises the majority of the organization's assets, resources, revenues, etc. (macro).
- An opinion on an individual business process or activity within a single organization, department, or location (micro).
- An opinion on the system of internal control at a subsidiary or reporting unit, when all work is performed in a single audit (micro).
- An opinion on the organization's compliance with policies, laws, and regulations regarding data privacy, when the scope of work is performed in a single or just a few business units (micro).

In contrast to, for example, the Sarbanes-Oxley Act, King III does not require external attestation on internal financial controls.

Process Of Reporting On Internal Financial



Nature Of Assessment Provided

The written assessment of internal financial controls provided by internal audit to the audit committee should include a comprehensive memorandum by internal audit that documents:

- The scope of internal audit activities, which includes the appropriate level and quality of work based on the company's risks.
- The cycle on which audit plans are based.
- Consideration of the control components and limitations of control.
- The status of follow-up activities.
- An expression on the pervasive effects being considered.
- A discussion of serious problems and possible solutions.
- The overall assessment statement for the year.

Conclusion

Internal financial controls can be considered effective by the audit committee if the risk of material error is adequately reduced and, as a result, financial information is reliable. To determine whether weaknesses in financial control, or a combination of control weaknesses, resulted in actual material financial loss, including fraud and/or material errors that should be reported to the board for disclosure, the audit committee should make

reference to the International Accounting Standards Board's "Framework for the Preparation and Presentation of Financial Statements.

This requirement has the following impact on companies, boards and audit committees:

- Increased time and resource commitments for audit committees, management and internal audit regarding a formally documented review of internal financial controls.
- Audit committees should assess the adequacy of available skills to conduct internal financial control reviews.
- The audit committees' conclusions on the effectiveness of internal financial controls are on public record.
- Does the internal audit function possess the necessary and diverse skills required to give assurance to the audit committee?

How can we assist you

- Internal financial controls scoping
- Assistance with the development and implementation of the internal control framework
- Assistance with development and implementation of a combined assurance framework
- Internal financial controls review

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