

# THE ROLE OF INTERNAL AUDITING IN PROVIDING COMBINED ASSURANCE: ASSESSING INTERNAL FINANCIAL CONTROLS

by

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## Abstract

Internal auditors are playing a vital role in the corporate governance structure of an increasing number of organisations and are a fundamental component of the combined assurance task force. The objective of this study is to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment within the financial services industry from the chief audit executive's (CAE) perspective. Survey research was selected as an inquiry strategy. The survey research that was conducted, was in the form of questionnaires. The financial service companies that appeared on the 2012 Top 200 African Listed Companies were utilized as the population of this research study.

Based on the outcome of the results of the research study, the relevance and value of the written assessment regarding the effectiveness of internal financial controls should be customised for and by every organisation. The most important aspect, firstly, is that the significant financial risks relating to material misstatement of the organisation's financial position are identified. Secondly, that the internal audit activity performs a formal assessment on the effectiveness of the internal financial controls relating to the above mentioned risks, in the form of a written report.

The results of this research study endorse the fact that the King III Report on Corporate Governance emphasises the role of internal audit in combined assurance and corporate governance. It was further noted that internal audit is perceived by the CAEs within the financial services industry as one of the most important role players within an organisation's combined assurance processes. The written assessment of the effectiveness of internal financial controls is seen as the result and/ or final outcome based on Principle 7.3.6 of the King III Report (Institute of Directors Southern Africa, 2009:45). If all the associated stakeholders and/ or assurance providers offer valuable and constructive feedback on how to assess, manage and mitigate the significant internal financial control risks facing the organisation, it has the potential to result in increasingly sound corporate governance for the organisation.

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## INTRODUCTION

“YOU CANNOT BUILD A REPUTATION ON WHAT YOU ARE GOING TO DO”. (HENRY FORD)

Referencing method used in this study:

Kotze, T. 2011. *Referencing in Academic Documents, Official guidelines of the Department of Marketing and Communication Management*. University of Pretoria.

Notes on referencing:

1. No page numbers are used when electronic journals were referenced.
2. Direct quotations are indicated in *Italic*.

## CHAPTER 1

### Abbreviations used in this chapter

Abbreviation	Meaning
B.C.	Before Christ
CAE	Chief Audit Executive
IIA	Institute of Internal Auditors
IoDSA	Institute of Directors Southern Africa
IPPF	International Professional Practice Framework
JSE Ltd	Johannesburg Stock Exchange Limited
SOX	Sarbanes Oxley Act No 107-204 of 2002 (USA)
USA	United States of America

### 1.1 INTRODUCTION AND BACKGROUND

In the restaurant business questions like “why are the promotion figures not as anticipated?” should be aimed at operational management. Similarly, questions about building materials that have not been delivered to a construction site due to a failure to pay the supplier on time should be of concern to the operational management of the construction company. The solutions to these problems should be readily available from the finance department, simply by looking at the numbers. The point is that business financial reports should be accurate and complete, in order to assist the operational team to make informed decisions pertaining to the business. To an internal auditor, financial information of any organisation should make sense. Adequate and effective financial controls will assist internal auditing and operational management by giving them confidence in the numbers being reported.

Internal financial controls differ from industry to industry. Manufacturing companies’ statements of financial position will look significantly different from statements of financial position of a financial institution. Manufacturing companies’ property, plant and equipment line items on the statement of financial position will consist of equipment and machinery that will produce a specific product and it would in all likelihood be a substantial amount. Financial services institutions on the other hand, do not have the same focus on their statements of financial position. Within a financial services institution the focus will almost

invariably be on intangible assets like derivatives and financial instruments. The composition of an audit committee in the manufacturing industry will also vary from the composition of an audit committee in the financial services industry.

For the purpose of this study, the focus is restricted to the financial services industry and the research addresses the following three concepts:

- Corporate governance;
- combined assurance; and
- internal audit.

Corporate governance, combined assurance and internal auditing are concepts that are connected and are treated as such for the purpose of this study. These concepts are compared to a road map to the destination and purpose of this study. Chapter One, in summary:

- Provides a brief overview of the conceptual foundation provided by the literature;
- presents the problem and purpose statements guiding the research;
- identifies the academic value of the research;
- defines the research methodology;
- provides definitions of key terms; and
- concludes with an overview of the rest of the study.

Corporate governance within South Africa has changed significantly over the last two decades, and the rate of change is accelerating. The King Committee issued its third Report on Corporate Governance for South Africa (the so-called King III Report) (Institute of Directors Southern Africa, 2009) on 1 September 2009 and it became effective on 1 March 2010. According to Lorange, Neubauer, Ward and George (2004:1), corporate governance in an organisation can be characterised as a leading-by-example or walking-the-talk initiative. Within today's business world a great deal of emphasis is placed on how companies address the challenge of providing good corporate governance. Good corporate governance is essentially the result of effective leadership (Lorange *et al.*, 2004:1).

Internal auditors are now playing a vital role in the corporate governance structure of an increasing number of organisations and are a fundamental component of the combined assurance task force. It is through the effective co-operation between an entity's leadership and top management structures on the one hand, and its internal audit function on the other, that a good reputation is built. This is why Henry Ford's idea about reputation, quoted at the beginning, is pertinent: your reputation is built on your actions, not your intentions. Henry Ford, the founder, former vice-president and chief engineer of the Ford Motor Company, while he was not the inventor of the gasoline powered motor vehicle, it was his assembly line production techniques (with its reliance on team work) that enabled the western world's population to become motorists. His legacy and reputation still lives on (The Henry Ford, 2003).

According to the King III Report, one of the aspects of how internal auditors can assist a company's efforts to build a reputation for good corporate governance is by providing an assessment of the effectiveness of the organisation's internal financial controls (Institute of Directors Southern Africa, 2009:39).

Internationally, companies have developed a number of different perspectives on what constitutes combined assurance. (Ernst & Young, 2011; Nkonki, 2011; PwC, 2011:4). The King III Report stipulates that it is the audit committee's responsibility to monitor the appropriateness and effectiveness of the organisations' combined assurance policies and efforts. The combined assurance model that is used by a company should ensure that the significant risks that are identified are adequately addressed.

The combined assurance model can be compared to a motor vehicle. The requirement, according to the King III Report (Institute of Directors Southern Africa, 2009:39), that internal audit should provide a written assessment of the effectiveness of a company's internal financial controls can be seen as one of the rear wheels. This is required to ensure that the corporate governance vehicle has a degree of mobility. The assurance duty of the external auditors can be seen as the other rear wheel. Together, the rear wheels combine as the independent assurance providers. The internal assurance providers, (typically risk, compliance, forensic and legal-based assurance) represent the front wheels of the corporate governance vehicle. Management is the steering wheel of the vehicle. The

board of directors should drive the vehicle, and the audit committee and other committees should provide route analysis and selection. The important aspect to consider, in terms of this analogy, is that no one part can propel the whole vehicle: but with all the components acting as a single unit, you have movement and useful functionality.

All the activities of the individual assurance providers should be adequately coordinated to ensure the success of the combined assurance efforts of the organisation. The presentation and/ or assessment of the effectiveness of internal financial controls based on the assurance provided, should be combined in a document. The document could be in any of a variety of non-verbal formats like for example quarterly reports or annual reports depending on the preference of the audit committee.

Currently limited articles in scholarly journals have been published relating to combined assurance and / or the written assessment regarding the effectiveness of internal financial controls. The available literature that could be found relating to combined assurance and / or the written assessment regarding the effectiveness of internal financial controls are the following:

- Co-ordinating risk management and assurance – a practice guide that was published by the Institute of Internal Auditor’s Research Foundation (MacLeod, Foster, Macdonald, Robertson, Stokka & Ybarra, 2012:1-11); and
- Combined Assurance: case studies on a holistic approach to organisational governance that was also published by the Institute of Internal Auditor’s Research Foundation (Sarens, Lewis & Thornhill, 2012).

MacLeod *et al.* (2012:11) describe a practical guide as a reference that could assist in solving a specific problem. Guidance material is not envisioned to supply specific and definite solutions to explicit scenarios. Guidance material should be seen as a map that could result in getting the passengers to the intended destination; however, it should be noted that there could also be more than one road to travel. Practice Guidelines form part of the Institute of Internal Audit’s International Professional Practice Framework (IPPF) (Institute of Internal Auditors, 2011). The Institute of Internal Auditors Practice Guidelines consist of mandatory guidance and strongly recommended guidance. Mandatory guidance consists of the Definition of Internal Audit, the Internal Audit Code of Ethics and the

Internal Audit International Standards. The strongly recommended guidance consists of Position Papers, Practice Advisories and Practice Guides (Institute of Internal Auditors, 2011).

The Practice Guide relating to *Coordinating and Assurance* indicated that assurance activities are shared among relevant assurance providers. Assurance providers further work in silos, performing independent assurance activities, compliance activities and risk management activities. Co-ordinating these specific functions is crucial in order to eliminate duplication of work as well as to ensure that the significant risks that the organisation might be faced with, are adequately addressed (MacLeod *et al.*, 2012:1). Effective governance processes within an organisation underline the need for assurance activities. Assurance activities enhance the relationship between the organisation, the board of directors and the relevant stakeholders of the organisation. This Practice Guide (relating to *Coordinating Risk Management and Assurance*) does not specifically focus on the role of internal audit within combined assurance in assessing the effectiveness of internal financial controls. The Practice Guide focuses in general on the role of risk management and assurance.

The second available literature that was investigated relates to a case study that was conducted. According to Leedy and Ormrod (2010:108) the characteristics of case studies are indicated as a type of quantitative research. Case studies provide comprehensive detail relating to a particular example and/ or event that could be used to apply as a solution to a specific problem.

The IIA Research Foundation issued a research report pertaining to combined assurance as *Combined Assurance: Case studies on a holistic approach to organisational governance* (Sarens *et al.*, 2012). The objective of the research was to investigate the various stages of combined assurance of six multinational organisations. The purpose of this research was to raise combined assurance awareness from the definition of combined assurance to the implementation thereof in the organisations. The research further investigated the challenges, benefits and barriers pertaining to the combined assurance implementation framework (Sarens *et al.*, 2012: xi-xii). The case study research that was conducted related to combined assurance, however, it does not specifically focus of the

role of internal audit pertaining to the assessment regarding the effectiveness of internal financial controls.

Based on the above mentioned literature study, the problem and purpose statement of this study is developed and outlined in the following section.

## 1.2 PROBLEM STATEMENT

Audit committees are required to navigate the combined assurance reports provided by internal and external auditors, risk departments, legal departments and management (Institute of Directors Southern Africa, 2009:32-33). Audit committees additionally need to assess the assurance provided by these parties in addressing the significant risks the organisation might be facing, and thereby ensuring that the corporate governance vehicle is mobile. This study will be based on the problem statement as follows: There is currently uncertainty how the chief audit executive (CAE) perceives the relevance and value of the internal audit written assessment regarding the effectiveness of internal financial controls.

## 1.3 PURPOSE STATEMENT

According to the King III Report on Corporate Governance, one of the responsibilities of internal audit is stipulated as follows:

- Principle 7.3.6 p 45: “...*Internal audit should provide a written assessment of internal financial controls to the audit committee...*” (Institute of Directors Southern Africa, 2009).

(The research study’s focus is limited to the above mentioned principle - Principle 7.3.6)

The purpose of the study is to analyse the relevance and value of the internal audit written assessment regarding the effectiveness of internal financial controls in a combined assurance environment within the financial services industry, from the CAE’s perspective.

The Oxford English Dictionary (2002:528,703-704) defines relevance and value as follows:

- Relevance is defined as *closely connected or appropriate to the matter in hand*; and

- Value is defined as *the regard that something is deemed to deserve; the importance, worth or usefulness of something.*

Based on the above mentioned definitions, the concepts of relevance and value were used as a foundation for this study. The researcher made an assumption that the study should determine firstly if it is relevant to perform a written assessment regarding the effectiveness of internal financial controls as viewed by the CAE. If the assessment is relevant, it is easier to determine the value of the assessment. The two concepts – relevance and value – are for the purpose of this study therefore connected.

#### 1.4 RESEARCH OBJECTIVES

- To determine the relevance of internal auditing as it pertains to corporate governance.
- To determine the relevance of combined assurance in respect of internal auditing.
- To determine the value of the internal audit written assessment of the effectiveness of internal financial controls within the financial services industry from the CAEs perspective.
- To determine whether the perceived relevance and value of the internal auditor's written assessment regarding the effectiveness of internal financial controls, differ between companies within the financial services industry from the CAEs perspective.

#### 1.5 ACADEMIC VALUE AND CONTRIBUTION OF THE PROPOSED STUDY

This study is important from both theoretical and practical perspectives.

From a theoretical outlook the study provides knowledge based on the perceptions of the CAE pertaining to the **relevance** of the written assessment regarding the effectiveness of internal financial controls as part of the assurance provider team entrusted with providing combined assurance. From a practical perspective, also based on the view of the CAE, the study provides an insight into the **value** of internal auditing's written assessment regarding the effectiveness, which is required in terms of the King III Report.



## **1.6 PARAMETERS, ASSUMPTIONS AND LIMITATIONS**

### **1.6.1 PARAMETERS**

This study focus on the King III Report on Corporate Governance (Institute of Directors Southern Africa, 2009) with regard to the roles and requirements that are listed for internal auditing to fulfil as part of the assessment of internal financial controls, thereby making it relevant to the South African context. The overall impact of the King III Report, The Companies Act No. 71 of 2008 and other guidelines of private sector businesses are analysed as far as they impact on the assessment of internal financial controls. It should be noted that the researcher only investigated the situation in listed financial services industry companies.

The study further focuses on the relevance and value regarding the internal audit written assessment of effectiveness of internal financial controls within combined assurance. Management, risk departments, forensic departments, legal departments, external auditors, the board of directors and audit committees are all various stakeholders within the combined assurance process. These are other stakeholders that have a significant influence on and responsibility to contribute to the combined assurance report regarding the effectiveness of internal financial controls. These other assurance providers are not the focus of this study.

### **1.6.2 ASSUMPTIONS**

According to Leedy and Ormrod (2010:6) assumptions are circumstances that are confidently accepted without relevant and adequate evidence. It is vital to validate the assumptions for the research to contribute positively to the body of knowledge. In this study it is assumed that:

- The data collected from each organisation (from the CAE), provide an accurate representation of the situation within that organisation;

- the quantitative research, by means of a survey, is an appropriate means to explore the perceptions the CAE has of the internal audit activity regarding the assessment of internal financial controls pertaining to combined assurance;
- the quantitative research, by means of a survey, is an appropriate means to explore the perceptions the CAE has of the written assessment that is provided by the internal audit activity with regard to the effectiveness of internal financial controls; and
- The CAE within the financial service industry has the willingness and ability to understand and truthfully complete the questionnaire.

## 1.7 DEFINITION OF KEY TERMS

The key terms that are used in this research dissertation are defined in this section.

**Audit Committee's Composition:** Section 94(2)(a) of The Companies Act No. 71 of 2008 (hereafter referred to as the Act), "*inter alia, states that companies must elect an audit committee comprising at least three members*". The committee should, furthermore, consist of people with accounting and financial expertise as well as industry-related expertise pertaining to the specific organisation. One of the objectives of the committee is to oversee the internal and external audit functions of an organisation (QFinance, 2009).

**Control Environment:** According to the Institute of Internal Auditors, a control environment is defined as follows:

*The attitude and actions of the board and management regarding the significance of control within the organization. The control environment provides the discipline and structure for the achievement of the primary objectives of the system of internal control* (Institute of Internal Auditors, 2012).

**Institute of Internal Auditors (IIA):** This is a global professional organisation that provides guidance and information for practicing internal audit professionals. According to the Institute of Internal Auditors (2011) and Coetzee and Lubbe (2011), the objective of the IIA is to provide the following:

- *International Standards for the Professional Practice of Internal Auditing; and*
- *Practice Advisories of the Institute of Internal Auditors.*

According to Lewington (1996), the IIA will further provide the following:

- *Responsibility statements;*
- *ethical requirements; and*
- *other industry-related information to Internal Auditors.*

**Institute of Internal Auditors Code of Ethics:** The code of ethics promotes ethical behavior for all professionals within the industry. The objective of the code of ethics is to provide guidelines for an ethical culture for all internal audit professionals (Institute of Internal auditors, 2012)

**Institute of Internal Auditors' definition of internal auditing is:** According to the Institute of Internal Auditors internal auditing is defined as follows:

*Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve the organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes(Institute of Internal Auditors, 2012).*

**King III Report on Corporate Governance** is the governance document that lays out for South African companies what are sound governance practices . All companies that are listed on the Johannesburg Stock Exchange Ltd (JSE) are required to abide by the regulations contained in the King III Report (Institute of Directors Southern Africa, 2009).

**Sarbanes-Oxley Act No 107-204 of 2002 (SOX)** is a federal law that was enacted in the United States of America (USA) on 30 July 2002, that defines and regulates good corporate governance. SOX sets governance standards for USA public company boards, management and external audit firms. All companies, including South African, with subsidiaries in the United States of America are bound by the regulations contained in SOX (Gramling, 2008; Millar & Bowen, 2011).

- According to Gramling (2008) and Millar and Bowen (2011), section 404 of the Sarbanes Oxley Act No 107-204 of 2002 requires that an internal control report should address the following issues:

- ❖ Recognise that it is the responsibility of management to establish and maintain an adequate internal control structure, including the procedures for financial reporting.
- ❖ Verify the functionality of the framework used by management to conduct its evaluation of effectiveness of internal control over financial reporting.
- ❖ Perform an evaluation of the effectiveness of management of internal control over financial reporting.

**Statement of Financial Position:** This is a formal reporting method used by management to present a company's financial position on a specific date, summarising the status of all accounts holding equity, assets and liabilities. Assets include cash and cash equivalents, fixed assets and intangible assets. Equity includes all capital, earnings and reserves. Liabilities include long-term liabilities and short-term liabilities (International Financial Reporting Standards, 2012:A572-A579).

**Statement of Comprehensive Income:** This is a formal reporting method used by management to present a company's performance measured in profit and/or loss on a specific date (International Financial Reporting Standards, 2012:A580).

**Reasonable assurance:** This is the level of confidence that an auditor gives, while exercising professional skill and care, that the specific control that was analysed is working as intended (Page, 2006). According to the ISAE 3000 (Revised), section 12 (a) (i) a reasonable assurance can be defined as follows:

*In a reasonable assurance engagement, the practitioner reduced the engagement risk to an acceptable level in the circumstances of the engagement as the basis for the practitioner's conclusion. The practitioner's conclusion is expressed in a form that conveys the practitioner's opinion on the outcome of the measurement or evaluation of the underlying subject matter against the criteria. (International Standard on Assurance Engagements, 2013:7).*

**Risk management:** The process where possible risks facing an organisation are assessed and evaluated. Risk management requires a transparent approach to providing oversight of the organisation's risk environment, and being able to inform the relevant

stakeholders and the management team of the situation at any given time (The Institute of Risk Management South Africa, 2013).

## 1.8 OVERVIEW OF THE STUDY

Corporate governance, combined assurance and internal audit are connected for the purpose of this study and cannot individually provide effective assurance pertaining to the effectiveness of internal financial controls. As Henry Ford noted: *coming together is the beginning, keeping together is progress and working together is success*. This is equally relevant to the achievement of combined assurance in any organisation.

The following comparisons are used in this study to explain various concepts:

- The combined assurance model of an organisation can be compared to a motor vehicle.
- Each assurance provider gives a different view of how the significant risks of the organisation will be addressed and / or mitigated. Therefore, assurance providers are compared to the components/ parts of the vehicle.
- The objective of this study is compared to the destination of the corporate governance vehicle pertaining to the relevance and value regarding to the assessment of the effectiveness of internal financial controls within combined assurance.

Quantitative research was selected for the purpose of this study because it allowed the researcher to analyse the data and to compare how combined assurance and the assessment of the effectiveness of internal financial controls are implemented in the surveyed organisations.

Table 1 represents an overview of the chapters in this study.

**Table 1: Overview of this study**

Chapter 1 - Introduction and background
Chapter 2 - Corporate governance
Chapter 3 - Combined assurance
Chapter 4 - Internal auditing
Chapter 5 - Research design
Chapter 6 - Results
Chapter 7 - Summary and conclusion

## 1.9 SUMMARY AND CONCLUSION

To conclude, the objective of this study is to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment within the financial services industry from the CAE's perspective. Even though there are many different role players within combined assurance, the study will only focus on the role of internal audit regarding the relevance and value of the written assessment of internal financial controls.

According to Lorange *et al.* (2004:1) corporate governance has changed significantly over the last decade and can be seen as the leading-by-example initiative. Good corporate governance results in effective leadership. One of the methods that internal audit can add value to the organisation's corporate governance processes is by providing a written assessment regarding the effectiveness of internal financial controls within a combined assurance process. The relevance and value of internal audit pertaining to corporate governance will be discussed in detail in Chapter Two.

Currently limited articles in scholarly journals have been published relating to combined assurance and/ or the written assessment regarding the effectiveness of internal financial

controls. A Practice Guide relating to the coordination of risk management and assurance as well as a case study research relating to the holistic approach of combined assurance was the only available literature that could be found. Upon inspection of the available literature it was noted that the role of internal audit relating to the assessment of the effectiveness of internal financial controls was not yet researched in detail.

Arising from the requirements noted in the King III Report, with specific focus on Principle 7.3.6 (Institute of Directors Southern Africa, 2009:45), pertaining to the responsibility of internal audit, the problem statement and purpose statement of the study were formulated.

The problem statement of this study highlights the fact that there is currently uncertainty how CAEs perceived the relevance and value of the written assessment regarding the effectiveness of internal financial controls. The reason for this is that no other empirical study has been done on the view of the CAE pertaining to the relevance and value regarding the written assessment of internal financial controls.

The purpose of the study is to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment, within the financial services industry, from the CAE's perspective.

Based on the problem and purpose statement of this study, several research questions were developed in order to reach the destination of this study.

The academic value and knowledge contribution of this study rests in its efforts to provide valuable knowledge relating to the relevance and value of the written assessment regarding the effectiveness of internal financial controls from the CAE's perspective. It furthermore aims to provide an insight into the value of internal audit's written assessment of the effectiveness, which is required in terms of King III Report.

The study focuses on the requirements listed in the King III Report pertaining to internal audit within a South African context. The study focuses specifically on financial services companies, listed on the JSE Ltd. The study has been limited to the current role of internal

audit pertaining to relevance and value with regard to the assessment regarding the effectiveness of internal financial controls within combined assurance.

The literature review of this study will be comprise of corporate governance, combined assurance and internal auditing. The next chapter will be the start of the literature review and will focus on corporate governance.



# CORPORATE GOVERNANCE

## CHAPTER 2: CORPORATE GOVERNANCE

### Abbreviations used in this chapter

Abbreviation	Meaning
CAE	Chief Audit Executive
CEO	Chief Executive Officer
CHF	Swiss Franc is the currency of Switzerland
COSO	Committee of Sponsoring Organisations of the Treadway Commission: Control Framework
GPS	Global Positioning System
IIA	Institute of Internal Auditors
IoDSA	Institute of Directors Southern Africa
JSE Ltd	Johannesburg Stock Exchange Limited
King I, II and III	The King Report on Corporate Governance. The numbers (I, II, III) represent the various versions that have been published
SOX	Sarbanes-Oxley Act No. 107-204 of 2002 (USA)
UK	United Kingdom
USA	United States of America
USD	Currency - United States of America dollar

### 2.1 INTRODUCTION AND BACKGROUND

In the previous chapter, the problem and purpose of this research study were introduced. The problem statement of this study highlights the fact that there is currently uncertainty how the chief audit executive (CAE) perceives the relevance and value of the written assessment regarding the effectiveness of internal financial controls.

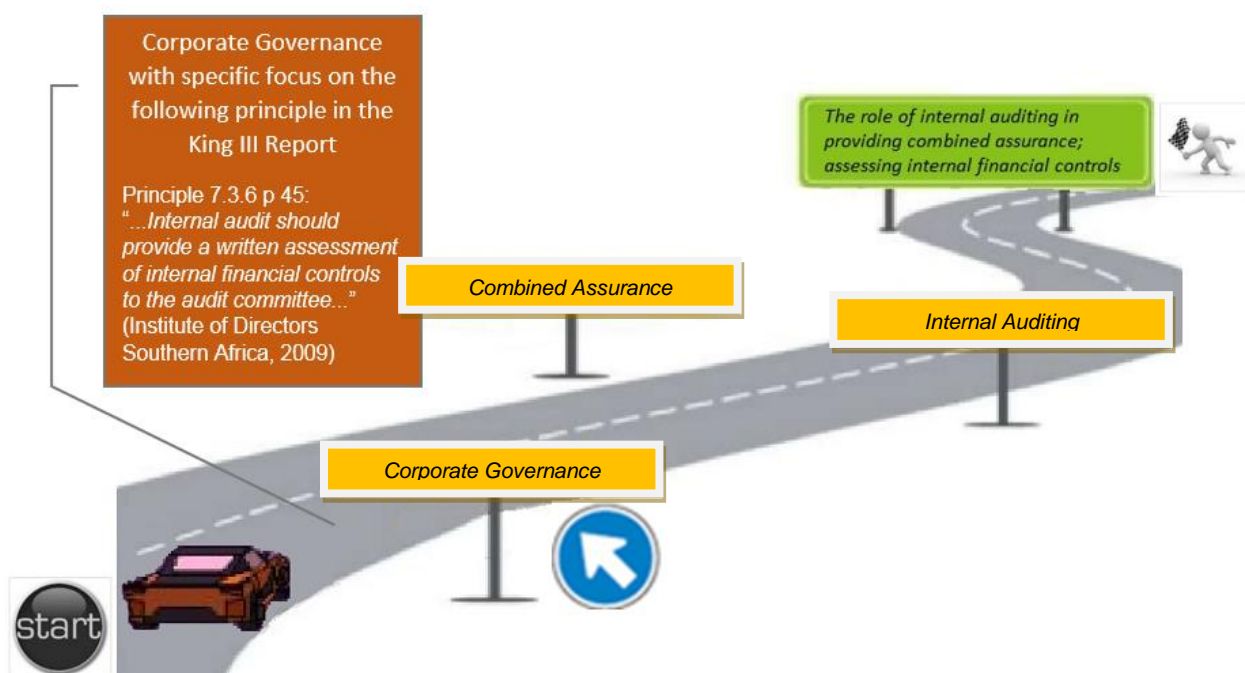
The purpose of the study is to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment, within the financial services industry, from the CAE's perspective.

Based on the King III Report on Corporate Governance the starting point to understand the importance of the role of internal audit in the assessment of the effectiveness of internal financial controls, is to understand "corporate governance". Corporate governance can be described as a way of directing and/ or governing the organisation's business. It is an action, *how* organisations conducts day-to-day business. The objective of this chapter is to determine the relevance and value of the contribution of internal audit to corporate governance (Institute of Directors Southern Africa, 2009).

In South Africa, corporate governance is not regulated by legislation. However, it can be described as best practices according to which a company should operate. The King Reports (I, II and III) contain guidelines on how to implement and/or maintain sound corporate governance principles. These types of guidelines' usefulness to a business should not be underestimated because they support the organisation's vision, mission and values. Corporate governance assists an organisation to achieve a healthy internal business environment (which should positively influence its external business relationships).

In other words, corporate governance is the web of relationships linking the board of directors and its sub-committees with combined assurance and internal audit. The visual presented in Figure 1 illustrates the road map of this study, the road of corporate governance, combined assurance and internal auditing. This visual will be used in each chapter.

**Figure 1: The map of this study's progress along the road towards understanding corporate governance, combined assurance and internal auditing, with specific focus on corporate governance**



Corporate governance is flexible in nature. Each organisation develops its own corporate governance strategy that adjusts and develops in accordance with the growth and development of the company. Corporate governance can (and should) be regularly reviewed and changed to meet the changing needs of the company (Lorange *et al.*, 2004:1-12).

As the analogy used in this research study suggests, corporate governance is compared to a motor vehicle and thus, the summary at the end of each section within the chapter is a pit stop providing an opportunity for review and reflection. In this chapter, the background of corporate governance will be investigated. The second pit stop will be a review of the history of corporate governance. The third pit stop reviews the adoption of corporate governance by South African businesses. The fourth and fifth pit stops investigate the importance of corporate governance for businesses, and the impact of legislation on corporate governance. The last pit stop at the end of this chapter reviews the relevance of legislation and guidance to internal audit practice in South Africa. It is important to obtain an understanding of the various pit stops in order to achieve the objective of this study.

## **2.2 HISTORY OF CORPORATE GOVERNANCE**

### **2.2.1 CORPORATE GOVERNANCE CODES**

The European Corporate Governance Institute (2014) compiled a list of the various countries in the world's corporate governance codes. From that list, it was interesting to note that the United Kingdom (UK) issued the first corporate governance code, the Cadbury Report (The Financial Aspects of Corporate Governance) in 1992. South Africa was the second country in the world to issue their corporate governance code, the King I Report, in November 1994. Canada followed in December 1994 with the Canadian Corporate Governance Code, *Where were the Directors? Guidelines for Improved Corporate Governance in Canada (The Toronto Report)*. In 1995 Australia and France respectively issued the Bosch Report (Australian) and the Vienot I Report (France) (The European Corporate Governance Institute, 2014).

It was further noted that there are 102 different countries' corporate governance codes listed in the European Corporate Governance Institute (2014) index of codes. From the 102 countries, the following 10 African countries issued their respective corporate governance codes in the 21<sup>st</sup> century:

- The Algerian Corporate Governance Code was first issued in 2009;
- the Egyptian Corporate Governance Code was first issued in 2006;
- the Ghana Corporate Governance Code was first issued in 2010;
- the Kenyan Corporate Governance Code was first issued in 2002;
- the Malawian Corporate Governance Code was first issued in 2010;
- the Mauritius Corporate Governance Code was first issued in 2004;
- the Moroccan Corporate Governance Code was first issued in 2008;
- the Nigerian Corporate Governance Code was first issued in 2003;
- the South African Corporate Governance Code was first issued in 1994; and
- the Tunisian Corporate Governance Code was first issued in 2008.

Based on the information noted above, it may be concluded that South Africa can be seen as the leading country in Africa and one of the leading countries in the world relating to the principles of corporate governance. It may also be concluded that the UK is seen as one of the most prominent countries in the world pertaining to the field of corporate governance.

Why would the UK be at the forefront of corporate governance? By the end of the 1980s and the early 1990s there were several corporate collapses in the UK that needed radical corporate governance guidance. The following corporate collapses in the UK were analysed to determine why a governance guidance document was necessary in the UK:

1. The Telegraph (2006) noted that in 1966, Laker Airlines was founded by Sir Freddie Laker with the objective to remain a small company with a maximum of six aeroplanes. Laker airlines offered chartered flights to companies that could book the entire plane for business and/ or holiday packages. Sir Freddie Laker's ambition grew together with his company but unfortunately to his detriment. By the early 1980s the currency of the Pound declined in relation to the Dollar (USD). The primary reason for the downfall of Laker Airlines was the result of inadequate currency fluctuation cover.
2. The Independent (1993) reported on another corporate collapse. A printed paper bag manufacturer. Coloroll, started in the 1970s trading mostly in fabrics and wallpapers.

The success and downfall of the organisation was based on ineffective management style and over eagerness to change existing products like glass, duvets, crockery, carpets, and so forth into the combined group name - Coloroll. Ineffective management style resulted in foolish business acquisitions being made. The combination of the collapsing housing market in the UK by the end of the 1980s and the irrational business acquisitions resulted in £350-million debt and the collapse of Coloroll.

3. According to the Telegraph (2012), Polly Peck International was founded and owned by Asil Nadir. Nadir was an entrepreneur that could have been described as a “*Jack of all Trades*” because he had businesses in various industries. Fluctuations and manipulation of share prices as well as weak internal controls resulted in Polly Peck International’s failure. The following indicators are some examples of lack of adequate governance processes being in place:

- a. Directors did not question the fact that share prices fluctuated and recovered miraculously; and
- b. There was a lack of delegation of authority because only one signature was needed for a payment to be made.

The company went from being one of the stock market’s most favourable organisations in the 1990s to liquidation.

4. According to the Serious Fraud Office (2014), banking fraud of £800 million was the result of the collapse of the Bank of Credit and Commerce International (BCCI) in 1991. The BCCI was funded specifically to deal with the banking requirements of Third World countries in the UK.

Based on the above mentioned corporate collapse a group of accountancy professionals, the London Stock Exchange and the Financial Reporting Council requested that a committee be instituted in the UK to govern a corporate governance system. The lack of accountability of listed organisations as well as a decreasing factor of investor confidence in these companies underlined the need for a corporate governance code. According to the University of Cambridge’s Judge Business School (2014), the Committee of the Financial Aspects of Corporate Governance, also known as the Cadbury Committee, was instituted in 1991. Sir Adrian Cadbury has been the chairman of the Cadbury Committee and is regarded as an exceptional figure in corporate governance. The main objective of

the Cadbury committee was to re-establish stakeholder confidence and promote sound governance practices in UK financial organisations.

The Cadbury committee suggested various factors that should be considered to build sound corporate governance, however, for the purpose of this study the focus will only be on the following:

- The Cadbury Report suggested that the Board of Directors should appoint an independent Audit Committee that consisted of executive and non-executive directors to manage the governance practices of the company (University of Cambridge's Judge Business School, 2014); and
- the Cadbury Report suggested that auditors should report to the audit committee and be able to perform their tasks without any management limitations (University of Cambridge's Judge Business School, 2014).

The principles discussed in the Cadbury Report are very similar to the principles that will be discussed in the King Report (Refer to section 2.3). There is a clear link between these two governance frameworks.

## **2.2.2 THE FOCUS OF CORPORATE GOVERNANCE**

Visser (2009) points out that in the past corporate governance was narrowly focused on ensuring that a company should first and foremost serve the interest of its shareholders. This view has given way to a more inclusive approach that considers (or is supposed to consider) all stakeholders' interests. Historically, spectacular and disastrous corporate collapses have shaped the development of corporate governance. Enron's collapse is seen as one of the most significant historical incidents. The independence of the auditors was compromised, which meant that they could not deliver what they promised (Lorange *et al.*, 2004:12). Similarly, Swissair lost CHF 700 million in 2000 because the board of directors was too far removed from the operational details of the business being performed by management (Lorange *et al.*, 2004:12).

From a South African perspective African Bank, Fidentia and Masterbond could be classified as corporate collapses that will impact the future of how South African business will be governed in the future.

- According to The Business Times (2014), the combination of inadequate risk management techniques and the increase of bad debt as a result of unsecured lending resulted in the collapse of African Bank.
- According to Fin24 (2013) an investigation by the Financial Services Board (FSB) revealed a discrepancy of approximately R400 million pertaining to Fidentia's 2006 accounting records. Fidentia's operations were based on a pyramid scheme and the funds of investors were used for personal gain. It was further revealed that the auditors of Fidentia could not perform an audit in 2004/2005 due to inadequate documentation and undisclosed difficulties.
- Lastly Masterbond was identified by The Citizen (2009) as the largest South African fraud case of the 1990s and involved pension funds of approximately R600 million. Masterbond was fraudulently introduced to investors as a registered bank. The directors further fraudulently informed investors that the Masterbond investments will be protected by the South African reserve bank.

Incidents like these have shaped the new statutory requirements surrounding corporate risk management and have re-defined the concept of adequate control in organisations.

Corporate governance may be seen from various perspectives. One perspective is that it is considered as a list of rules, regulations, and statutory acts and laws that stipulate how the organisation should be managed (Gillan & Starks, 2003). Another perspective is that it is the process by which the providers of capital to an organisation assure themselves that a beneficial rate of return is being achieved on their investment (Shleifer & Vishny, 1997). Within the current business world there is an increasing emphasis on effective management, sound business decisions by the board of directors, and an effective and efficient audit committee.

Sir Adrian Cadbury simplifies corporate governance in the Cadbury Report, describing it as follows: "...the way in which a company is controlled and directed..." (Cadbury Report, 1992).



Corporate governance legislation (like The Sarbanes-Oxley Act No. 107-204 of 2002) and codes (like the King III Report) provide best practices for all organisations. If best practices become the norm in the business world today, future incidents similar to Enron and Swissair and many others could possibly be prevented. Corporate governance is not a new concept for organisations to grapple with, and its implementation and improvement appears to be accelerating.

### **2.3 CORPORATE GOVERNANCE IN SOUTH AFRICA**

An understanding of corporate governance is critical to this study because The King III Report on Governance (released on 1 September 2009 by the Institute of Directors Southern Africa) became a central landmark for any organisation's corporate governance structure. The King III Report also became more relevant and important because of the promulgation of South Africa's Companies Act No. 71 of 2008 that focuses on achieving compatibility with global corporate governance best practices. For an organisation to achieve good and sound corporate governance there are a number of opportunities and / or requirements to explore and implement. One of these is specifically focussed on internal auditing's responsibility to the company. According to the King III Report, internal auditors are advised to provide a written assessment of the effectiveness of the organisation's internal financial controls.

Prescribed and regulated corporate governance was introduced to South Africa in 1994 with the objective of ensuring that all entities (whether statutory or commercial) achieve the highest level of governance. During this time, South Africa was in the process of an unusual culture change that ended an era of isolation, and enabled its re-emergence into international markets. The necessity of a governance code for companies to assist them in dealing with these changes was extremely important. The Institute of Directors Southern Africa (IoDSA) and the Johannesburg Stock Exchange (JSE Ltd.) requested lawyer and former Judge Mervin King S.C. to provide them with guidelines on governance (Baker, 2010:30 and Institute of Directors Southern Africa, 2012).

The IoDSA is a non-profit organisation that represents business leaders, professionals and directors responsible for the governance duties of organisations (IoDSA, 2012). The JSE

Ltd. is Africa's premier securities exchange and is a licensed exchange under the Securities Service Act No 36 of 2004 (JSE, 2013). Mervin King was tasked to establish a commission to research and draft effective rules of corporate governance. This commission produced what is now known as the King Reports of Corporate Governance (Baker, 2010:30). It should be noted that the King Reports cover almost all aspects of corporate governance, and that internal audit is but one of its areas of focus. The focus of this study is to analyse the current implementation regarding the written assessment of the effectiveness of internal financial controls in a combined assurance environment within the financial services industry, and to provide basic steps to assess the quality and effectiveness of the controls.

A research study that was conducted in 2001 pertaining to Corporate Governance in South Africa (Malherbe & Segal, 2001:3-6) indicated that there were many changes in the organisational culture of South African companies since the country became a democracy. There were also various factors that impacted on the need for change in the way organisations operate. According to Malherbe and Segal (2001:4) the principal factor that required drastic change in the corporate governance structure was based on the fact that international companies wanted to enter the South African market once the sanctions were lifted.

According to Baker (2010:30), Malherbe and Segal (2001:3-6), Schulschenk (2012:6) and the IoDSA (2014), in the early 1990s there were two other governance frameworks that assisted and supported the King Commission in writing and publishing the first King Report (King I). The Committee of Sponsoring Organisations (COSO) produced a governance framework on Internal Control, while the Cadbury Report dealt with governance pertaining to the financial aspects of an organisation. The King Reports on governance, by way of contrast, have all taken a wide and unreserved view of the business organisation (Baker, 2010:30 and Schulschenk, 2012:6). The King I Report promoted an integrated approach to business, and incorporated all relevant governance areas including environmental, ethical, financial and social governance (Cliffe Dekker Attorneys, 2002). The impact and value of internal auditing was introduced in the first King Report (Baker, 2010:30).

Baker (2010:30), Schulschenk (2012:9) and the IoDSA (2014) further explained it was necessary in 2002 (eight years after its publication) to update the initial King I Report, due

to changes in South African legislation and based on the fact that the organisations should have a foundation of an ethical corporate citizen. The update was also necessary due to the growth of and changes in the global economy. The value of internal auditing was underlined in the King II Report in that it included a more detailed section on internal auditing, with specific reference to the Institute of Internal Auditors (IIA) definition of internal auditing, its Standards and Code of Ethics. The King II Report also emphasised the responsibilities of the CAE to report to the audit committee of the organisation, and administratively on financial matters to report to the chief executive officer (CEO) of the company. This recognition of the role of internal auditing developed and enhanced their responsibilities within the organisation. The King II Report also suggested that the risk an organisation faces should be the focus point of the internal audit activity (Baker, 2010:30).

According to Baker (2010:30) and the IoDSA (2014), King II suggested that the internal audit activity should address or incorporate the following:

- The annual internal audit plan should continuously assess the on-going risk an organisation is facing;
- the internal audit activity should assess and provide assurance that the operational processes of an organisation effectively identify significant risks and that management is continuously monitoring the organisation's exposure to those identified significant risks; and
- internal auditing has the responsibility to assess the effectiveness of the organisation's internal control system, as well as to report on the quality of management information pertaining to the organisation.

The King II Report highlighted the responsibility of internal auditing within the governance framework of the organisation. This report suggested that internal auditing, which is seen as one of the independent assurance providers of the organisation, should liaise with other assurance providers, including external auditing, and should also ensure that there is limited duplication of coverage in terms the testing of compliance controls, financial controls and operational controls (Baker, 2010:30, Schulschenk, 2012:10 and the IoDSA, 2014).

Various authors (Baker, 2010:31, Schulschenk, 2012:10 and the IoDSA, 2014), argue that from the middle of 2007, the economy worldwide faced an enormous global crisis when

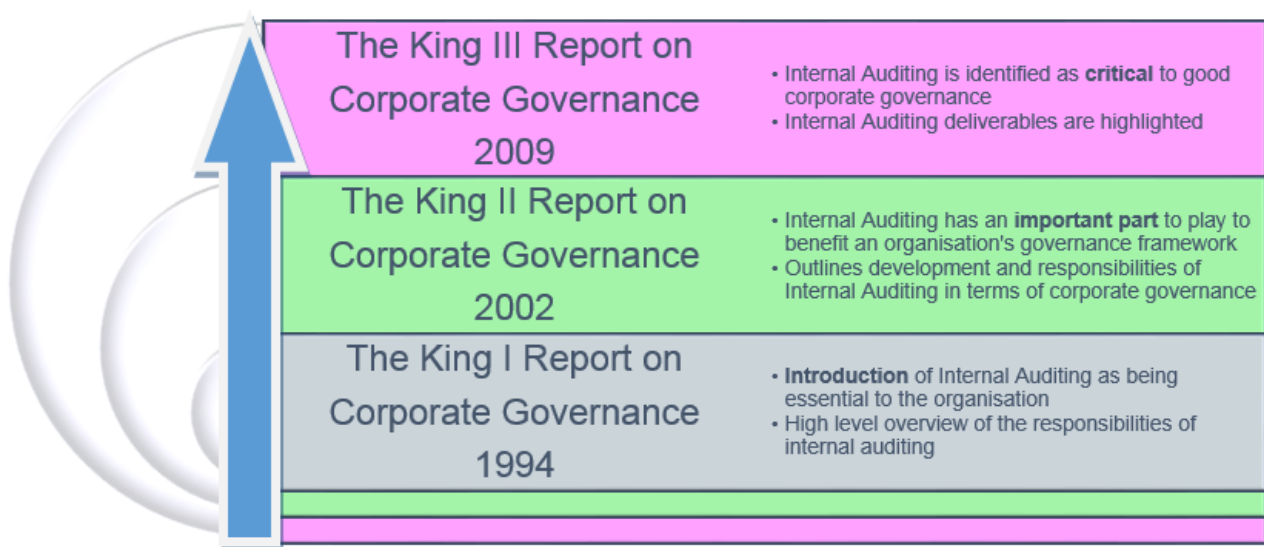
financial institutions collapsed and stock markets fell to multi-decade lows. In these turbulent times, the King Commission published its third Report on Corporate Governance. Of all reports, The King III Report had the most significant impact on internal auditing. The King III Report again changed business' perception of internal auditing from being "merely" an *important* part of good corporate governance to being *critical* to good corporate governance. The King III Report addressed four major aspects of governance that increasingly influences the internal audit activity. These are:

- **Internal audit plans** should be risk based (Baker, 2010:31 and the IoDSA, 2014). Annual audit plans should be focused on the significant risks an organisation is facing, and internal audits should be performed in order to test the controls that have been put in place to address the significant risks facing the organisation.
- It is the responsibility of the audit committee to ensure that the organisation has an adequate **combined assurance model** (Baker, 2010:31 and the IoDSA, 2014). The objective of the combined assurance model is to ensure that each of the assurance providers is providing adequate coverage to effectively mitigate the organisation's risks. With reference to the vehicle analogy presented in Chapter One, the audit committee provides the navigation input to the governance vehicle, and is effectively the map and/ or the global positioning system (GPS) guiding the vehicle's driver. Inaccurate maps and poor skills at using GPS data will invariably result in "interesting" journeys, full of unintended sightseeing detours.
- One of the responsibilities of internal audit is to provide **written assessments** of the effectiveness of the organisation's internal financial controls, (Baker, 2010:31 and the IoDSA, 2014). This study will analyse the relevance and value of the written assessment of the effectiveness of internal financial controls in a combined assurance environment within the financial services industry from the CAE's perspective. It is important to note that the King III Report indicates that internal audit should provide an *assessment* of the effectiveness internal financial controls.
- The latter aspect specifically pertains to the **CAE**. The CAE should have access to all minutes, and be invited to attend the meetings of the company's executive committee, risk committees and audit committees (Baker, 2010:31-32 and the IoDSA, 2014).

The King I Report introduced internal auditing as being fundamental to the organisation and provided a high-level overview of the responsibilities of the internal audit activity. The

King II Report changed the perspective of internal auditing, emphasising the importance of the role that it should play, and the ways in which it would benefit the organisation. Finally, the King III Report emphasised the internal audit activity (including its diverse functions) by providing more concrete deliverables. Figure 2 summarises the three King Reports on corporate governance in the developing corporate governance universe.

**Figure 2: A diagrammatic representation of the King Reports on corporate governance progression**



Source: Adapted from Baker 2010

## 2.4 IMPORTANCE OF CORPORATE GOVERNANCE

Before the importance of corporate governance can be analysed, an understanding of the past appears to be necessary. Brown (2003:7) points out that entrepreneurialism has been practiced since the Middle Ages, particularly by the Royalty of the era and by the Catholic Church. There were a few private individuals that owned businesses and traded products commercially; however, people's capital was limited to what the family was able to generate, and it was exposed to the predatory whims of the Catholic Church and the Royalty. During this time, the Catholic Church was seen as an entity that was separate from its members. This is a key attribute in the development of modern commerce, in that the Church, as a separate entity, had the ability to out-vote any individual member. The

concept of the Catholic Church being a separate entity was the predecessor of the legal persona that defines the concept of the company as it is known today (Cadler, 2008:6-7).

The Oxford English Dictionary (2002: 145; 275; 434) defines the following concepts:

- An **organisation** is defined as *a group of people who are clustered together with a particular objective and/ or purpose, like for example business.*
- **Corporate** is defined as *a group of people.*
- **Governance** is defined as *a manner and/ or action used to administer and direct an organisation and/ or state.*

Based on these definitions, corporate governance relates to the methods and actions used by the stakeholders of the company to manage the organisation. Before an organisation can be managed, as Cadler (2008:8-9) noted, it must be characterised as a legal entity that is independent of its members. The organisation has the ability to transfer ownership by transferring shares, without influencing the existence of the company. The organisation can function independently from its members, and the organisation's existence is not dependent on the continuing life of the entity's shareholder/s, and has limited legal responsibility, like a baby – a legalistically managed foghorn voice at one end and no sense of responsibility at the other.

Cadler (2008:10) further points out that Robert Tricker identified that those responsible for corporate governance in 1984 were apprehensive about the techniques being advocated as to how corporate entities should be governed. That aside, the one concept of corporate governance that is a golden thread running through all the definitions listed, is that corporate governance is a process and/ or a method defining how organisations should be administered and how the oversight of an organisation's activities should be performed.

It is difficult to provide a universally applicable implementation method of corporate governance because it is, to a greater or lesser extent, personalised and adapted to each organisation's specific needs. The governance structures of any organisation will depend on the anatomy of the organisation. The key aspect of corporate governance is that it should be easy to understand and to implement in the day-to-day operation of the business.

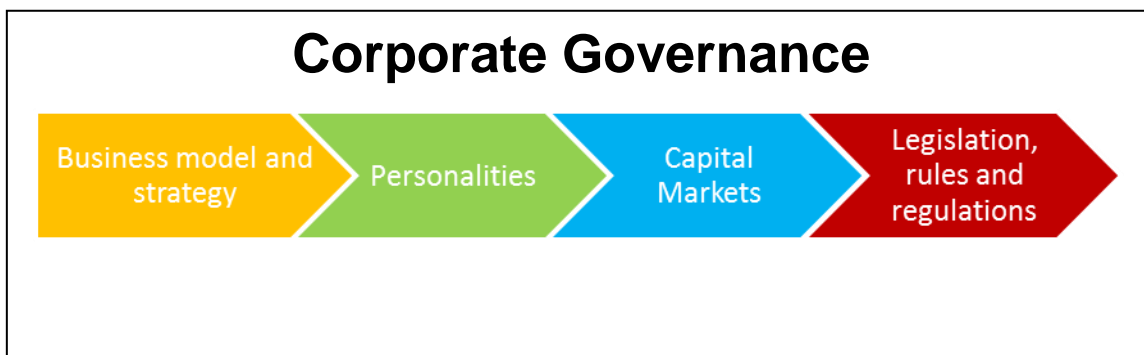
Godfrey (2002:25-29) indicated that the private sector in South Africa is leading the corporate governance vehicle in terms of development, and since the publication of King III in South Africa in 2009 there has been a further acceleration in the development of corporate governance thinking.

There are numerous factors (both internal and external to the organisation) that have an impact on corporate governance (Lorange *et al.*, 2004:41-43). The most influential elements are the following:

- The business model and the strategy of the organisation;
- personalities of key personnel;
- the state of the capital markets; and
- legislation and its associated rules and regulations.

Figure 3 is a graphic representation of the most influential elements that have an impact on corporate governance.

**Figure 3: The four elements of corporate governance**



Source: Lorange *et al.* 2004:41-43.

Lorange *et al.*, (2004:41-43) argues that the business model and associated strategy elements are important and variable. They should be continually reviewed and adjusted. Corporate governance needs to adjust in parallel with these changes to the company's strategy. Corporate governance adjustments are important in order to ensure that the significant (and changing) risks that an organisation might be facing are consistently and adequately mitigated. These risks should be consciously addressed and their impact and

mitigating factors should be thoroughly understood. This assessment is likely to have an impact on the development of the organisation's strategy (Lorange *et al.*, 2004:41-43). Returning to the corporate governance vehicle analogy, the business model and strategy relate to the growth of the organisation. The strategy of an organisation should be continuously and appropriately adjusted to accommodate the effects of business that the organisation operates in. The requirements of JSE listed organisations are different to the requirements of unlisted organisations. Based on these variables, the business model and strategy of an organisation is not one size fit all (Hermalin, 2005:2351-2384).

Lorange *et al.*, (2004:41-43) further indicated that personalities represent the human aspect that is involved in corporate governance, and addresses the issues of attracting appropriately skilled and qualified people, and assigning them to the most appropriate positions for their skills. This is essential to effective decision making, intelligent leadership and good governance. With reference to the corporate governance vehicle analogy, personalities are compared to the passengers in the vehicle. Passengers in this context refers to the human resources, and the efforts to attract and retain appropriately skilled and qualified people. Unruly passengers can dangerously distract the driver and navigator (Hermalin, 2005:2351-2384).

Capital market expectations have changed and reporting is becoming increasingly transparent. Undesirable results become more difficult to conceal due to IA's enhanced skills, qualifications and expertise (Lorange *et al.*, 2004:41-43). The capital markets can be compared to the financing of a vehicle. Financing of a vehicle is significantly influenced by the interest rates, and the periodic rate changes require prompt but considered responses. Capital markets are dynamic environments and need to be monitored (Hermalin, 2005:2351-2384).

The impact of rules, regulations and laws will differ depending on the countries where the organisation is doing business (Lorange *et al.*, 2004:41-43). Rules, regulations and laws are the rules that inform the board of directors on how to manage the organisation. Experience and skill affect safety (Hermalin, 2005:2351-2384).



## 2.5 CORPORATE GOVERNANCE: THE IMPACT OF LEGISLATION

The Sarbanes-Oxley Act No. 107-204 of 2002 (and other legislation of similar intent around the world) was introduced to protect small investors from the negative impact of large stakeholder interference (Becht, Bolton & Roëll, 2002). The legislation was promulgated to ensure better corporate accountability structures (Dodd-Frank, 2010). The Sarbanes-Oxley Act No. 107-204 of 2002 and Dodd-Frank Act No. 111-203 of 2010 are applicable to businesses in the United States of America (USA), and it is mandatory for organisations to abide by the provisions. While South Africa does participate in the global economy, this study will focus only on the King III Report on Corporate Governance's requirements for internal auditors working in South African entities.

Within the private sector in South Africa the most important guidance document on corporate governance is the King III Report. King III presents requirements for JSE-listed companies and explains how and why these principles should be applied. However, unlike the Sarbanes-Oxley Act No 107-204 of 2002, King III is not an Act of Parliament. Principal 3.5 of the King III merely presents combined assurance as an *acceptable* governance structure – it is not mandatory (Institute of Directors Southern Africa, 2009).

## 2.6 CORPORATE GOVERNANCE: RELEVANCE TO INTERNAL AUDITING

Internal auditing by definition is required to add value to the organisation. With the combination of an internal auditor's theoretical knowledge of the standards contained in the Institute of Internal Audit's (IIA) guidance publications, the Code of Ethics, knowledge of the business and an understanding of corporate governance, internal auditing can add more value to the business by fulfilling their designated roles. Internal auditing can assist the organisation and management by recommending good governance practices that will benefit in general terms, the organisation, its stakeholders and the greater economy.

CAEs have the responsibility to consistently improve their competence and should understand the needs of the audit committee and the board of directors (Marks, 2012:75-77). According to Cathcart and Kapoor (2010:47) internal auditing should expand its scope of work to adequately address governance. The CAE should ensure that risk based audit

plans are in place to address all significant risks faced by the organisation. The focus of this study is based on the responsibility of internal auditing to provide a written assessment of the effectiveness of the internal financial controls of the organisation; however the effectiveness of risk management should not be underestimated. Risk and risk management form part of the integral thinking and combined assurance process. The approved internal audit plan should be linked to the organisations risk register to ensure that all the significant risk of the organisations is adequately addressed (IoDSA, 2014).

## **2.7 SUMMARY AND CONCLUSION**

The objective of this chapter was to determine the relevance and value of internal auditing within corporate governance and to understand the concept of corporate governance from a historical perspective.

According to the European Corporate Governance Institute there are 102 corporate governance codes issued worldwide. South Africa was the second country in the world and the first country in Africa that issued a corporate governance code (the King I Report) in 1994. A remarkable finding was that the majority of the corporate governance codes were only issued in the 21<sup>st</sup> century according to the European Corporate Governance Institute. South Africa may be seen as one of the leading countries in the world as well as the leading country in Africa pertaining to the policies, procedures and guidance how organisations should promote sound corporate governance. The King III Report became a central landmark for any organisation's corporate governance structure. It was also noted that the internal auditor's responsibility to provide a written assessment on the effectiveness of internal financial controls is an essential component to the achievement of sound corporate governance. Further, it was noted that historically, spectacular and disastrous corporate collapses have shaped the development of corporate governance. Many organisations learned from mistakes that were made by large corporate entities. Lastly, corporate governance provides best practice for businesses. If best practice becomes the norm, the quality of examples which big corporate companies set, can change the business world for good.

Corporate governance is not a new concept and dated as far back as the Middle Ages. The Catholic Church and the Royalty of the era practiced the first form of corporate governance. Corporate governance could be seen as a process and / or a way of doing business.

South Africa has undergone massive culture and political changes since 1994, which have had a significant impact on the way that business is done. During this time, the need for guidelines to nurture corporate governance's implementation in South Africa was extremely high. A commission to research and draft corporate governance guidelines was established. The commission produced the so-called King Reports on Corporate Governance. Since the publication of the first King Report in 1994, there have been two updates. The so-called King II Report in 2002 identified the value and responsibility of internal audit pertaining to corporate governance. Then in 2007, the world faced a global economic crisis where financial institutions collapsed and stock markets fell to multi-decade lows. Against this background the King III Report on corporate governance was published in 2009, and had a most significant impact on internal audit. This report changed the perception of internal audit from being merely an *important* part of good corporate governance to being *critical* to good corporate governance.

The numerous factors that have an impact on corporate governance, was analysed in this chapter. Most influential are the personalities of key personnel, the business model and strategy of the organisation, the state of the capital markets, legislation and its associated rules and regulations.

Lastly the impact of legislation and its relevance to internal audit on the corporate governance were examined. It was noted that corporate governance in South Africa is not governed by legislation. The King III Report merely presents combined assurance as an *acceptable* governance structure – it is not mandatory and internal audit should add value to the organisation as described in the IIA's definition of internal audit. The King III Report should therefore be used as guidance for the implementation of corporate governance within any organisation. Internal audit should assist the organisation in testing the effectiveness of the governance structure of the organisation, ensuring that risk based audit plans are in place to address all significant risks faced by the organisation, and

providing a written assessment of the effectiveness of the internal financial controls of the organisation. The CAE of the organisation should attend, and be allowed to attend, the governance-related executive meetings, and be sufficiently independent and objective to address the issues identified at an appropriate operational and administrative level to achieve effective governance.

In the understanding of corporate governance it is again worth noting that it should be more than compliance with rules, regulations and legislation. Corporate governance should add value to corporate strategy; it should also be monitored and controlled by this strategy. Excellence in corporate governance should be the organisation's objective (separate from business excellence). This is achievable by consistently aligning the organisation's strategy with its developing and changing objectives, and by actively following the business rules and regulations of the country.

Corporate governance should be defined specifically for each organisation and should be a priority of the board of directors together with its audit committee. With reference to the vehicle analogy, the organisation's governance vehicle used should be appropriate for the race in which the company is competing.

Based on this understanding of corporate governance, it is important to note that internal audit, as well as the other role players, have a significant role to play within combined assurance provided to the organisation. The following key concepts were noted pertaining to corporate governance:

- Corporate governance is flexible and approaches differ from company to company;
- the King III Report on Corporate Governance has become a central landmark for all organisations' corporate governance structures;
- the King III Report has played an enormous part in reforming internal audit's roles and responsibilities;
- corporate governance is not legislatively backed; however, it promotes best practices and provides guidelines on risk mitigation amongst other vital issues; and
- internal audit can assist the organisations and add value by recommending good governance practices that will benefit the organisation in general terms, its

stakeholders, and the greater economy. Internal audit should further ensure that their scope of work adequately address the governance aspects of the organisation.

Based on the key concepts addressed in this chapter, it may be concluded that the role of internal auditing is relevant within corporate governance. In the next chapter, combined assurance will be defined and explained.

## COMBINED ASSURANCE

## CHAPTER 3: COMBINED ASSURANCE

### Abbreviations used in this chapter

Abbreviation	Meaning
CAE	Chief Audit Executive
IIA	Institute of Internal Auditors
MFMA	Municipal Financial Management Act No. 56 of 2003
PFMA	Public Finance Management Act No 1 of 1999

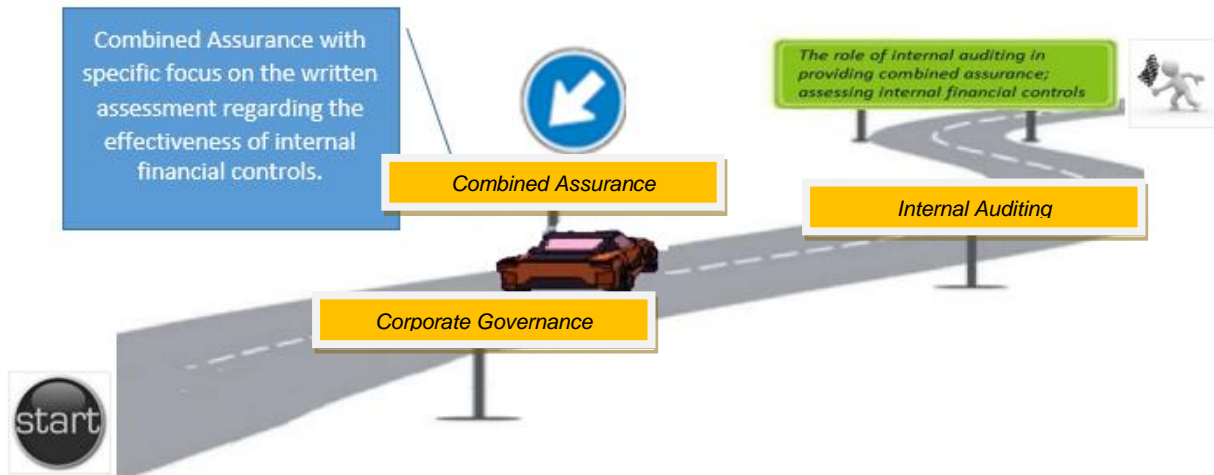
### 3.1 INTRODUCTION AND BACKGROUND

In the previous chapter, the importance and relevance of internal audit within corporate governance was identified and discussed.

The objective of this study is to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment within the financial services industry from the chief audit executive's (CAE) perspective. As noted in the previous chapter, according to the King III Report, internal audit is responsible to provide a written assessment of the effectiveness of the company's risk management and internal control environment. Therefore, internal audit is already relying on the other assurance providers within the organisation to assist them to fulfil the role required of them.

Figure 4 was introduced in the previous chapter as a representation of the map this study is following along the road towards understanding corporate governance, combined assurance and internal audit. The focus of this chapter will be combined assurance.

**Figure 4: The map of this study's progress along the road towards understanding corporate governance, combined assurance and internal auditing, with specific focus on combined assurance**



The objective of this chapter is to analyse combined assurance. In this chapter the following aspects will be discussed:

- The background of combined assurance;
- addressing the question as to why combined assurance should be implemented by any organisation;
- the different combined assurance models;
- the importance of combined assurance; and
- the relevance of combined assurance to the role played by internal audit will be analysed.

According to Nomvalo, Le Roux and Theron (2010:27-28) the definition of combined assurance, based on the King III Report, is summarised as the process of incorporating and aligning assurance processes with due consideration for the organisation's risk appetite, and to optimise overall assurance pertaining to risk. This is a task performed by the audit committee. Nomvalo *et al.*, (2010:27-28) noted that incorrect financial reporting is not the primary reason why companies go bankrupt. Bankruptcy is more likely to be caused by inadequate control and risk management, as well as being a consequence of poor governance (Nomvalo *et al.*, 2010:28).



As is the case with corporate governance, combined assurance is not a new concept. Combined assurance has always existed; however, its formal implementation was never a specific requirement. It is safe to say that it was a concept without a name. Within the King III Report the significance of combined assurance was enhanced and outlines of the responsibilities of the various assurance providers were highlighted.

As defined by Freeman Nomvalo, a previous Accountant-General of South Africa, combined assurance is the process that merges and organises the hard work of assurance providers to provide a more detailed, effective, independent and complete assessment of risk, control and governance in an organisation (Nomvalo *et al.*, 2010:28). Participation in combined assurance efforts has the potential to motivate internal audit to become the efficient, effective and successful function that would be an asset for any organisation.

Figure 4 is a representation of the road map of this study. In order to understand what the written assessment of the effectiveness of internal financial controls entails, an understanding of combined assurance is crucial. Combined assurance can be seen as the end result of the assurance process that is given to the board of directors and the audit committee.

Each of the assurance providers has to provide their insight as to how the processes within the organisation are functioning. Processes within an organisation fit together like the pieces of a puzzle. Separately, the individual pieces do not create the picture of the puzzle as indicated on the puzzle box. Once all the pieces are put together, the picture is clearly visible. The individual pieces of the puzzle can be compared to the assurance given by each assurance provider, with combined assurance being the “big picture” of the puzzle. Each assurance provider has a different viewpoint and if they are combined, the organisation’s combined assurance picture/situation becomes clearly visible.

Within every organisation, activity can be divided into the following activity groups, based on their risk exposures. It should be noted that these are the most commonly encountered activities and the ones emphasised in this research study. These are:

- Financial and related activities: Financial and related activities can be defined as all financial activities that have a risk exposure on the organisation’s financial statements.

The impact and/ or likelihood of the risk exposure materialising should be clearly defined and documented. Each organisation should identify their key risks associated with their financial activities, and each assurance provider should assess their assurance given on each specific risk. This should be similar for each of the activities listed in the combined assurance framework of the organisation (Discovery Integrated Report: 2011:110-111).

- Strategy-related activities: Strategy-related activities can be defined as all activities that have a risk exposure in the organisation's corporate governance functions and strategy development. Sustainability, transformation, governance and stakeholder relations are a few examples of strategy-related activities (Discovery Integrated Report: 2011:110-111).
- Environmental and cultural activities: Based on all the controversy surrounding and growing concerns about global warming, environmental activities have been pushed to the forefront in the business world today. Organisations have a corporate responsibility to protect the environment. Cultural activities also have an impact on the way organisations conduct business: for example, production may be impacted by community protest action. (Discovery Integrated Report: 2011:110-111).
- Economic efficiency and governance activities: Activities associated with economic efficiency and governance processes could possibly result in innovative enhancements to current processes due to improved production (Discovery Integrated Report: 2011:110-111).
- Operational and related activities: Operational activities are defined as the day-to-day operation of each organisation that could present a risk exposure for the organisation. Another important operational activity that should be considered is people management. Every organisation deals with people. The importance of recruiting adequately skilled people, the retention of current employees, and the training and development needs of staff should not be underestimated (Discovery Integrated Report: 2011:110-111).
- Assessment of the internal control environment and risk management activities: According to the King III Report, this is a requirement that internal audit should deliver a written assessment of the effectiveness of internal financial controls.

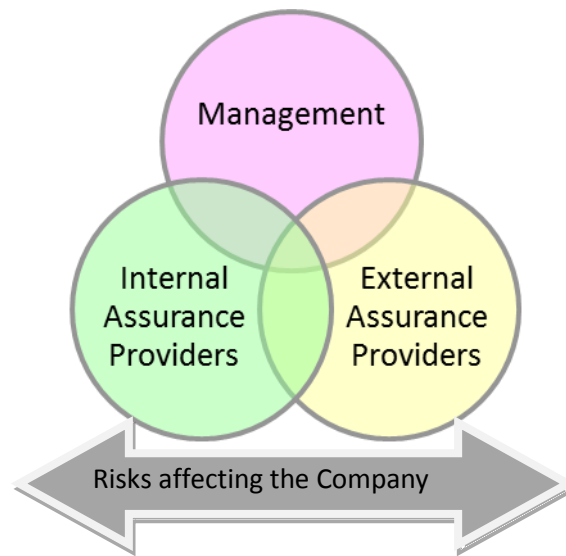
The above-mentioned activities should be further defined and categorised based on their risk exposures. All significant risks relating to each activity should be listed and evaluated by each of the assurance providers. Assurance regarding the activities' effective implementation of risk mitigation factors should be given on each of the above-mentioned activities by all the assurance providers. This will assist in providing a holistic view of the processes within the organisation: the sum of the assurances given by each of the assurance providers (based on the assessments they performed) should identify any gaps in the individual assurance processes. The assurance given by each of the assurance providers should be collated and given as a single document to the board of directors and audit committee, and comprise statements of the views of the various assurance providers.

### **3.2 WHY SHOULD COMBINED ASSURANCE BE IMPLEMENTED**

In society in general, hand-written notebooks are being replaced with iPads; anything can be bought on the Internet, and business can be done everywhere due to the power and portability of modern communication devices. Business today operates in an ever-changing environment, with new risks arising constantly.

Combined assurance should be based on effective and adequate risk management. The assurance providers should give feedback to the board of directors and the audit committee, describing how the significant risks faced by the organisation are being (or are to be) addressed (PwC, 2011:4). It has become vitally important that assurance providers and the risk management team work together in providing a believable and effective combined assurance (Timm, 2010:22). According to Nomvalo *et al.* (2010:28), the outcome of effective combined assurance will be beneficial to the organisation. Effective combined assurance will result in the reduction of duplication of efforts, the consistent improvement of the organisation, and should ultimately result in operational excellence (Nomvalo *et al.*, 2010:28). With reference to the motor vehicle analogy presented at the beginning of this study, all the assurance providers should work together to achieve combined assurance – each bolt having its own washer and nut, and the wheels all balanced and correctly aligned. Figure 5 below is a diagrammatic representation of the combined assurance interrelationships.

**Figure 5: Combined assurance model**



Source: Nkonki, 2011; PwC, 2011:4; IoDSA, 2009.

All the assurance providers should work together to present an effective combined assurance outcome. Combined assurance can be defined as the process in which assurance providers give diverse perspectives on key risks they have all identified. According to Sarens *et al.*, (2012:21) merely focusing on controls and providing assurance in terms of the effectiveness of risk management, governance and internal control processes is no longer adequate: assurance providers need to be responsible for the assurance that they supply. They should, furthermore, bear the consequences should that assurance prove to be inadequate. In other words, assurance providers must remain accountable.

According to Sarens *et al.*, in the past, assurance providers produced reports and assessments attempting to summarise large volumes of information. Due to the amount of detailed information still present in the reports, the objective of these assurance reports was often not achieved. Either organisations over complicate the assurance reports or assurance providers operate in silos where their isolation results in duplication of work that has already been done by others in the combined assurance field. Effectively implemented, combined assurance is a method to re-establish reliance on the assurance providers (Sarens *et al.*, 2012:22-24). Combined assurance's objective is therefore to use the different skills of the individual assurance providers to mitigate the organisation's risk

exposure. It should break down the silo mentality of the individual assurance providers and reinforce teamwork, efficiency and joint accountability.

Effective combined assurance can be beneficial to the organisation. Combined assurance provides the board of directors and the audit committee with a assessment and/ or report. The assessment and / or report should list the key risks faced by the organisation, together with the assurance processes that are being provided, in a single report. Combined assurance therefore ensures more transparency for management and the assurance providers, as it views the organisation (Sarens *et al.*, 2012:22-24).

The implementation of a combined assurance approach produces an effective and efficient coordination of efforts between assurance providers. The process also assists the organisation to better understand the operational challenges they face, as well as identifying the possible risks they are exposed to. Assurance providers, collectively and collaboratively, can more effectively identify possible missed opportunities, and can provide more insightful recommendations to address these opportunities (Sarens *et al.*, 2012:22-24). Furthermore, it should be noted that:

- According to the King III Report combined assurance should be implemented by the organisation as it is beneficial and will enhance the results of the organisation, if implemented adequately and effectively. Sarens *et al.* (2012:43-49) provide reasons as to why combined assurance should be implemented: combined assurance provides a broad perception and understanding of all significant risks that might impact on the organisation, as it is viewed by the assurance providers;
- the organisation's governance processes can be improved with effective implementation of combined assurance. This will provide the audit committee, board of directors and stakeholders with the confirmation that the management team is performing its duties with integrity and in the best interests of the company;
- combined assurance can be seen as a method to accumulate data and facts pertaining to a specific process from various areas and perspectives. This information is then used to identify possible gaps in the organisation's processes and/ or its delegation of organisational responsibilities;
- combined assurance can be obtained from various sources inside the organisation and from outside the organisation. This aggregation of views will assist the audit committee

and board of directors with information that will enable them to determine whether the objectives of the organisation are being met;

- combined assurance should reduce the duplication of efforts in the process of providing a combined risk evaluation of the organisation;
- combined assurance is a combined effort; and
- traditionally the focus of the organisation's assurance providers was restricted to the financial risk that the organisation might have been facing. Combined assurance focuses on all the significant risk factors encountered by and within the organisation.

In conclusion, if combined assurance is implemented in the organisation effectively and efficiently, it should be beneficial to the organisation. On the other hand, if the combined assurance concept is not understood, it is impossible to implement it.

### 3.3 COMBINED ASSURANCE MODELS

Combined assurance models should be tailor made to each organisation's needs: there is no one-size-fits-all solution. Implementing a combined assurance model will define mechanisms that assist the organisation in understanding the reporting lines of the assurance providers. In addition, combined assurance models (will be discussed in detail later) can provide a structured approach to provide combined assurance within an organisation.

According to the King III Report on Corporate Governance, the responsibilities of internal auditing pertaining to combined assurance and the integrated report is stipulated as follows:

- Principle 7.3.1 p 45: "...*Internal audit should form an integral part of the combined assurance model as internal assurance provider...*" (IoDSA, 2009).
- Principle 9.1.3 p 49: "...*The integrated report should be prepared every year...*" (IoDSA, 2009).
- Principle 9.1.4 p 49: "...*The integrated report should convey adequate information regarding the company's financial and sustainable performance...*" (IoDSA, 2009).
- Principle 9.1.5 p 49: "...*The integrated report should focus on substance over form...*" (IoDSA, 2009).

Based on the above mentioned, it is clear that internal auditing can be beneficial to the organisation as control environment. An effective internal auditing activity could result in effective internal controls within the organisation. The integrated report should consist of aspects that pertains to environmental, sustainable and financial reporting. The combined assurance model that is utilised by the organisation should be adequately described in the integrated report of the organisation.

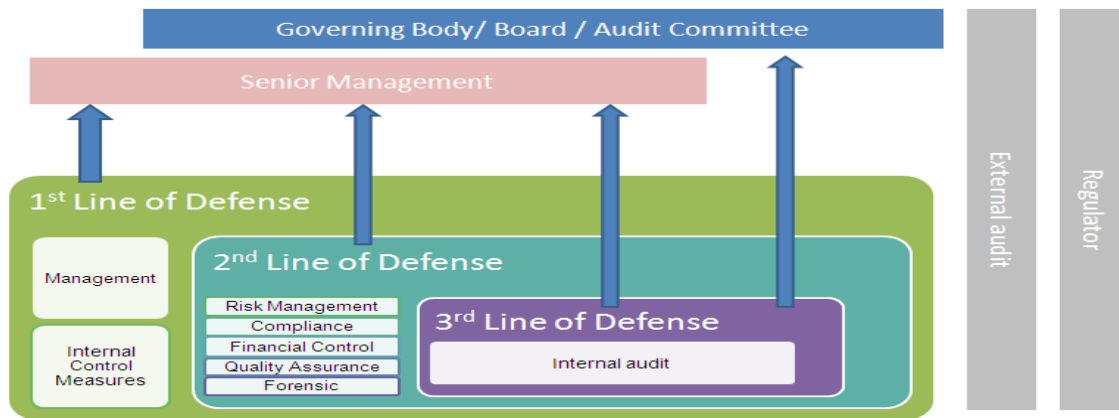
The objective of a combined assurance model is to optimise the assurance that is given by the assurance providers in their assessments of the risk exposures that the organisation is facing (KPMG: 2010). The audit committee is ultimately responsible for monitoring and examining the combined assurance model that the organisation uses, specifically to assess the model's appropriateness and to ensure that the significant risks are adequately and effectively addressed (KPMG: 2010). Assurance providers (internal assurance providers, external assurance providers and management) should provide information that adequately confirms that the significant risks faced by the organisation are being addressed. As a result, the audit committee should be comfortable with the assurance provided by the assurance providers (KPMG: 2010).

There are currently two combined assurance models that enjoy relatively widespread implementation, namely the combined assurance defence model and the assurance model. These will be analysed to gain a better understanding of combined assurance.

### **3.3.1 COMBINED ASSURANCE: DEFENCE MODEL**

There are a number of different combined assurance models currently in use. In some instances, combined assurance is seen as being one of the organisation's 'lines of defence' (Nkonki, 2011; PwC, 2011:4). According to PwC (2011:4) and Nkonki (2011), the defence model is seen as being provided by clear and direct reporting lines that facilitate sound internal financial controls. Management is the first line of defence. Within an organisation the risk, compliance, forensic and legal departments, for example, provide the second line of defence and the internal auditors the third. External audit and government regulators provide the last line of defence. Figure 6 is a diagrammatic representation of the defence model. .

**Figure 6: Combined assurance: defence model**



Source: Nkonki, 2011; PwC, 2011:4; Adapted from ECIIA/FERMA *Guidance on the 8<sup>th</sup> EU Company Law Directive, article 41*

With reference to the vehicle analogy, senior management and the board of directors are collectively responsible for driving the governance vehicle. They are primarily responsible for keeping the vehicle on the road and ensuring that the vehicle runs smoothly. According to the IIA's Position Paper (2013:1-7), regarding the three lines of defence in effective risk management and controls, the allocation of responsibilities between the relevant assurance providers should be clearly established. The defence model of combined assurance can also be seen as a top-down approach. To ensure the most favourable results for the organisation implementing this model, the board of directors, governing bodies of the organisation, and executive management should vigorously support the implementation (IIA Position Paper, 2013:1-7).

Management and/ or operational management are an organisation's first line of defence. They are primarily responsible for the day-to-day activities of the organisation and should implement corrective measures to mitigate risks on a daily basis. Management is further required to monitor daily operations and to identify possible control breakdowns, unforeseen exposures to risk on the part of the organisation, and inadequate and/or inefficient and ineffective operational processes (IIA Position Paper, 2013:1-7).

The second line of defence comprises risk management, legal departments, compliance departments and forensic departments. The exact composition of the second line of defence will be specific to each organisation because not all the above-mentioned departments may be present in the organisation. The second line of defence is more



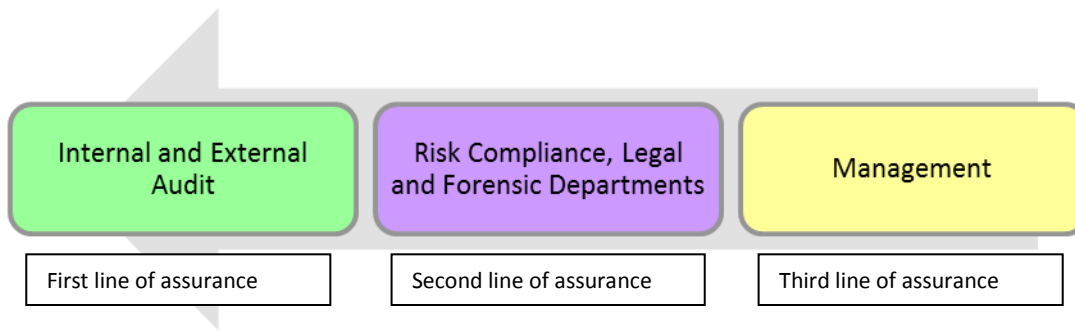
remote from day-to-day management, and is only indirectly responsible for combined assurance. The second line of defence departments' contribution to combined assurance is more of a support role to management; however, they can also assist operational management with the defining of policies, procedures, roles and responsibilities. In addition, the second line of defence departments can provide risk-mitigating frameworks to operational management, assist management with the identification of risk, and provide training and guidance to management. The second line of defence can also assist management with the monitoring of the day-to-day business of the organisation (IIA Position Paper, 2013:1-7).

According to the IIA's Position Paper (2013: 1-7), there are three lines of defence in effective risk management and controls, the organisation's final line of defence being internal audit. Internal audit should operate objectively, be independent from management, and therefore be able to combine the assurance given by the first and second lines of defence into an overall assurance opinion for the organisation. According to the model analysed in Figure 6, regulators and external auditors are not part of the governance structure of the organisation; however, they are important parties and it is important to consider their input in order to achieve generally accepted and sound governance.

### **3.3.2 COMBINED ASSURANCE: ASSURANCE MODEL**

Ernst and Young (2011) refer to combined assurance as lines of assurance. This model places a different emphasis on the reporting lines when compared to the previous one. External and internal audit form the first line of assurance, followed by risk and legal departments, and finally management. While the models being used by various companies may differ, the objective is essentially similar. Combined assurance should integrate all the responsible assurance providers' opinions when an assessment in terms of the company's internal financial controls policy is given to the audit committee. Figure 7 presents the assurance model diagrammatically.

**Figure 7: Combined assurance: assurance model**



Source: Ernst and Young, 2011

Combined assurance models should be made specific to the organisation, addressing the significant risks and loss situations that the organisation might be facing. Combined assurance models should merge and co-ordinate the individual efforts of each assurance provider to the benefit of the organisation. Each organisation should implement a combined assurance model that will add value to that organisation and ultimately address the concerns of the board of directors and the audit committee.

### 3.4 IMPORTANCE OF COMBINED ASSURANCE

Timm (2010) points out that combined assurance can be explained as the relationship between the board of directors of an organisation and its assurance providers. The communication lines between management and assurance providers should be open and active. This study focuses only on internal audit's perspective of the combined assurance interaction.

According to the King III Report on Corporate Governance the responsibility of internal audit is stipulated as follows:

- Principle 7.3 p 45: "...Internal audit should provide a written assessment of the effectiveness of the company's system of internal controls and risk management..." (Institute of Directors Southern Africa, 2009);
- Principle 7.3.5 p 45: "...Internal audit should provide a written assessment of the system of internal controls and risk management, to the board..." (Institute of Directors Southern Africa, 2009); and

- Principle 7.3.6 p 45: “...*Internal audit should provide a written assessment of internal financial controls to the audit committee...*” (Institute of Directors Southern Africa, 2009).

For the purposes of this study the focus is on **Principle 7.3.6**.

Audit committees for state-owned enterprises and public companies have become mandatory, arising from the promulgation of the Companies Act No. 71 of 2008, Municipal Finance Management Act No. 56 of 2003 (MFMA) and the Public Finance Management Act No. 1 of 1999 (PFMA). The King III Report further indicates that it would be beneficial for all companies to appoint an audit committee. Audit committees have the responsibility to ensure that an adequate combined assurance model is used, which satisfies the needs of the organisation (Deloitte, 2010:1-3). Even though combined assurance is a new concept, its importance should not be underestimated. Combined assurance, if effectively provided, will assist the organisation to achieve a sound internal financial control environment.

In conclusion, combined assurance models may differ from one organisation to another, and from one legislative environment to another. Nevertheless, the overridingly important aspect is that adequate assurance is provided by relevant and appropriately qualified assurance providers. These assurances should contain an appropriate level of detail and relevance in order for the audit committee of the organisation to understand the situation and formulate appropriate responses.

### **3.5 COMBINED ASSURANCE AND THE INSTITUTE OF INTERNAL AUDITORS’ “STANDARDS”**

According to the International Standards for the Professional Practice of Internal Auditing published by the Institute of Internal Auditors (IIA) the following was noted:

**IIA Standard 2600:** “...*When the chief audit executive (CAE) believes that management has accepted a level of residual risk that may be unacceptable to the organisation, the CAE must discuss the matter with senior management. If the*

*decision regarding the residual risk is not resolved, the CAE must report the matter to the board for resolution...*” (Institute of Internal Auditors: 2012).

Combined assurance is a new concept; however, the requirements and responsibilities pertaining to internal audit and to the CAE are not new. Based on the requirements laid out in the IIA’s Standards, the CAE has the responsibility to report on the effectiveness and quality of the assurance provided. Combined assurance, as noted in the King III Report, has only formalised this responsibility by requiring that a written assessment be presented, in which the effectiveness of the organisation’s internal controls, systems of risk management, and the effectiveness of internal financial controls are presented.

**IIA Standard 2050:** “...*The chief audit executive (CAE) should share information and coordinate activities with other internal and external providers of relevant assurance and consulting services to ensure proper coverage and minimise duplication of efforts...*” (Institute of Internal Auditors: 2012).

The responsibility of the CAE to coordinate the activities of the individual assurance providers is essential to the success of the combined assurance efforts of the organisation. Each assurance provider has its own field of responsibility pertaining to risk, compliance and management; however, internal audit, together with the CAE should combine all the efforts of the various assurance providers to gain an organisation-wide overview/perspective. The presentation of this perspective could be in any of a variety of non-verbal formats.

According to Sarens *et al.*, (2012:51-63) there are three important reasons / factors, which should be considered in the process of implementation of combined assurance. :

- *Governance factor:* The first factor that should be considered in the implementation of combined assurance is its integration with existing governance. As described in Chapter Two of this study, corporate governance guidelines within South Africa were introduced by the King III Report.
- *Risk factor:* The second factor that should be considered in the implementation of combined assurance is ensuring that the significant risks which the organisation faces, are adequately addressed. Organisations today focus a lot more on risk management,

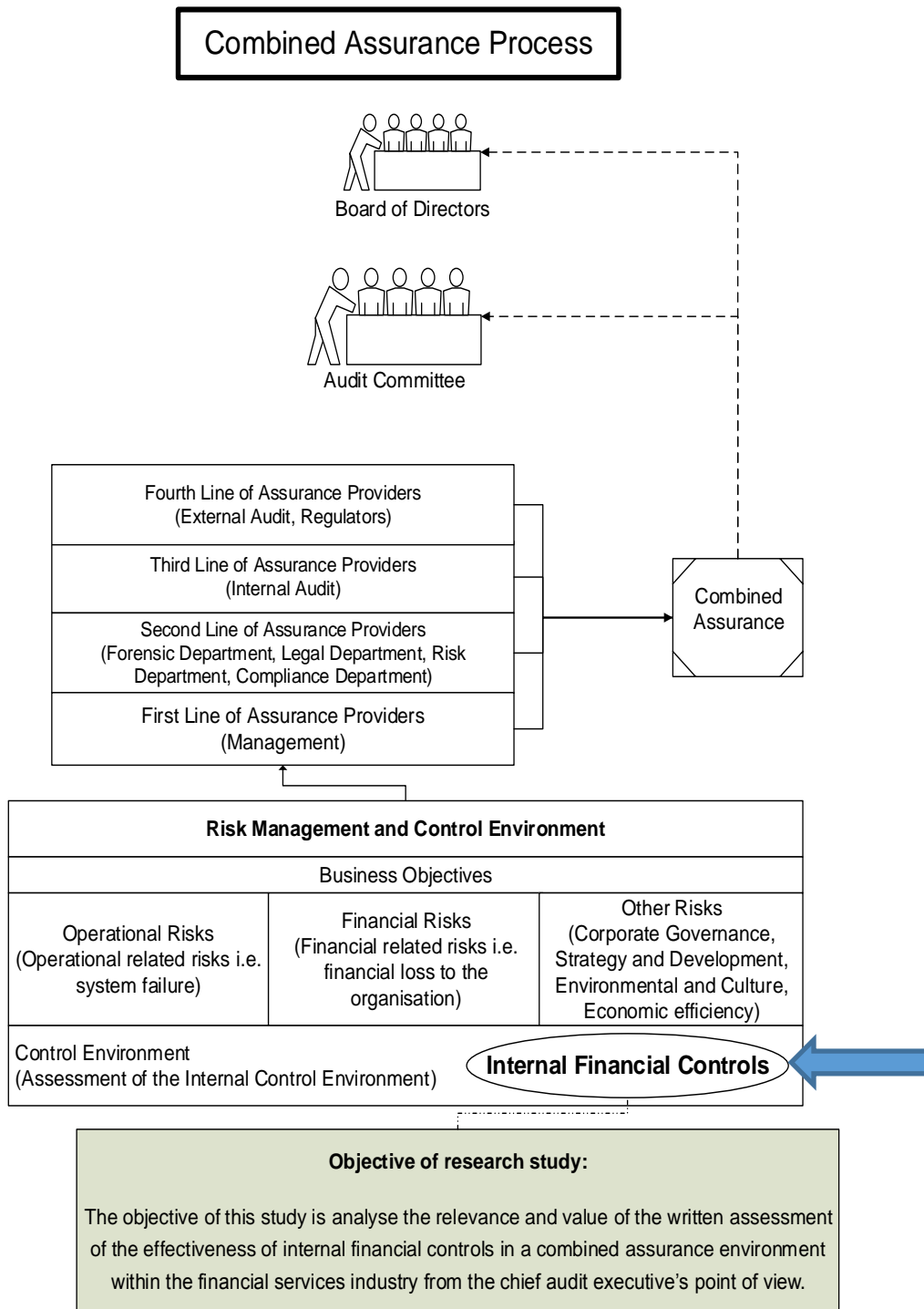
because past experience has taught that this is of most interest to all stakeholders. A risk factor can also be described as any incident that prevents the organisation from accomplishing its objectives. The risks faced by the organisation can be divided into the following: operational risks, financial risks and other risks. Operational risks refer to all the risks relating to the day-to-day business of an organisation. Financial risks refer to the risks affecting the financial aspects of the organisation. Other risks refer to the risks relating to the corporate governance strategy of the organisation, the development strategy of the organisation, and the environmental and cultural strategies of the organisation.

- *Efficiency factor:* The last factor under consideration is that of efficiency. In order to be efficient, an organisation should perform its work well. According to Sarens *et al.* (2012:61-62), traditionally within some businesses, certain units were audited extensively whilst other business units did not receive any coverage. By the effective implementation of combined assurance, assurance exhaustion could be eliminated from the process and the focus by assurance providers could possibly be more effectively targeted. The efficiency factor, according to Sarens *et al.*, (2012:57), results in more effective auditing. In comparison to the vehicle analogy, when a motor vehicle is on a service plan, all the parts of the vehicle (i.e. the brakes, radiator and so forth) will be inspected to ensure that the vehicle remains roadworthy for at least another 15,000 kilometres. The servicing of a vehicle is a singular concept and an integrated process. It is not conducted as a semi-random collection of presumed beneficial individual processes. Similarly, with reference to audits that are conducted – the significant risks faced by the organisation will be assessed and evaluated in order to add value to the organisation (i.e., enable it to continue to function as intended).
- Combined assurance has the ability to eliminate silos and to create an open playing field where all assurance providers can operate so as to best benefit the organisation.
- Combined assurance has the ability to decrease the cost of compliance to the organisation. The combined assurance process will assess the organisation's control environment based on the assurance that is provided by the participating parties.
- According to the King III Report, internal audit has a responsibility to assess the overall internal control environment of the organisation and also to assess the effectiveness of the internal financial controls.

The empirical research component of this study analyses the relevance and value of the written assessment of the effectiveness of internal financial controls in a combined assurance environment within the financial services industry, from the chief audit executive's perspective.

Figure 8 is a graphic representation of the detail of the combined assurance process within the organisation.

**Figure 8: Combined assurance process**



Diagrammatical representation of the combined assurance process within an organisation

### 3.6 ADVANTAGES AND DISADVANTAGES OF COMBINED ASSURANCE

According to Sarens *et al.*, (2012:65-72) combined assurance has both advantages and disadvantages associated with its implementation within the organisation; overall, however, the process of implementing combined assurance will be more beneficial to the organisation than if it is not implemented. From the perspective of this study the following advantages and disadvantages are the most significant:

Advantages of the implementation of combined assurance:

- Based on the coverage provided by the participating assurance providers, combined assurance could result in an enhanced decision-making process. Assurance providers' individual focus will differ pertaining to the mitigation of the significant risks faced by the organisation. This will result in better decision-making as more assurance providers will identify a greater number of risks, and be responsible and accountable to ensure the risks are mitigated;
- prioritisation abilities of the organisation are enhanced. The assurance providers are required to give feedback pertaining to the significant risks facing the organisation, thus enhancing the ability of the organisation to adequately prioritise addressing the risks;
- based on the fact that all assurance providers give their individual insights into the organisational processes, combined assurance provides adequate and sufficient detail to the audit committee and board of directors. Various assurance providers will assess the risks of the organisation differently. This will result in more detailed feedback pertaining to the significant risks facing the organisation. The audit committee will receive the end-product of the assurance process, which should provide adequate detail that allows effective and appropriate conclusions to be drawn;
- combined assurance should result in better risk awareness/consciousness and the understanding of the business on the part of management and directors;
- combined assurance could result in the elimination of a silo mentality, and promote accountability and transparency, which in turn enhances the effective use of resources. Assurance providers, through working together, provide combined assurance that changes the traditional single view of the risk-mitigation effort required to address the significant risks facing the organisation into a multi-dimensional view;



- the value added by internal audit activities could be enhanced by implementing effective combined assurance because various assurance providers will challenge internal audit (and themselves) to improve their performances; and
- under the combined assurance purview a consistency of assurance work provided among participating assurance providers could be achieved.

Disadvantages of the implementation of combined assurance (Sarens *et al.*, 2012:74-78):

- Combined assurance is a new concept that does not yet boast a well-documented research library of successful implementations. It is therefore, for most participants, a learning process, a work-in-progress. As a starting point, assurance providers should work closely together to compile a combined assurance process (essentially route-planning, but without immediate pay-offs). With time, the process will be enhanced and will address the needs of the organisation, with readily apparent benefits;
- combined assurance does not have a uniform framework (standard template) that can be implemented by all organisations wanting to implement it. It is a concept that should be customised to practically address each organisation's needs; and
- lastly, combined assurance is defined according to the maturity of the organisation's risk departments. Combined assurance could possibly fail in organisation that do not yet have an adequate risk management culture.

### **3.7 SUMMARY AND CONCLUSION**

The objective of this chapter was to analyse combined assurance. The objective of this study which is to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment within the financial services industry, from the chief audit executive's perspective. The objective of this study is to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment within the financial services industry from the CAE's perspective.

According to various authors, the definition of combined assurance is a process of integrating and aligning the various assurance processes with each other and to the

organisation's risk appetite. Combined assurance is not a new concept; however, the relevance thereof was enhanced with the publication of the King III Report on Corporate Governance in 2009. Assurance providers are required to provide feedback on all the processes within the organisation. These processes can be divided into various activities namely: finance-related activities, strategy-related activities, environmental and culture-related activities, economic efficiency and governance processes/ activities, and operational activities. The assessment of the internal control environment and risk management is the primary responsibility of internal audit that is required to provide an assessment of the effectiveness of internal control and risk management, as well as a written assessment of the effectiveness of internal financial controls. These above-mentioned activities should then be further defined and categorised based on their risk exposure.

Through the understanding of combined assurance, it was noted that within the lifetime of this researcher iPads have replaced hand-written notebooks, and almost everything can now be bought over the internet. The business world continues to evolve at an accelerating pace and new risks arise as a matter of course. The combined assurance given by all participating assurance providers can benefit the organisation by mitigating these significant risks with which organisations are faced.

To achieve sound corporate governance, and with reference to the King III Report, combined assurance may be implemented in any organisation and should address the requirements of that specific organisation. Various models may be used to implement combined assurance. The model that is used should be specific to the organisation's needs and appropriate to the requirements of the industry in which the organisation operates. The combined assurance model that is used should address, link and utilise all the lines of defence present in the organisation, in instances where the defence model is used. Similarly, in instances where the assurance model is used, all the assurance providers should be appropriately and effectively drawn into a single team.

The King III Report on Corporate Governance was scrutinised to determine what internal audit's role is with respect to combined assurance. The responsibility of internal audit and the importance of the written assessment on the effectiveness of internal financial controls

were highlighted. It was further noted that is the audit committee has a responsibility to the organisation to ensure that the assurance provided by the participating parties is adequate and that it provides enough detail for the audit committee to do its work.

The Standards of the IIA were analysed to determine their relevance to the provision of combined assurance. It was noted that the IIA's Standards stipulate that the CAE has a responsibility to communicate to the board of directors and to the audit committee the levels of risk exposure the organisation is facing. In addition, the CAE should also communicate the results of monitoring of the identified risks to the directors and audit committee. The CAE has an additional responsibility to coordinate the activities of the various assurance providers. Within the organisation, because of these different requirements, it is evident that internal audit plays an essential role within combined assurance. Various factors influence the implementation of a combined assurance plan. If the factors are implemented accurately, combined assurance will result in the enhancement of business processes.

Enhanced decision-making processes and achieving a better understanding of risk are some of the advantages of combined assurance. Combined assurance can also result in the elimination of a silo mentality, and add value to internal audit activities. Some of the disadvantages of combined assurance are that it is still a learning process, a work-in-progress, and the likelihood of early success is directly linked to the risk maturity of the organisation.

To conclude, the role of internal audit is integral to the combined assurance process. The following key concepts were noted pertaining to combined assurance:

- Combined assurance is a process of integrating and aligning the various assurance processes with each other and with reference to the organisation's risk appetite;
- combined assurance should optimise overall assurance feedback to the audit committee, particularly as it pertains to the significant risks with which the organisation is faced;
- internal audit should play an advisory role and should be seen as the custodian of the combined assurance process within the organisation;

- the combined assurance process should be seen as one of internal audit's key responsibilities within the organisation;
- the audit committee should approve the combined assurance model that is to be used by the organisation; and
- effective combined assurance has the potential to eliminate silos and to enhance decision-making within the organisation.

Corporate governance and combined assurance have been analysed in detail from the perspective of their relevance to this study. The next chapter will focus specifically on the role of internal audit to provide a *written* assessment of the effectiveness of internal financial controls.

# INTERNAL AUDITING

## CHAPTER 4: INTERNAL AUDITING

### Abbreviations used in this chapter

Abbreviation	Meaning
B.C.	Before Christ
CAE	Chief Audit Executive
CIA	Certified Internal Auditor
IAS	International Accounting Standards
IIA	Institute of Internal Auditors

### 4.1 INTRODUCTION

As discussed in the previous chapter, the functions of corporate governance, combined assurance and internal auditing are symbiotically linked, a part of the road to the destination of this study, if you will. The focus of the previous chapter was combined assurance. Combined assurance is the process that enables audit committees to ensure that the corporate governance vehicle remains mobile. The key principles of combined assurance discussed in the previous chapter, are:

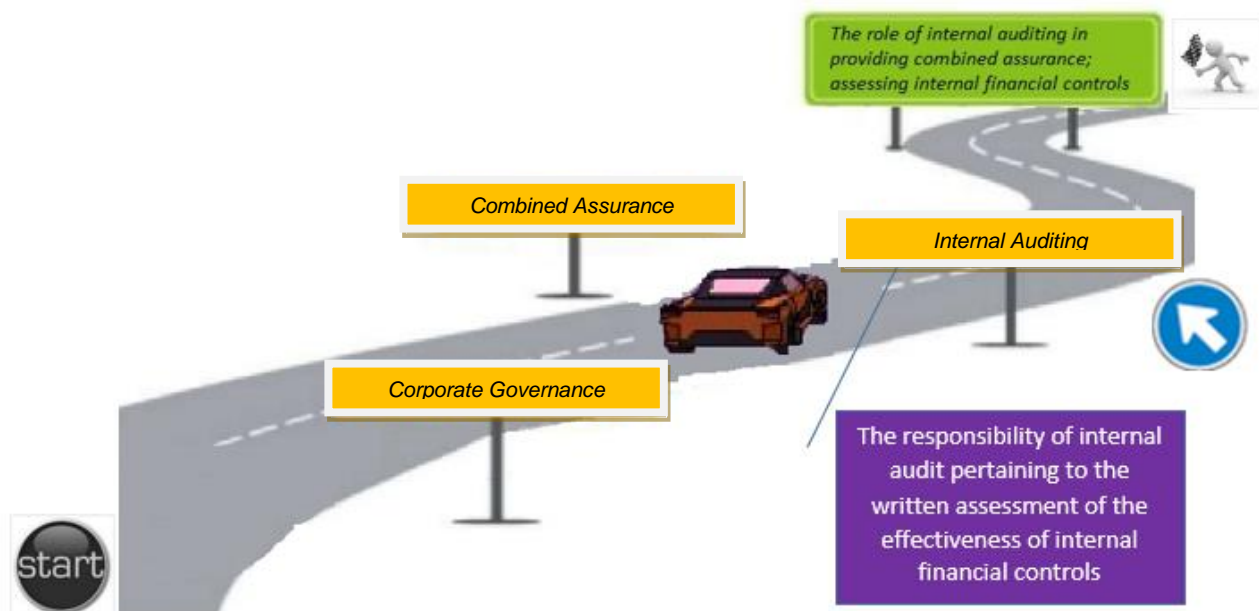
- Every organisation is faced with increasing volumes of new risks. The audit committee should be satisfied that the assurance being provided adequately mitigates and addresses these risks;
- the combined assurance model that is used should be tailor made for the organisation's needs; and
- internal audit has a responsibility to provide a written assessment regarding the effectiveness of internal financial controls, and the audit committee has a responsibility to ensure that it is fulfilled.

The objective of this study is to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment within the financial services industry from the chief audit executive's (CAE) perspective. The research study's focus is limited to Principle 7.3.6 of the King III Report.

- Principle 7.3.6 p 45: “...*Internal audit should provide a written assessment of internal financial controls to the audit committee...*” (Institute of Directors Southern Africa, 2009).

Figure 9 represents the road map of this study. As indicated in the diagram, it is clear that the destination of this study is in sight. The written assessment is a product that is delivered to the audit committee. It is the result, the outcome, of all the assurance provided by the participating providers within combined assurance.

**Figure 9: The map of this study’s progress along the road towards understanding corporate governance, combined assurance and internal auditing, with specific focus on internal audit**



Internal audit plays an important role in delivering a written assessment of the effectiveness of internal financial controls. The objective of this chapter is to determine the perceived importance of internal audit within combined assurance. In this chapter the following aspects will be discussed:

- A brief history and analysis of internal auditing;
- the role of internal auditing within combined assurance;
- the responsibility of internal auditing within combined assurance;

- internal financial controls; and
- the importance of the written assessment of internal financial controls.

## 4.2 HISTORY OF INTERNAL AUDIT

As long ago as 4000 B.C., business owners identified a need for independent and objective people to verify accounting and bookkeeping records. The objective was to diminish the number of errors and possible fraud, and the misappropriation of assets. Babylonia, the Roman Empire, Greece and Italy were among the first countries where financial institutions requested and developed a specific detailed system of counterchecks and verification. This request stemmed from governments' concerns that their officials would make bookkeeping errors that could result in corruption and fraud (Ramamoorti 2003:3). The Bible (1982), with references starting in 1800 B.C., contains several references to the need for effective internal controls, like the risk associated with surety (Proverbs 11:15), the advantages of honest employees with integrity (Luke 12:42-44) and the danger of wastage of capital (Luke 15:13-16).

Organisations have grown increasingly complex over time, and the need for independent assurance providers has increased in parallel. The necessity to review the organisation as a whole – from top management to operators and clerks, from the raw materials used to the manufacturing of finished products, to sales and distribution - became increasingly important because organisations were not only concerned about the reliability of the figures, but also with the integrity of the employees, the corporate governance structure and the internal and external risks facing the organisation (Ramamoorti 2003:3).

The Institute of Internal Auditors (IIA) was established in 1941; however, at that time internal auditing was seen as a 'nice-to-have' addition to the work performed by external audit (Ramamoorti 2003:4). In 1970, the IIA published an updated definition of internal auditing from which today's definition was formulated. According to Ramamoorti (2003:7) by the end of 1970 internal auditing was seen as a separate profession, and not just an expansion of external audit, because by then:



- It boasted its own professional qualification (the Certified Internal Auditor), granted to those who demonstrated proficiency in its specialised knowledge;
- internal audit had a formal examination and education process supporting the CIA qualification;
- industry-specific standards that guide and govern the profession had been written and put into widespread use; and
- there was a specific Code of Ethics, a specific designation (Certified Internal Auditor) and status in the form of a license for the profession, together with a market demand for and public interest in the work performed by an individual certified internal auditor.

Even though internal auditing, as a formally recognised profession, is young in comparison to other professions, its importance should not be underestimated.

Throughout this research and in pursuit of the objective of this study, one of the concepts that holds it all together is the fact that corporate governance, combined assurance and internal auditing are not new concepts. They have been in play for millennia, but have only relatively recently been given modern names and definitions.

#### **4.3 ROLE OF INTERNAL AUDITING WITHIN COMBINED ASSURANCE**

The IIA's definition of internal audit emphasises the fact that internal auditors are required to be an "*independent and objective assurance provider designed to add value to an organisation*". Furthermore, "*... internal auditors need to assist the organisation to achieve its objectives by bringing a systematic, disciplined approach to evaluate the effectiveness of risk management, internal control and corporate governance*" (Institute of Internal Auditors, 2012). From this definition the importance of risk-based auditing is obvious and paramount.

According to Cathcart and Kapoor (2010:47-49), internal auditors should constantly revise their methods, practices and processes, and move beyond the traditional methods of auditing. In so doing they should develop a forward-looking audit approach. Internal

auditors should apply the definition of internal auditing to their ever-changing working environment in order to be able to continue to add value.

The reason why internal auditors are considered as reliable assurance providers is because of the integrity and reputation of their designation (Steward & Subramaniam 2010). According to the IIA's Code of Ethics there are four principles that underline ethical behaviour for internal audit professionals (Institute of Internal Auditors Code of Ethics, 2012). These principles are integrity, objectivity, confidentiality and competency (Institute of Internal Auditors Code of Ethics, 2012).

- **Integrity** is the foundation enabling one to place reliance on an internal auditor's opinion.
- **Objectivity** applies to the way in which an internal auditor's work is conducted – with attention to evidence and facts. Internal auditors should always be objective in the performance of their work, evaluating the outcomes and communicating results clearly and unemotionally. The objectivity of internal auditors should be such that they are beyond any hint of bias in favour of any party.
- Due to the nature of the work that is conducted by internal auditors, **confidentiality** is important. Internal auditors need to conduct their work without disclosing confidential information to any party, unless there is a professional and/ or legal obligation to do so. Internal auditors should also not use the confidential information to their own advantage.
- Lastly, **competency**: auditors are required to have the necessary experience, skills and knowledge to successfully perform the work required of them (Institute of Internal Auditors Code of Ethics 2012). All reputable organisations want reputable assurance providers giving their objective and well-researched opinions on the state of their businesses. By performing their duties in line with the IIA's Code of Ethics, internal audit can fulfil these expectations.

Internal auditing is one of the wheels of the corporate governance vehicle. Internal auditing is also part of the organisation, and in an ideal position to provide assurance within the combined assurance model of the organisation, on the way the internal financial controls are functioning (Steward & Subramaniam 2010).

According to Marks (2012) there are two types of assurance that can be provided by internal audit, namely positive and negative assurance. Negative assurance occurs when internal audit issues a list of usually negative findings that were identified in the audit, while positive assurance occurs when internal audit provides an opinion on the effectiveness of internal financial controls. Internal auditors should not just provide the board of directors with a list of the findings that were identified in the audit. Internal audit should also provide the board of directors with recommendations in terms of the existing controls, that adequately address the identified risks. Based on internal audit's professional opinion this objective can be reached.

#### **4.4 RESPONSIBILITY OF INTERNAL AUDITING WITH REGARD TO COMBINED ASSURANCE**

In terms of the corporate-governance-as-motor-vehicle analogy above, the internal audit assurance provider's wheels are necessary to keep the corporate vehicle roadworthy. It is the responsibility of internal audit assurance providers to ensure that the wheels keep turning freely. Even though the other assurance providers also have a responsibility to ensure their wheels are turning, this study was focused only on the responsibility of internal audit assurance within combined assurance.

The King III Report (IoDSA, 2009:45) suggests in Principle 7.3.1 that internal auditing should form part of combined assurance. In the previous chapter combined assurance was discussed in detail. The objective of this chapter is to analyse combined assurance from the internal audit view point. The King III Report defined combined assurance as *"Integrating and aligning assurance processes in a company to maximise risk and governance oversight and control efficiencies, and optimise overall assurance to the audit and risk committee, considering the company's risk appetite"* (IoDSA, 2009:50).

Victor (2013:4) suggests that the combined assurance process should be formalised and that internal audit should play an important role in formalising it. Risks resulting from the overall business and/ or corporate strategy would be better managed based on an effective, efficient and adequate control environment. Combined assurance will ultimately

result in the significant risks being identified and adequately mitigated by the relevant controls.

Based on King III's requirements and the views of the various authors mentioned in this study, it is clear to see that there is an expectation that internal audit should be part of the combined assurance process.

According to Leung, Cooper and Perera (2011), there is a lower-than-expected correlation between the internal audit function's view of their relationship with management and management's view of the relationship. An Australian study indicated that internal audit is an essential building block of effective corporate governance. This study also found that there is currently a misalignment between what internal auditors think their relationship with management is, and how it actually is. Internal audit should give attention to all aspects of the organisation in order to enhance the overall performance of the organisation (Leung *et al.* 2011). Internal audit's communication efforts should also enhance the effectiveness of corporate governance, if there is to be a close relationship between internal audit and the audit committee (Razahee 2010).

Internal audit can assist in the detection of fraud through monitoring the control environment of an organisation (Coram, Ferguson & Moroney 2008).

Internal auditors need to evaluate business risks, and to provide reasonable assurance. The reasonable assurance should be in terms of the effectiveness of risk management, of governance, and of the control environment. If effectively carried out, this should ensure that the organisation's objectives and goals are being achieved. The individual internal auditors should also have open lines of communication with the audit committee and with management. Deficiencies noted as a result of control breakdowns and risk management issues should be communicated immediately. Recommendations made by internal audit should address the concerns of the organisation, and should thereby ensure that the overall performance of the organisation is enhanced (Deloitte, 2010).

Van Wyk (2010) suggests that there are eight factors that will enhance the effectiveness of an internal audit activity. Five of these factors that define an effective internal audit activity

can also be applied to the performance of combined assurance provided by internal auditors.

Therefore, internal audit should:

- Manage stakeholder expectations in relation to the value proposition;
- make value-adding recommendations that are feasible for the business operation;
- focus on significant risks and issues with which the company might be faced;
- manage relationships with all participating parties; and
- make use of skilled, knowledgeable and professional staff.

Effectiveness of the internal audit activity can be directly related to the value of the service that is delivered.

#### **4.5 INTERNAL FINANCIAL CONTROLS**

According to Gleim (2009:104) transactions within an organisation are represented in the financial statements of the organisation. Financial statements of an organisation consist of the following:

- Statement of financial position – this displays the organisation’s financial structure, solvency (relationship between assets and liabilities), liquidity (relationship between current assets, less inventory and current liabilities) and economic structure;
- the statement of financial performance provides information regarding the organisation’s performance; and
- the cash flow statement primarily provides information regarding the changes in an organisation’s financial position.

Financial statements should assist users and stakeholders with their decision-making processes. Information displayed in the organisation’s financial statements should be fairly represented, understandable and relevant (Gleim, 2009:144). Internal audit should understand the controls applicable to the financial statements of the organisation. Internal financial controls are directly related to the financial statements of the organisation. To identify internal financial controls, the processes within the organisation which pose the highest risks to the accuracy of the financial statements should be analysed. A materiality

figure should be determined by the external auditors and should be approved by the audit committee. According to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the materiality figure for financial statements can be defined as the maximum amount by which the auditor believes the statements could be misstated and still not affect the decisions taken by affected stakeholders (International Accounting Standards 2005). Materiality further refers to the method used in the estimation of the effect that the absence or presence of information may have on the validity and/or accuracy of the financial statement. Materiality can therefore be estimated in terms of its value, impact, nature, influence and circumstance in which it takes place (Businessdictionary.com August 2013)

Once the materiality figure has been determined, all financial statement line items above the materiality figure in the statement of financial position and the statement of comprehensive income, should be identified. Management then has a responsibility to identify the controls applicable to those line items and to inform internal audit. These controls will form the basis of the testing that will be performed by internal audit. Based on the outcome of the testing the written assessment of the effectiveness of internal financial controls can be drafted by internal audit.

The word “auditor” is derived from the Latin word *audire*, which means to listen, and/ or to hear (Latin-dictionary.org August, 2013). In order to provide a written assessment of the effectiveness of internal financial controls, internal auditors have a responsibility towards the organisation to listen carefully to the relevant assurance providers. Furthermore, internal auditors have to assess the veracity of the information and thereafter to provide a written assessment to the audit committee.

#### **4.6 IMPORTANCE OF THE WRITTEN ASSESSMENT OF THE INTERNAL FINANCIAL CONTROLS AND POSSIBLE GUIDANCE PERTAINING TO WHAT THE WRITTEN ASSESSMENT SHOULD ENTAIL**

The assessment of the internal financial controls is the destination of the corporate governance vehicle. It refers to the professional opinion that is given by internal audit on the effectiveness of the internal financial controls within the organisation.

PwC (2011:4-11) has suggested a five-step approach for the implementation of combined assurance in an organisation:

- The first step is to determine what assurance is provided by the various assurance specialists by identifying the risks that an organisation is exposed to.
- The second step is to assess the actual assurance that is provided by each of the assurance providers. (The audit committee should also have confidence in the assurance that is being provided by these specialists.) The quality of the assurance provided should also be evident in the quality of the specialists' reports on their view of the risk.
- The third step is to map the risks. This is seen as providing a reality check between what assurance is currently being provided and what assurance needs to be provided. This step is also seen as the gap identification step.
- The fourth step is the design of the combined assurance assignment. This step will identify the responsibilities of the various assurance providers, the methodologies to be used, and the agreement on the general universe for combined assurance.
- The fifth step is to ensure that combined assurance is performed on a continuous basis.

Deloitte's combined assurance approach has also been analysed for the purpose of this study and it was noted that, according to Victor (2013:11), the Deloitte approach is based on the IIA Standards.

- The first step is to define the audit universe in order to assess what should be included and excluded from the scope.
- The second step is to determine what the materiality framework of the organisation should be. The materiality framework, and specifically the materiality figure, will determine the extent of the audit testing. In addition, it would also assist with the risk identification.
- The third step is to determine the period under review and the frequency of the testing.
- The fourth step is to decide on what audit evidence should be delivered to determine the overall adequacy and appropriateness of the testing performed.
- The final step would be the results of the testing as well as the overall conclusion drawn from the controls tested.

Based on the above-mentioned combined assurance approaches from PwC and Deloitte it can be seen that they are similar. The PwC approach focuses more on the combined assurance **providers** and their responsibilities (refer to PwC combined assurance approach step 1 – 3), whereas the Deloitte approach focuses more on the combined assurance **process** (refer to Deloitte combined assurance approach).

The problem statement of this study indicated that there is uncertainty how CAEs perceived the relevance and value of the written assessment regarding the effectiveness of internal financial controls and how the assessment should promote sound corporate governance and combined assurance. Based on the research performed in this study, as well as the insight obtained from various authors and companies, the following guidance is offered as a proposal for the form and content of the written assessment of the effectiveness of internal financial controls, and how it would support sound corporate governance. The proposal is presented in the table below.

**Table 2: Guidance regarding what the written assessment of the effectiveness of internal financial controls should entail**

#	<b>Guidance pertaining to what the assessment of the effectiveness of internal financial controls should entail</b>
Step 1	<ul style="list-style-type: none"> <li>• The internal audit activity should determine what the <b>audit universe</b> should be for the assessment of the internal financial controls. The audit universe pertaining to internal financial controls should then be presented to the audit committee.</li> <li>• The audit committee should determine and approve the <b>materiality figure</b> for the organisation, based on the financial statements of the organisation. The above-mentioned should be done in accordance with the IIA's Performance Standards 2200 (Institute of Internal Auditors, 2012).</li> <li>• The audit committee should approve a <b>combined assurance model</b> based on the King III Requirement.</li> </ul>
Step 2	<ul style="list-style-type: none"> <li>• The <b>significant risks</b> pertaining to the organisation's internal financial controls audit universe, as approved by the audit committee, should be</li> </ul>



#	<b>Guidance pertaining to what the assessment of the effectiveness of internal financial controls should entail</b>
	identified.
Step 3	<ul style="list-style-type: none"> <li>The <b>combined assurance providers</b> should be identified, based on the various lines of defence and/ or lines of assurance present in the approved combined assurance model.</li> </ul>
Step 4	<ul style="list-style-type: none"> <li>The assurance providers should <b>assess the significant risks</b> identified in step 3 and should <b>provide evidence</b> on how these risks were assessed.</li> <li>Internal audit should combine the assessments received from the various assurance providers in one document in order to provide an overall view of the organisation's risks and how they have been assessed.</li> </ul>
Step 5	<ul style="list-style-type: none"> <li>Internal audit should <b>review the overall assessments of and the evidence</b> received from the assurance providers. The quality of the assurance provided should be evident in the quality of the specialists' reports containing their views of the risks.</li> <li>Internal audit should <b>perform audit testing</b> in order to validate the quality of the assessment provided by the assurance providers.</li> <li>Internal audit should present this overall assessment of the effectiveness of internal financial controls to the audit committee.</li> </ul>
Step 6	<ul style="list-style-type: none"> <li>The audit committee should <b>approve the overall assessment</b> of the effectiveness of internal financial controls</li> <li>The audit committee should further determine the <b>frequency</b> of performance of the assessment, and when the written assessment on the effectiveness of internal financial controls should be presented.</li> </ul>

Figure 10 displays the various stages of the combined assurance process and how the written assessment on the effectiveness of internal financial controls is arrived at.

**Figure 10: Combined assurance stages**



Source: Victor, 2013:12

#### **4.7 SUMMARY AND CONCLUSION**

The objective of this study is to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls, in a combined assurance environment within the financial services industry, from the CAE's perspective.

The auditing profession has played an important part in the business world for centuries, even though the internal audit profession (as it is known today) is relatively young. Economic enterprises in ancient Babylon, Greece, and Italy, (including the Roman Empire), were among the first countries that identified the need for the auditing profession; however, as the business world grows increasingly complex, the need for the internal audit profession cannot be underestimated.

Risk based auditing is a central concept to the definition of internal audit. Internal audit should move away from the traditional way of auditing and should develop a forward-looking approach, which will result in adding value to the organisation.

In terms of the corporate governance vehicle analogy above, the internal audit assurance provider's wheels are essential to keep the corporate vehicle roadworthy. It is the responsibility of internal audit assurance providers to ensure that wheels keep turning freely. The internal audit activity can implement various strategies and approaches to ensure the mobility of the vehicle: examples include managing expectations, adding value to the organisation, and identifying and implementing the correct risk-based focus on the organisation's operations.

Internal financial controls are directly related to the organisation's financial statements. Assurance providers should work together to provide feedback regarding the presence and effectiveness of the controls that management has implemented in order to assess the truth of the financial statements.

The written assessment may be seen as the product that is delivered to the audit committee. Before the product can be delivered, the recipe, raw materials and production should be determined. Based on this research study, the recipe for the product was published as the requirements of the King III Report on Corporate Governance. The raw materials are all the assurance efforts pertaining to the financial controls that are provided in a combined assurance environment. The assessment performed by internal audit, based on the assurance provided, can be seen as the production process. A possible guidance framework was suggested based on the research performed in this study into what the written assessment of the effectiveness of internal financial controls should entail and how it should promote sound corporate governance. The guidance consists of six (6) steps that could be implemented by the organisation. The final pit stop presented a diagrammatic representation (using Deloitte's suggestion as a basis) on what the process of combined assurance should be.

In conclusion, corporate governance and combined assurance are important aspects to consider in the assessment of the organisation's internal financial control situation. From a theoretical perspective, and with reference to the research objectives, the following key conclusions can already be drawn simply by looking at the recently published literature:

- Internal auditing is an essential part of the combined assurance process;

- The written assessment of the effectiveness of internal financial controls has the potential to add value to the organisation, provided that the following issues have been addressed:
  - Significant risks relating to material misstatement of the financial statements are adequately identified;
  - recognition has been given to the various and integrated roles played by assurance providers in the combined assurance process;
  - materiality figures applicable to the organisation’s financial statements are accurate, valid and adequately determined;
  - internal audit has performed an assessment of the effectiveness of the internal financial controls; and
  - internal audit has provided a written document recording the assessment performed.
- The importance of internal auditing was readily apparent in the literature reviewed.
- The CAE has a responsibility towards the organisation, and the audit committee (and is governed by the IIA’s Standards), to ensure that risks are mitigated effectively by means of adequate controls. The views of CAEs within the financial services industry are analysed in detail in Chapter Six of this study.

# RESEARCH METHODOLOGY

## CHAPTER 5: RESEARCH METHODOLOGY

### Abbreviations used in this chapter

Abbreviation	Meaning
CAE	Chief Audit Executive
IIA	Institute of Internal Auditors

### 5.1 OBJECTIVE OF THE CHAPTER

According to Saunders, Lewis & Thornhill (2009: 5) research is defined as an action that is undertaken in a systematic way so that the result will be an increase in knowledge. Since the purpose of this study is to analyse the relevance and value of the written assessment of the effectiveness of internal financial controls in a combined assurance environment within the financial services industry from the chief audit executive's (CAE) perspective, survey research was selected as an inquiry strategy. Survey research entails asking questions of a specific audience and tabling the results (Leedy & Ormrod, 2010:187). The survey research that was conducted for this study was in the form of questionnaires. According to Saunders *et al.*, (2009:144-145) the following list identifies the advantages and disadvantages of using survey research as an inquiry strategy.

Advantages of survey research:

- Allows the collection of large amount of data from a sizeable population in a highly economical way;
- data is in a standard form and permits simple comparisons;
- uncomplicated to understand;
- the researcher can manage the research that is conducted alone; and
- sampling creates findings that can be applied to the entire population.

Disadvantages of survey research:

- Samples should be representative in order for the findings and conclusions to be accurate;

- dependent on participants for information;
- limited to the number of questions the questionnaire and/ or interview contains;
- survey research captures a snapshot of an in-progress activity; and
- it is subjective and dependant on people's memories and attitudes.

Quantitative research was selected for the purpose of this study because it allowed the researcher to analyse the data and to compare how combined assurance and the assessment of the effectiveness of internal financial controls are implemented in the surveyed organisations. The data obtained from the questionnaire were standardised and easy to understand. Based on the fact that the entire population was tested, the disadvantages pertaining to samples and sampling were not applicable. The purpose of this research study was to analyse the CAE's perspective pertaining to the written assessment of the effectiveness of internal financial controls. Therefore the disadvantages relating to people's memories, attitudes and information should not be seen as a limitation.

## **5.2 DATA COLLECTION**

The financial service companies that appeared on the 2012 Top 200 African Listed Companies were utilized as the population of this research study. There were a total of 15 financial services companies listed. All 15 CAE of these companies participated in the research study.

This study made use of a questionnaire as the means of collecting primary data. Saunders et al., (2009:360) define a questionnaire as a set of questions that is presented in a predetermined order, to a set of appropriately qualified and selected participants. The questionnaire was sent to all 15 CAEs within the organisations in the financial services industry whose companies appeared in the Top 200 African Listed Companies survey of 2012. Appendix A contains the questionnaire that was electronically mailed to the selected participants.

Pilot testing of the questionnaire was performed. The objective with pilot testing is to ensure that the structure and sequence of the questions are accurately targeted, and to remove possible logical and linguistic inconsistencies from the questionnaire. This was also performed to ensure that the participants in the research would not have any linguistic or comprehension-related problems inhibiting their responses to the questions. The pilot testing also provided a reasonably accurate estimate of how long the questionnaire should take to complete (Saunders *et al.* 2009:395).

The questionnaires were circulated on 30 May 2013 to five different subject experts within the financial services industry, to ensure that the questions were accurate and complete in the way they addressed the study's research objectives. Responses and feedback were taken into consideration before the questionnaire was finalised and distributed to the intended participants in the research study on 4 July 2013. A follow-up email reminding potential participants of the request for their participation in this research was sent on 11 July 2013. By 23 July 2013, 100 per cent of the intended recipients had responded, and the quality of the responses was deemed high enough for the analysis to provide coherent results.

### **5.3 DATA ANALYSIS**

Data analysis is defined as follows: "...The process of evaluating data using analytical and logical reasoning to examine each component of the data provided. The form of analysis is just one of many steps that must be completed when conducting a research experiment. Data from various sources is gathered, reviewed and then analysed to form a conclusion..." (Businessdictionary.com, October 2014)

The data analysis of this study was performed on the information received from the questionnaires that was completed by the participants in this study. The questionnaire was divided into the following three sections:

1. Overview of the participant's profiles
2. Combined assurance



### 3. Internal Financial Controls

Refer to Chapter 6 for more detail on the analysis that was performed.

#### 5.3.1 RECORDING AND STORAGE OF DATA

The questionnaire was prepared in electronic format, and distributed as an attachment to personal e-mails. Responses were returned via email and were recorded in an Excel spread-sheet, prior to the performance of various statistical analyses. The objectives of the questionnaire were to determine:

- The relevance of internal financial controls within combined assurance;
- the value of the written assessment of the effectiveness of internal financial controls within the financial services industry; and
- the perceived relevance and value of the internal auditor's written assessment regarding the effectiveness of internal financial controls differs between companies within the financial services industry.

#### 5.3.2 VERIFICATION AND EVALUATION OF DATA

Validity of data as defined by Saunders *et al.*, (2009:603) is the degree to which the data collection methods precisely and completely measure the intended objective. CAEs within the financial services industry were asked to complete a structured questionnaire. It was therefore a recognised assumption that the respondents would share the following characteristics:

- CAEs are accredited members of the Institute of Internal Auditors (IIA); and
- the CAEs work primarily in internal audit within the financial services industry.

## **5.4 ASSESSING AND DEMONSTRATING THE QUALITY AND RIGOUR OF THE RESEARCH DESIGN**

### **5.4.1 SOURCES OF BIAS OR ERROR**

There are various biases to consider that relate specifically to the use of questionnaires. Personal time constraints may result in bias as participants attempt to complete the questionnaire process without due thought (Saunders *et al.* 2009:327). Time constraints need to be managed (amongst others, by balancing the researcher's need for information against the respondents' need for brevity) in order to ensure that the participants in the research are not unduly disturbed. The amount of time required to complete the questionnaire was assessed as 30 minutes, based on feedback from the pilot study participants, and this was communicated to the participants in the hope that this would allow them to allocate their time effectively, and to demonstrate the relative ease with which they could participate in the research.

Another type of bias that should always be considered is that introduced by a participant's unwillingness or failure to complete the questionnaire, for whatever reason. Consistent follow-up from the researcher did improve the count of completed questionnaires for the study, but this did also then introduce the risk of antagonising potential participants. Ultimately, given that there was a 100 per cent response rate, it would appear that much of the potential for bias was avoided.

### **5.4.2 QUALITY, CREDIBILITY AND THOROUGHNESS**

The entire population participated in this study and therefore it can be concluded that the bias for generalisation has been significantly reduced.

The quality of the data generated by this study was enhanced by addressing the questionnaire only to CAEs responsible for driving the combined assurance process.

CAEs are also responsible for providing the written assessment of the effectiveness of internal financial controls to the audit committees.

The validity and credibility of the data were ensured by the completeness and accuracy of the completed questionnaires, as well as subsequently, when the analysis was performed on the data.

## 5.5 RESEARCH ETHICS

When considering ethical issues pertaining to research the following four broad concepts should be addressed (Leedy & Ormrod 2010: 101):

- *Informed Consent* - Participants in any study should be advised that their participation is voluntary, and that they may withdraw from the study at any time. (The final consent form that was sent to participants is included as Appendix B.) The purpose of the study, the name and contact details of the researcher, as well as pertinent additional details relating to the study were all included in the consent form that was sent to the participants, together with the research questionnaire. This was done to ensure compliance with research ethics norms. The signatures of the participants were obtained as evidence of agreement to participate, and their consent to the use of their responses, which were then returned to the researcher along with the completed questionnaire;
- *Right to privacy* – Participants completed the surveys anonymously, only indicating their specific role within the organisation (in this research the respondents consisted exclusively of CAEs within the financial services industry); and
- *Honesty with professional colleagues* – This research has been conducted with honesty and with integrity. The ethical requirements, as indicated in the University of Pretoria's Research Ethics protocol, as well as the IIA's Code of Ethics, have been followed throughout the process. Ethical clearance was obtained from the Faculty of Economic and Business Science of the University of Pretoria in order to conduct this research.

## 5.6 SUMMARY AND CONCLUSION

The objective of this chapter has been to stipulate the research methodologies used in this research study. The researcher has determined that quantitative research would be the best method to use based on the following:

- The data obtained from survey research would be in a standard form and easy to perform comparisons on;
- the information obtained from the research questionnaire is uncomplicated to understand; and
- the entire population was tested and therefore the disadvantages pertaining to quantitative research regarding sample selection were reduced to a minimum.

A questionnaire was developed and sent to 15 CAEs within the financial services industry whose companies appeared on the Top 200 African Listed Companies survey of 2012.

Pilot testing was conducted to determine if the questions were relevant and understandable before the questionnaire was distributed. It further assisted to identify possible problems that the respondents could encounter when completing this questionnaire. The pilot testing further identified the amount of time the participants would need to complete the questionnaire. This information was then communicated to them to ensure that they were adequately informed when participating in this research.

The questionnaire was circulated on 30 May 2013 to the previously identified participants in this research study. By 23 July 2013 all the participants had completed and returned the questionnaire to the researcher. One hundred per cent of the population participated in this research study.

CAEs were asked to participate in this research study by completing a structured questionnaire. The participants were all accredited members of the IIA.

The following chapter provides details of the results of the questionnaire completed by the CAEs.

## RESULTS

## CHAPTER 6:RESULTS

### Abbreviations used in this chapter

Abbreviation	Meaning
CAE	Chief Audit Executive
IAA	Internal Audit Activity
IIA	Institute of Internal Auditors

### 6.1 INTRODUCTION

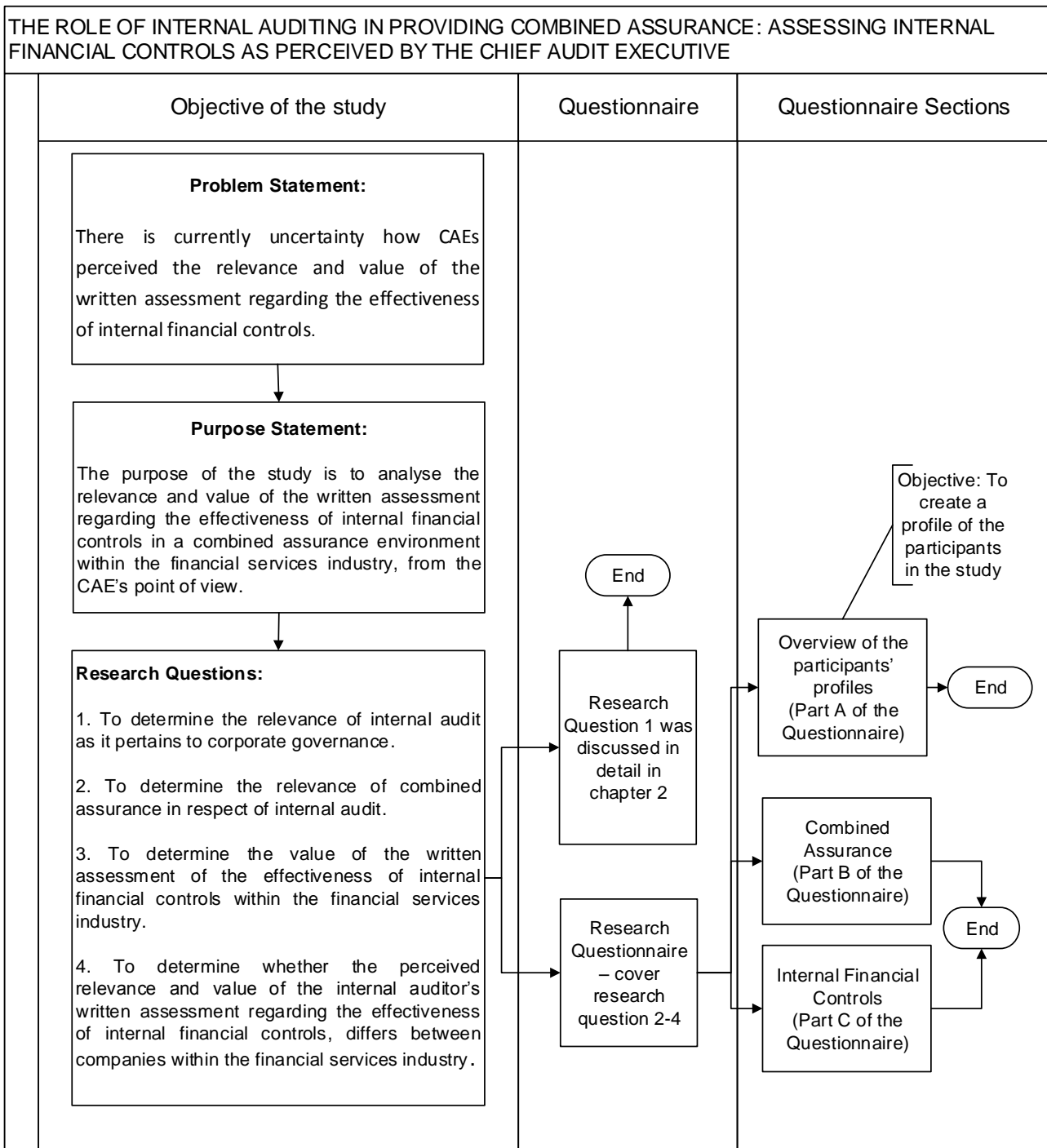
Combined assurance within the context of this study has been compared to a motor vehicle. It is the responsibility of the audit committee to assess the assurance provided by the relevant stakeholders. Audit committees should furthermore determine if the assurance provided is addressing the significant risks the organisation might be facing, and thereby ensure the corporate governance vehicle is (and remains) mobile.

As previously noted, the objective of the study was to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment within the financial services industry from the chief audit executive's (CAE) perspective. The objective of this chapter is twofold:

- To introduce the participants in this research study, by creating an overview profile of them; and
- to provide the results of the responses to the questionnaire that was sent out to the respondents. (The research objectives are listed in Chapter One).

Refer to Figure 11 for a representation of the subsections of the questionnaire.

**Figure 11: Subsections of the Research Questionnaire**



With reference to Figure 11, the questionnaire is divided into three (3) subsections. The objective of the first subsection (Part A of the Questionnaire) is to provide a demographical overview of the participants in this study with reference to their years of experience, gender and qualifications. The second and third subsections of the questionnaire (Parts B

and C of the Questionnaire), refer specifically to combined assurance and to internal financial controls respectively. The chapter is divided into the subsections corresponding to those of the Questionnaire, with specific focus on the research questions of this study.

## 6.2 OVERVIEW OF THE RESPONDENTS' PROFILES (PART A OF THE QUESTIONNAIRE)

CAE's within the financial services industry were requested to complete a survey questionnaire specifically pertaining to combined assurance and the assessment of the effectiveness of internal financial controls. The following section will provide feedback pertaining to the profiles of the respondents that participated in this research study. Table 3 provides the structure and overview of Part A of the questionnaire.

**Table 3: Overview of the questions pertaining to the respondents' profiles**

Number as per the research questionnaire	Detail of the question
Part A: Question 1	How many years experience do you have as a CAE?
Part A: Question 2	Gender?
Part A: Question 3	<p>Do you have any of the following qualifications?</p> <ul style="list-style-type: none"> <li>- Certified Internal Auditor (CIA)</li> <li>- Chartered Accountant (CA(SA))</li> <li>- Certified Control Self Assessment Auditor (CCSA)</li> <li>- Certified Financial Services Auditor (CFSA)</li> <li>- Certified Government Auditing Professional (CGAP)</li> <li>- Registered Auditor (RA)</li> <li>- Certified Information Systems Auditor (CISA)</li> <li>- Certified Professional Accountant (CPA)</li> <li>- Certification in Risk Management Assurance (CRMA)</li> <li>- Other</li> </ul>

The questions listed in the above-mentioned table will be discussed in detail.

*Profile overview of the participants in this research study (Part A – Questions 1, 2, & 3)*



## Objective:

The objective of this section was to create an overview profile of the participants in this research study, with specific focus on the following characteristics:

- The number of years experience that the CAEs have had in an internal audit activity;
- the gender of the participants in this research study; and
- the qualification of the CAEs.

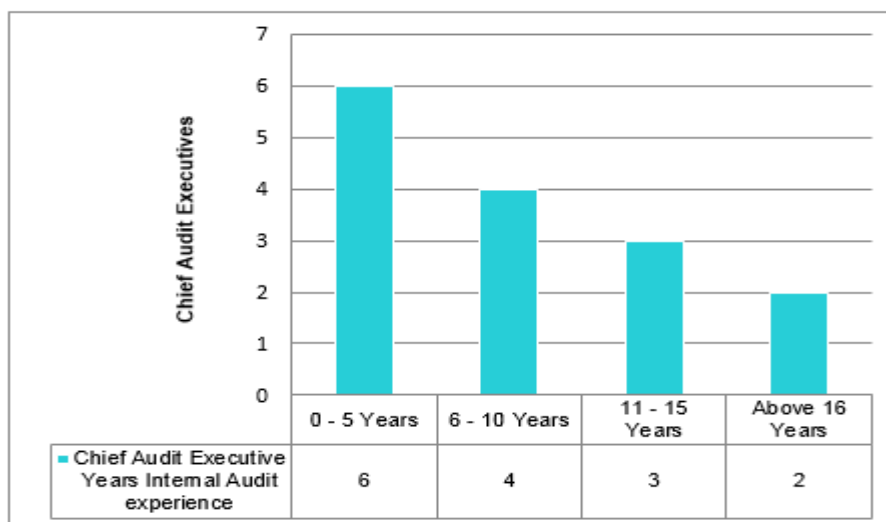
The purpose of the profile summary is to ensure that the information obtained from the participants in this study is relevant, representative and appropriate to address the research objective of this study.

## Results:

### Number of years experience of the participants:

Figure 12 presents the number of years' experience the participating CAE have had.

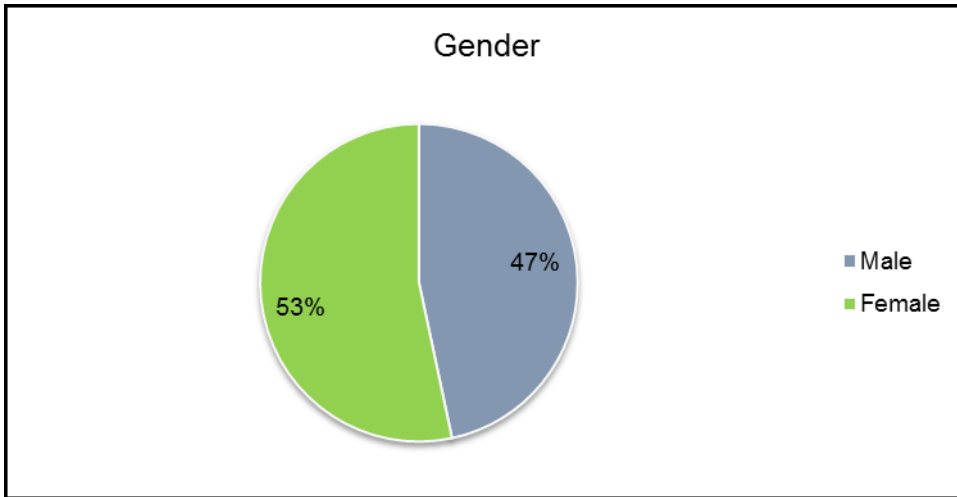
**Figure 12: Participants' total years of experience**



Gender of the participants:

The participants in the study were fairly represented between male and female. Figure 13 illustrates the proportions of males and females that participated in this research study.

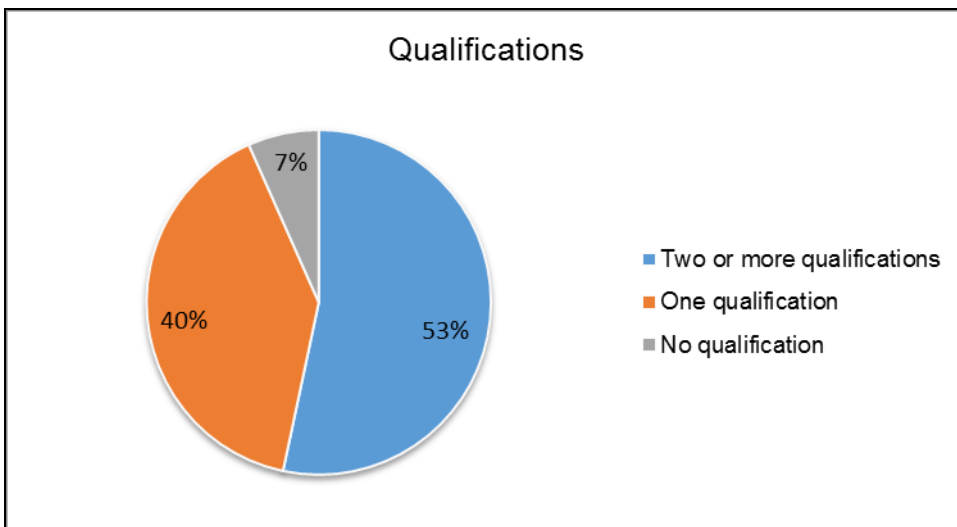
**Figure 13: Gender of the participants**



Qualifications of the participants:

Figure 14 presents the qualifications that the participating CAE have.

**Figure 14: Qualifications of the participants**



## 6.2.2 SUMMARISED FINDINGS ON DEMOGRAPHICS

The profile overview of the participants in this study revealed that the population had the following characteristics:

- The majority (66.66%) of the participants had between one (1) and ten (10) years' experience as CAEs of an internal audit department;
- the participants in the study were fairly evenly represented by gender: male (47 per cent) and female (53%); and
- the majority (93%) of the participants had one (1) or more qualifications.

It can therefore be concluded that the participants in this research study would be in a good position to provide reliable and representative information.

Appendix A contains the complete questionnaire. For the purposes of analysing the responses, the questions were grouped according to the study's research objectives that they relate to.

## 6.3 RESULTS: COMBINED ASSURANCE AND INTERNAL FINANCIAL CONTROLS

In order to achieve the objective of this study (as noted in Chapter 1) the following research objectives were developed to determine the following:

- To determine the relevance of internal financial controls within combined assurance;
- to determine the value of the written assessment of the effectiveness of internal financial controls within the financial services industry; and
- to determine whether the perceived relevance and value of the internal auditor's written assessment regarding the effectiveness of internal financial controls differs between companies within the financial services industry.

Table 4 displays the research objectives in relation to the questions in the research questionnaire in order to achieve the objective of this research study.

**Table 4: Research questions from the questionnaire in relation to the research objectives of this study**

Research Objective	Number as per the research questionnaire	Detail of the question
To determine the relevance of internal financial controls within combined assurance.	Part B: Question 1	Do you have a clear understanding of what the requirements of combined assurance are within an organisation?
	Part B: Question 2	How did you become aware of the requirement of the Internal Audit Activity to assess the effectiveness of internal financial controls within a combined assurance?
	Part B: Question 3	Do you have a combined assurance forum and/ or regular meeting in which your Internal Audit Activity actively participate?
	Part B: Question 4	In your view, how important is the role of the following parties within the organisation's combined assurance framework? (1 = Not Important - 5 = Extremely Important) <ul style="list-style-type: none"> <li>- Management</li> <li>- External audit</li> <li>- Internal audit</li> <li>- Risk department</li> <li>- Compliance department</li> <li>- Legal department</li> <li>- Forensic department</li> </ul>
	Part B: Question 5	Does the Chief Financial Officer and/ or Equivalent sign representation letters to confirm that they are not aware of any material misstatement?
	Part B: Question 6	Which of the following combined assurance models does your Internal Audit Activity make use of in the assessment of the effectiveness of internal financial controls? (Select only one) <ul style="list-style-type: none"> <li>- Assurance model: Assurance model can be defined as clear and direct reporting lines that facilitate sound internal financial controls where external and internal audit form the first line of assurance, followed by risk, forensic, compliance and legal etc. departments as the second line of assurance. Management will form the last line of assurance.</li> <li>- Defence Model: Defence model can be defined as clear and direct reporting lines that facilitate sound internal financial controls where management is the first line of defence. Within an organisation the risk, compliance, forensic and legal departments, for example, provide the second line of defence and the internal auditors the third. External audit and government regulators provide the last line of defence</li> <li>- Do not make use of any specific model</li> </ul>
	Part B: Question 7	What type of assurance does your Internal Audit Activity provide? (Select only one) <ul style="list-style-type: none"> <li>- Positive Assurance: Internal Audit Activity obtained reasonable assurance that the internal financial controls are operating effectively and efficiently and the financial statements are free from material misstatements.</li> <li>- Negative Assurance: No notable findings (other than what was reported) came to the Internal Audit Activity's attention that the internal financial controls are not operating effectively and efficiently.</li> </ul>
	Part B: Question 9 and Part C Question 13	The responses to the following two questions were combined to determine the view of the Chief Audit Executive (CAE) on the perceived maturity of their organisation's combined assurance process, and on the effectiveness of internal financial controls. (Maturity level is rated where 5 is most mature and 1 least mature) <ul style="list-style-type: none"> <li>- <i>In your view as the Chief Audit Executive (CAE), how mature is your combined assurance process?</i></li> <li>- <i>In your view as the Chief Audit Executive (CAE), how mature is your written assessment process pertaining to the effectiveness of internal financial controls? (Please rate the maturity level of your company's combined assurance process where 5 is most mature and 1 least mature)</i></li> </ul>
To determine the value of the written assessment of the effectiveness of internal financial controls within the financial services industry.	Part B: Question 8	In your view as the Chief Audit Executive, what is the importance of the involvement of the Internal Audit Activity within combined assurance in terms of the assessment of internal financial controls of the organisation (Select only one): <ul style="list-style-type: none"> <li>- The Internal Audit Activity owns the combined assurance process and is primarily and solely responsible for the combined assurance process</li> <li>- The Internal Audit Activity should assist management in documenting the internal financial controls. Management and the Internal Audit Activity play a dual role in the implementation of internal financial controls and are dually responsible for the combined assurance process</li> <li>- The Internal Audit Activity should perform the written assessment on internal financial control and the Internal Audit Activity manages the process of combined assurance in an advisory role capacity</li> </ul>

Research Objective	Number as per the research questionnaire	Detail of the question
		- The Internal Audit Activity can be excluded from the combined assurance process
	Part C: Question 7b	In your view as a Chief Audit Executive (Please answer all the questions below): - Your Internal Audit Activity is adding value to the organisation by providing a written assessment on the effectiveness of internal financial controls.
	Part C: Question 7c	In your view as a Chief Audit Executive (Please answer all the questions below): - Your Internal Audit Activity is significantly removed from management and objective enough to perform this assessment.
	Part C: Question 7d	In your view as a Chief Audit Executive (Please answer all the questions below): - Your Internal Audit Activity is capable and skilled to perform a written assessment on the effectiveness of the companies' internal financial controls.
	Part C: Question 9 a-d	Your Internal Audit Activity written assessment on the effectiveness of internal financial controls is derived from the following (Please answer all the below questions): - The evaluation/ assessment is done on the agreed and documented internal financial controls for effectiveness of design - The evaluation/ assessment is done on the agreed and documented internal financial controls for effectiveness of implementation - The evaluation/ assessment is done on the agreed and documented internal financial controls for effectiveness of operation - The Internal Audit Activity performs specific testing of internal financial controls. These results are then communicated
To determine whether the perceived relevance and value of the internal auditor's written assessment regarding the effectiveness of internal financial controls differs between companies within the financial services industry..	Part C: Question 1 Part C: Question 7a	Does your Internal Audit Activity provide a written assessment of the effectiveness of the organisation's internal financial controls?
	Part C: Question 2	To which of the following parties are the results of the written assessment of the effectiveness of internal financial controls communicated? - Senior Management - Board of Directors - Audit Committee - External Audit - Other
	Part C: Question 3	How often is the written assessment performed? - Monthly - Quarterly - Bi-annually - Annually
	Part C: Question 6	What is the end result of the written assessment performed by the Internal Audit Activity of the effectiveness of internal financial controls? (Select only one) - Formal written assessment i.e. in line with the requirements of the King III Report: Formal written assessment in the form of a separate report/memorandum/control self-assessment etc. specifically in terms of the effectiveness of internal financial controls - Informal written assessment i.e. apply judgement based on the audit work performed during the annual audit plan: Informal written assessment as part of the risk-based audits performed during the year. The assessments on the effectiveness of internal financial controls are included as a separate section in the audit reports. - No written assessment - Other
	Part C: Question 10	Is your Internal Audit Activity addressing the significant risks relating to material misstatement pertaining to internal financial controls?
	Part C: Question 4	What percentage of the annual audit plan is spent on the assessment of internal financial controls? - 0-25% - 26%-50% - 51%-75% - 76%-100%
	Part C: Question 5	In your view as the Chief Audit Executive, do you feel that the percentage of coverage of the assessment of internal financial controls are adequate (refer to Question 4, Part C)?
	Part C: Question 7e - f	In your view as a Chief Audit Executive (Please answer all the questions below): - The written assessment has enough detail for a prudent person to reach similar conclusions. - The written assessment is done in a timely manner?
	Part C: Question 8	In your view as the Chief Audit Executive, what are the important skills needed in your Internal Audit Activity to perform the written assessment on the effectiveness of internal financial controls?
	Part C: Question	Does external audit rely on the work performed by internal audit pertaining to the assessment of the

Research Objective	Number as per the research questionnaire	Detail of the question
	11	effectiveness of internal financial controls?
	Part C: Question 12	When does external audit place the most reliance on the work performed by internal audit pertaining to the assessment of the effectiveness of internal financial controls?

The questionnaire's results in relation to the research objectives will be the next focus of the chapter.

### 6.3.1 RESEARCH OBJECTIVES

#### 6.3.1.1 Relevance of internal financial controls within combined assurance

The following section will provide feedback pertaining to the perceived relevance of internal financial controls within a combined assurance milieu as viewed by this research study's participating CAEs. (Table 9 contains more details on the questions.)

*Do you have a clear understanding of what the requirements of combined assurance are within an organisation? (Part B – Question 1)*

#### Results:

One hundred per cent of the participants in the study positively confirmed that they had a clear understanding of what the requirements of combined assurance were within the organisation.

*How did you become aware of the requirement of the Internal Audit Activity to assess the effectiveness of internal financial controls within a combined assurance? (Part B – Question 2)*

Results:

The King III Report on Corporate Governance was identified by 100 per cent of the participants in the study as their primary source of information on the requirement that the internal audit activity assesses the effectiveness of internal financial controls. Other resources quoted as assisting with creating the respondents' awareness of the requirements of the internal audit activity included the following:

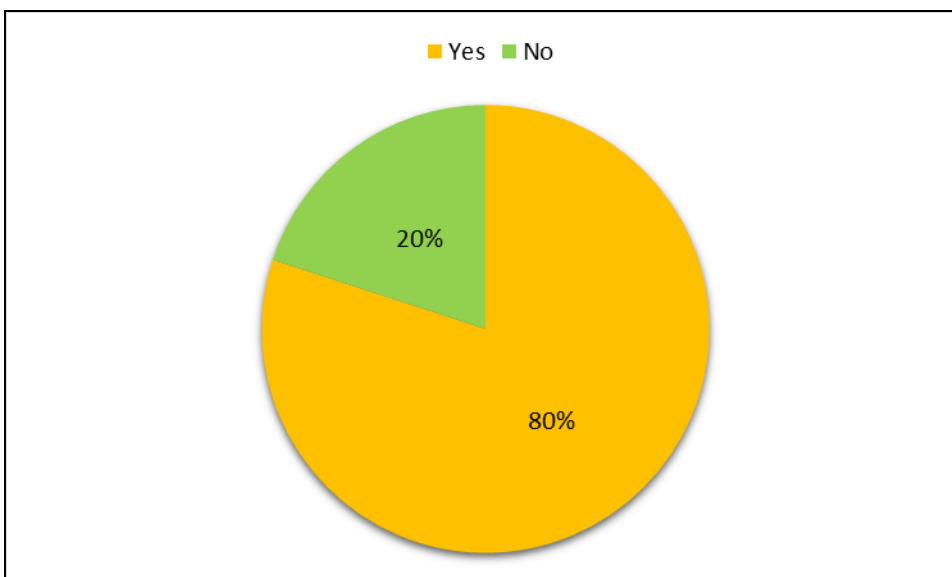
- Publications and other material provided by the IIA;
- training, courses and information session provided by private auditing firms; and
- legislation, regulations and other Acts that were applicable to corporate governance.

*Do you have a combined assurance forum and/ or regular meeting in which your Internal Audit Activity participates actively? (Part B - Question 3)*

Results:

Figure 15 illustrates the existence of a combined assurance forum and / or function in which the participant's internal audit activity participates actively.

**Figure 15: Combined assurance forum**



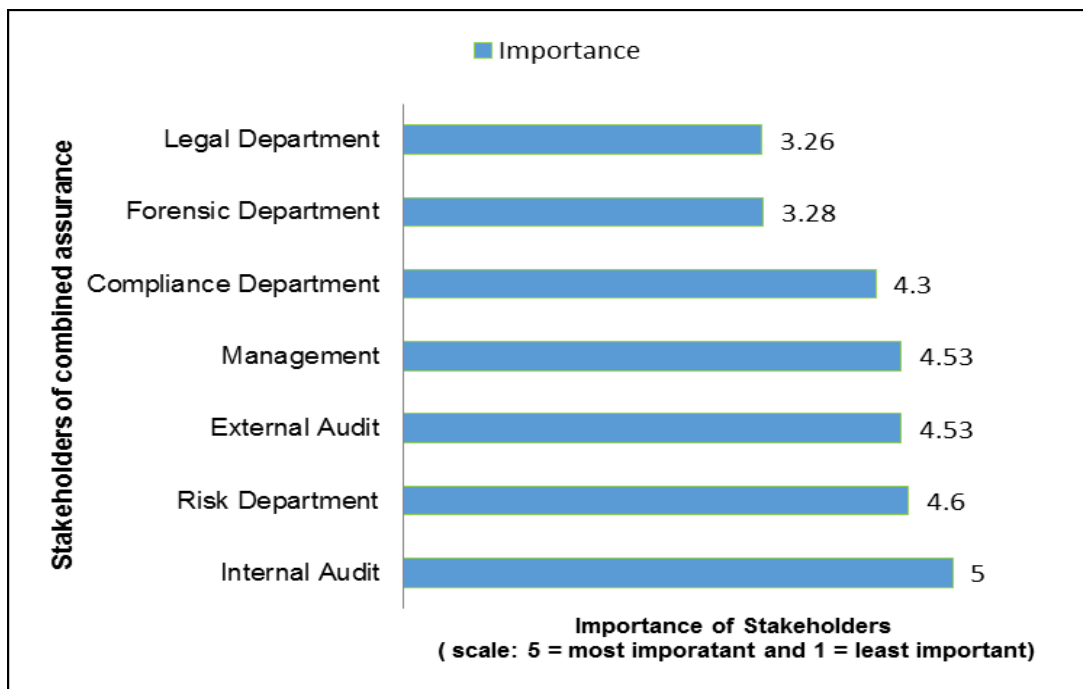
*In your view, how important is the role of the following parties within the organisation's combined assurance framework? (1 = Not Important - 5 = Extremely Important) (Part B – Question 4)*

*Management; External audit; Internal audit; Risk department; Compliance department; Legal department; Forensic department*

Results:

Figure 16 indicates the relative importance of the combined assurance stakeholders within the organisation.

**Figure 16: Importance of combined assurance stakeholders**



*Does the Chief Financial Officer and/ or Equivalent sign representation letters to confirm that they are not aware of any material misstatement (Part B – Question 5)*



Results:

One hundred per cent of the participants in the study positively confirmed that the Chief Financial Officer (CFO) and / or equivalent signs representation letters to confirm that they are not aware of any material misstatement pertaining to the organisation's financial statements.

*Which of the following combined assurance models does your Internal Audit Activity make use of in the assessment of the effectiveness of internal financial controls? (Select only one) (Part B – Question 6)*

**Assurance model:** Assurance model can be defined as clear and direct reporting lines that facilitate sound internal financial controls where external and internal audit form the first line of assurance, followed by risk, forensic, compliance and legal, and so forth. departments as the second line of assurance. Management will form the last line of assurance.

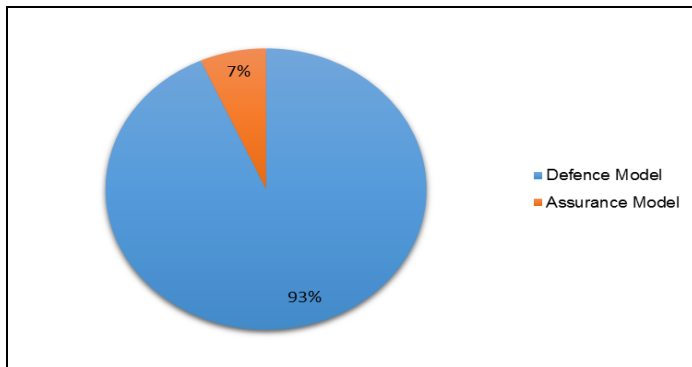
**Defence Model:** Defence model can be defined as clear and direct reporting lines that facilitate sound internal financial controls where management is the first line of defence. Within an organisation the risk, compliance, forensic and legal departments, for example, provide the second line of defence and the internal auditors the third. External audit and government regulators provide the final line of defence

*Do not make use of any specific model*

Results:

The current two combined assurance models, assurance and defence, as discussed in Chapter Three, were assessed through this research study. Figure 17 graphically illustrates the usage of these combined assurance models within the participant's internal audit activity.

**Figure 17: Combined assurance models**



*What type of assurance does your Internal Audit Activity provide? (Select only one)*  
*(PART B – QUESTION 7)*

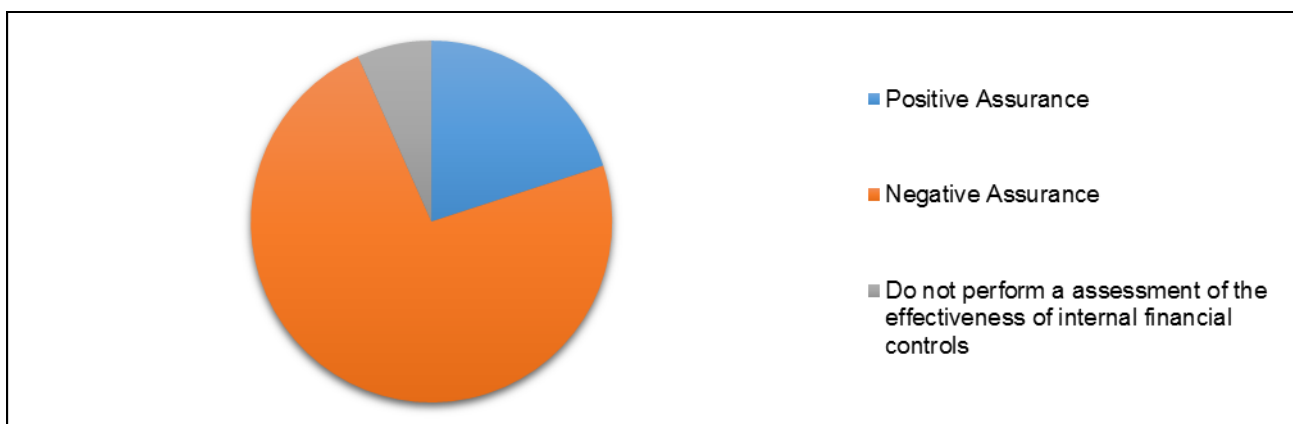
**Positive Assurance:** Internal Audit Activity obtained reasonable assurance that the internal financial controls are operating effectively and efficiently and the financial statements are free from material misstatements.

**Negative Assurance:** No notable findings (other than what was reported) come to the Internal Audit Activity's attention that the internal financial controls are not operating effectively and efficiently.

Results:

Figure 18 presents the type of combined assurance that is provided by the participants' internal audit activities.

**Figure 18: Type of assurance**



*Chief Audit Executives view on the maturity of the organisation’s combined assurance and the written assessment process of internal financial controls. (PART B – QUESTION 9 AND PART C – QUESTION 13)*

Results:

Figure 19 presents the organisation’s maturity pertaining to the written assessment of the effectiveness of internal financial controls. The frequency factor of the chart indicates the percentage of organisations in the research study as a percentage of all.

**Figure 19: Organisation’s maturity pertaining to the written assessment of the effectiveness of internal financial controls**

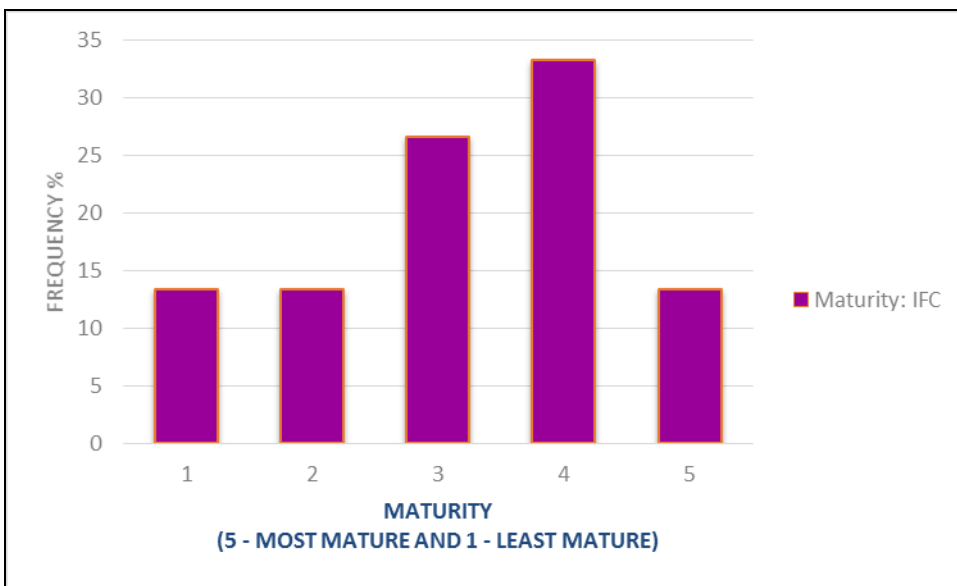


Figure 20 presents the organisation’s maturity as it pertains to the combined assurance process. The frequency factor of the chart indicates the percentage of organisations in the research study as a percentage of all.

**Figure 20: Organisation’s maturity pertaining to the combined assurance process**

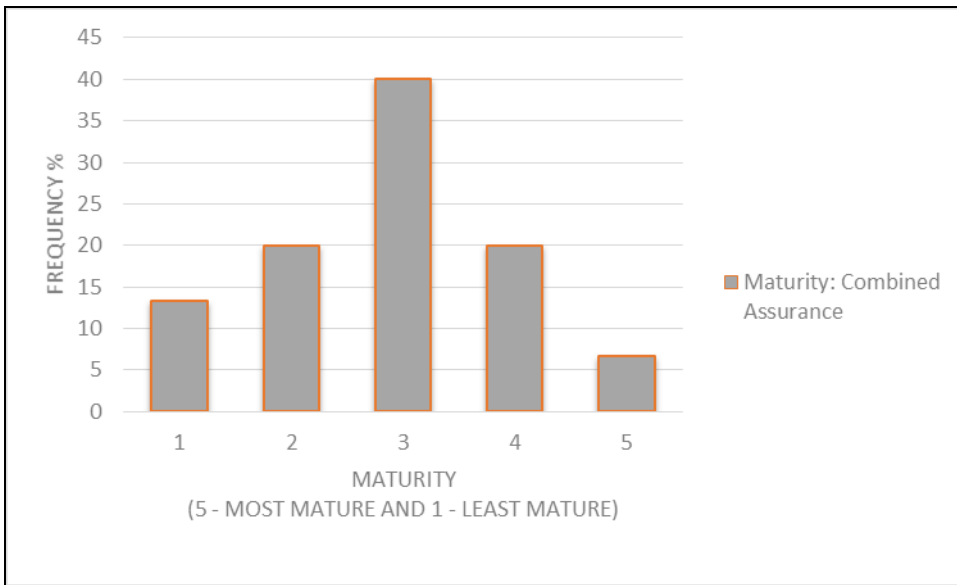
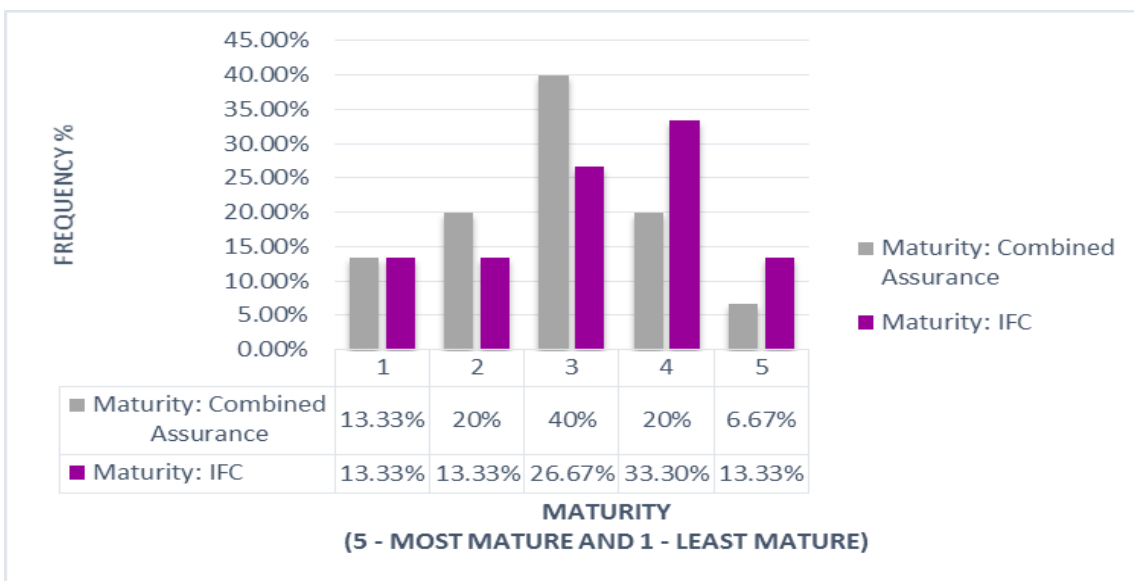


Figure 21 presents the combined view of the organisation’s maturity pertaining to the written assessment of the effectiveness of internal financial controls and the combined assurance process. The frequency factor of the chart indicates the percentage of organisations in the research study as a percentage of all.

**Figure 21: Combined view of the organisation’s maturity pertaining to the written assessment of the effectiveness of internal financial controls and combined assurance processes**



### 6.3.1.2 Summary and conclusion: relevance of internal financial controls within combined assurance

*Summary: relevance of internal financial controls within combined assurance*

All participants (100 per cent) in this study confirmed that they had a **clear understanding** of what are the requirements of combined assurance within an organisation. A clear understanding of combined assurance is essential when assessing the relevance of internal audit in respect of combined assurance.

The **primary reference source** that was identified as having raised the respondents' awareness of the requirement that the internal audit activity assesses the effectiveness of internal financial controls was the King III Report. Chapter 2 of this research study has discussed the significant impact of the King III Report on the assessment of the effectiveness of internal financial controls

Internal auditing was identified as the **most important role player** within combined assurance, followed by risk management, external auditing, management, compliance department, forensic department and legal department. All the various combined assurance role players are closely connected within combined assurance and this provides another building block in the process of establishing the relevance of the assessment of the effectiveness of internal financial controls.

The majority (80 per cent) of the participants in this research study indicated that their internal audit activity **participates actively in a combined assurance forum and/ or function**. Therefore, it can be concluded that combined assurance is receiving the necessary attention within the organisation. A combined assurance forum is "*appropriate to the matter at hand*" (Oxford dictionary 2002:528) and supports the research objectives pertaining to relevance.

The majority (93 per cent) of the participants in this research study indicated that they make use of the **defence combined assurance model** to assess the effectiveness of

internal financial controls. Based on this result it can be concluded that the model that has been used to assess the internal financial controls is relevant for the purpose of this study.

The majority (73 per cent) of the participants in this research study indicated that their internal audit activity provides **negative assurance** pertaining to the effectiveness of internal financial controls. Negative assurance is based on the generalisation in terms of the sample selected by the internal audit activity no notable adverse findings were identified pertaining to the effectiveness of internal financial controls. This may be seen as another building block towards achieving the objective of this research question pertaining to establishing the relevance of internal financial controls within combined assurance.

The majority of the participants in the research study indicated that their **organisation's maturity** with respect to written assessment of the effectiveness of internal financial controls was more advanced than the maturity of the organisation's combined assurance process. Based on the above-mentioned results, it can be concluded that internal financial controls have been assessed in the past as part of other process type audits and therefore have become a more mature process within the organisation. It can also be concluded that combined assurance is a less developed principle within the organisation, and as a result is a less mature practice within the organisation. Both internal financial controls and combined assurance have room to improve because neither of these concepts are at an optimal maturity level (refer to Figure 21 for detail).

*Conclusion: relevance of internal financial controls within combined assurance*

The internal audit activity plays an important role within the organisation by assessing the effectiveness of internal financial controls. The internal audit activity provides an assessment of the effectiveness of internal financial controls based on the combined assessments of the various assurance providers. In other words, the assessment of the effectiveness of internal financial controls is relevant within combined assurance.

### 6.3.1.3 Value of the written assessment of the effectiveness of internal financial controls

The following section provides feedback pertaining to the value of the written assessment of the effectiveness of internal financial controls as viewed by the CAEs that participated in this research study.

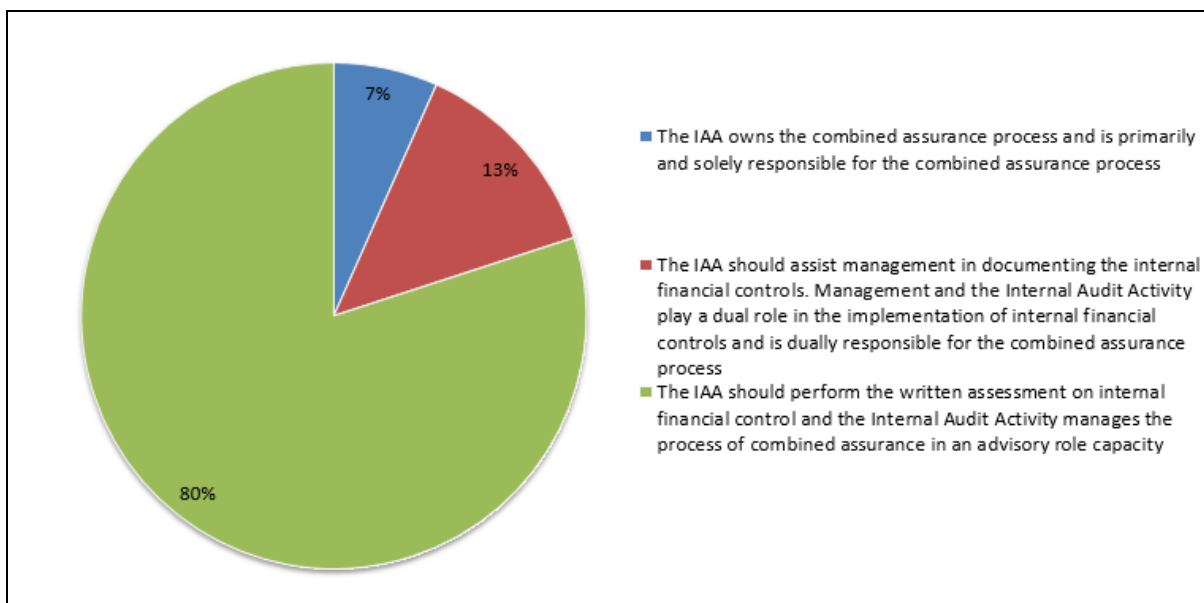
*In your view as the Chief Audit Executive, what is the importance of the involvement of the Internal Audit Activity within combined assurance in terms of the assessment of internal financial controls of the organisation (Select only one): (PART B – QUESTION 8)*

- *The Internal Audit Activity owns the combined assurance process and is primarily and solely responsible for the combined assurance process*
- *The Internal Audit Activity should assist management in documenting the internal financial controls. Management and the Internal Audit Activity play a dual role in the implementation of internal financial controls and is dually responsible for the combined assurance process*
- *The Internal Audit Activity should perform the written assessment on internal financial control and the Internal Audit Activity manages the process of combined assurance in an advisory role capacity*
- *The Internal Audit Activity can be excluded from the combined assurance process*

#### Results:

Figure 22 presents the importance of the involvement of the internal audit activity within combined assurance in relation to the written assessment of the effectiveness of internal financial controls.

**Figure 22: Responsibility the IAA within combined assurance in relation to the assessment of the effectiveness of internal financial controls**

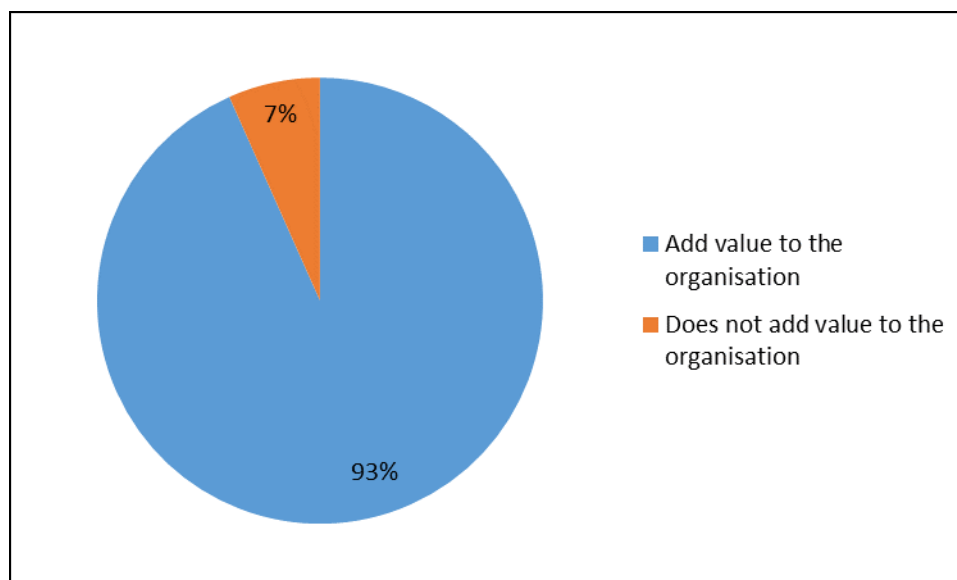


*In your view as a Chief Audit Executive : Your Internal Audit Activity is adding value to the organisation by providing a written assessment on the effectiveness of internal financial controls (PART C – QUESTION 7B)*

**Results:**

Figure 23 displays the value that the IAA is adding to the operations of the organisation by performing a written assessment on the effectiveness of internal financial controls, based on the views of the participants in this research study.

**Figure 23: Value adding with respect to the written assessment of the effectiveness of internal financial controls**



*In your view as a Chief Audit Executive : Your Internal Audit Activity is significantly removed from management and objective enough to perform this assessment (PART C – QUESTION 7C)*

**Results:**

All (100 per cent) of the participants in this research study indicated that their internal audit activity is sufficiently removed from management to be objective enough to perform the written assessment of the effectiveness of internal financial controls.



*In your view as a Chief Audit Executive : Your Internal Audit Activity is capable and skilled to perform the written assessment on the effectiveness of the companies' internal financial controls (PART C – QUESTION 7D)*

**Results:**

All (100 per cent) of the participants in this research study indicated that their internal audit activity is sufficiently capable and skilled to perform the written assessment of the effectiveness of internal financial controls.

*Your Internal Audit Activity's written assessment on the effectiveness of internal financial controls is derived from the following (Please answer all the questions below): (PART C – QUESTION 9 A-D)*

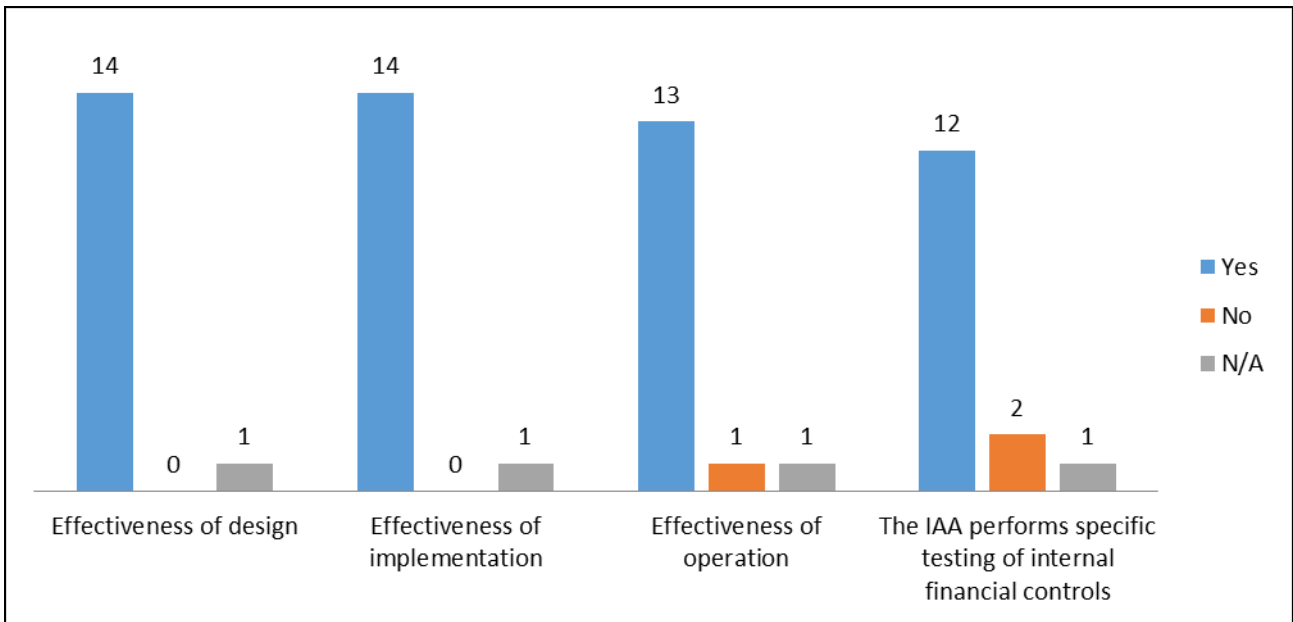
- *The evaluation/ assessment is done on the agreed and documented internal financial controls for effectiveness of design*
- *The evaluation/ assessment is done on the agreed and documented internal financial controls for effectiveness of implementation*
- *The evaluation/ assessment is done on the agreed and documented internal financial controls for effectiveness of operation*
- *The Internal Audit Activity performs specific testing of internal financial controls. These results are then communicated*

**Results:**

Figure 24 displays the responses to the above propositions related to how the final written assessment of the effectiveness of internal financial controls is derived. The assessment specifically focuses on the following:

- Effectiveness of design;
- effectiveness of implementation;
- effectiveness of operation; and
- whether the internal audit activity performs specific testing of the internal financial controls and communicates the results to the relevant parties.

**Figure 24: The written assessment of the effectiveness of internal financial controls**



**6.3.1.4 Summary and conclusion: value of the written assessment of the effectiveness of internal financial controls**

*Summary: value of the written assessment of the effectiveness of internal financial controls*

The majority (80 per cent) of the participants in this study indicated that the **internal audit activity should prepare the written assessment** on the effectiveness of internal financial controls, and should be done in an advisory capacity.

The majority (93 per cent) of the participants indicated that the internal audit activity **adds value** to the organisation by providing a written assessment of internal financial controls.

All (100 per cent) of the participants in this research study indicated that they are **significantly removed from management** and therefore sufficiently objective to perform the written assessment of the effectiveness of internal financial controls.

The entire population (100 per cent) indicated that their internal audit activity is **capable and sufficiently skilled** to perform the written assessment of the effectiveness of internal financial controls.

The results of this research study show that the majority of the participants in this research study believe that the value of the written assessment on the effectiveness of internal financial controls was achieved as a result of the **effectiveness of its design, implementation and operation**. It was further noted that **specific internal financial control testing** was performed to assess the effectiveness of internal financial controls.

*Conclusion: value of the written assessment of the effectiveness of internal financial controls*

The internal audit activity adds value to the organisation by performing a written assessment of the effectiveness of internal financial controls.

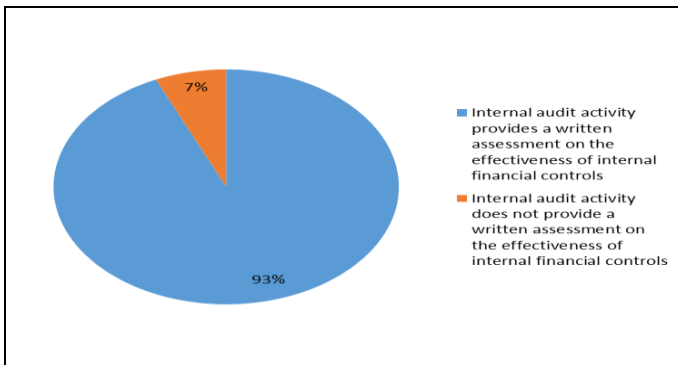
**6.3.1.5 To determine whether the perceived relevance and value of the internal auditor's written assessment of the effectiveness of internal financial controls differs between companies within the financial services industry.**

*Does your Internal Audit Activity provide a written assessment of the effectiveness of the organisation's internal financial controls? (PART C – QUESTION 1 AND 7A)*

**Results:**

Figure 25 indicates the number of the participants' internal audit activities that provide a written assessment of the effectiveness of organisation's internal financial controls.

**Figure 25: Written assessment of the effectiveness of internal financial controls**



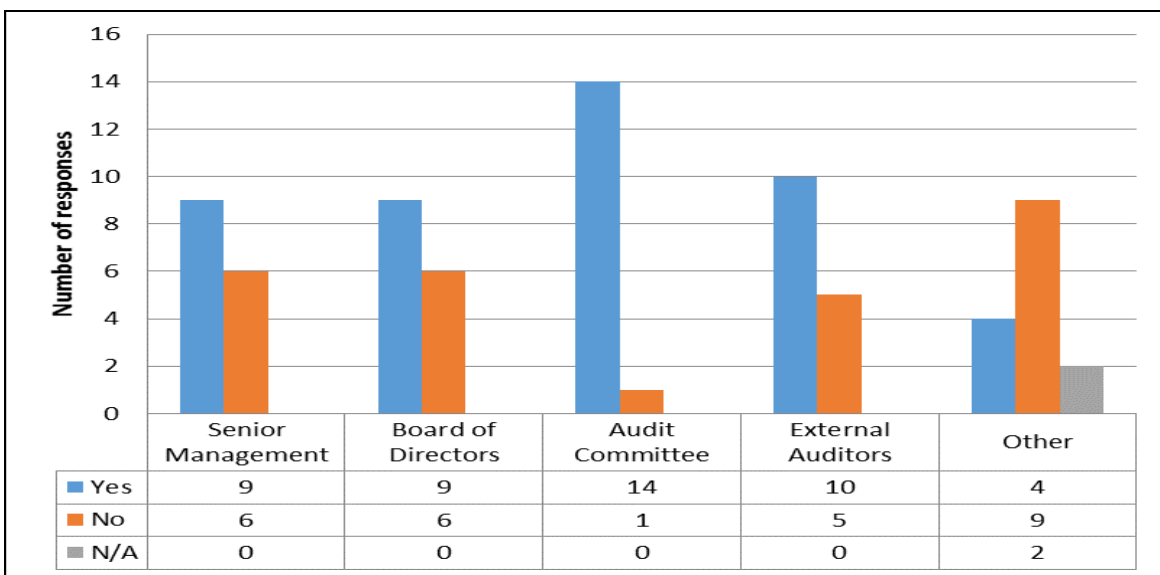
*To which of the following parties are the results of the written assessment of the effectiveness of internal financial controls communicated? (PART C – QUESTION 2)*

- Senior Management
- Board of Directors
- Audit Committee
- External Audit
- Other

Results:

Figure 26 indicates the recipients of the results of the written assessment on the effectiveness of internal financial controls.

**Figure 26: Recipients of the results of the written assessment of the effectiveness of internal financial controls**



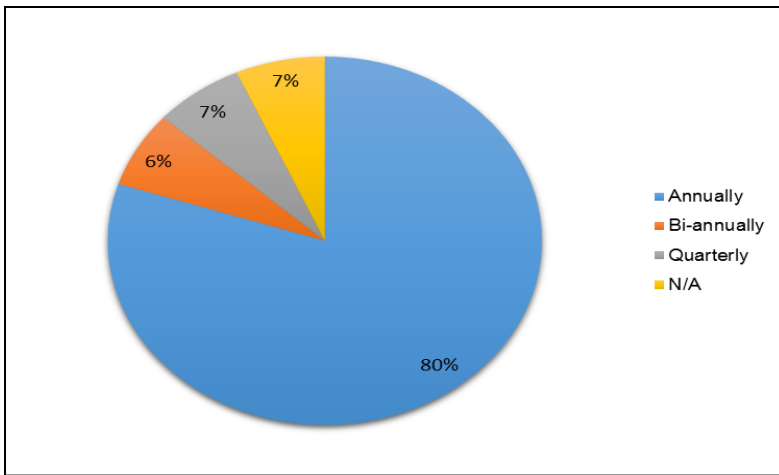
How often is the written assessment performed? (PART C – QUESTION 3)

- Monthly; Quarterly; Bi-Annually; Annually

**Results:**

Figure 27 indicates the frequency that the written assessment on the effectiveness of internal financial controls is performed.

**Figure 27: Frequency of preparation of the written assessment of the effectiveness of internal financial controls**



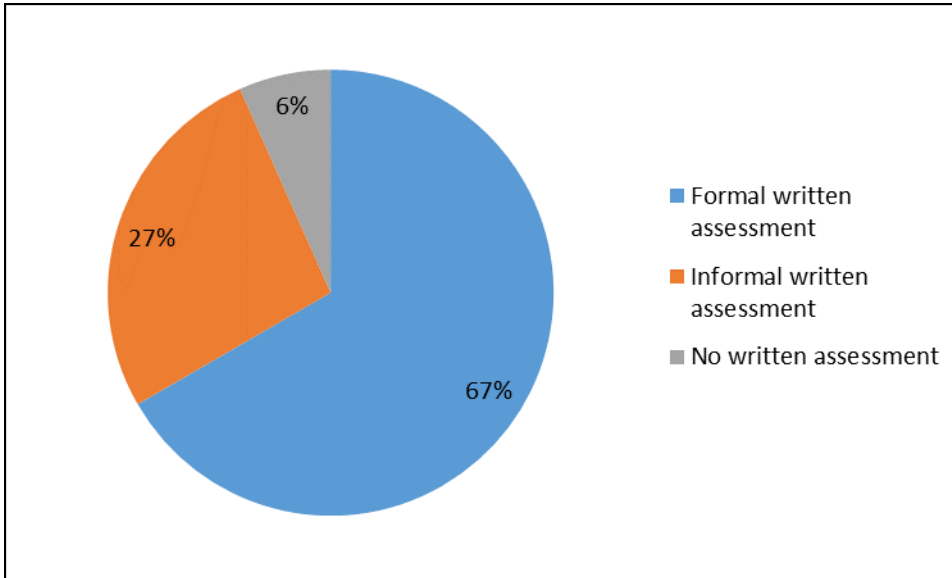
What is the end result of the written assessment performed by the Internal Audit Activity of the effectiveness of internal financial controls? (Select only one) (PART C – QUESTION 6)

- Formal written assessment i.e. in line with the requirements of the King III Report: Formal written assessment in the form of a separate report/memorandum/control self-assessment, and so forthc. specifically in terms of the effectiveness of internal financial controls
- Informal written assessment i.e. apply judgement based on the audit work performed during the annual audit plan: Informal written assessment as part of the risk based audits performed during the year. The assessments on the effectiveness of internal financial controls are included as a separate section in the audit reports.
- No written assessment
- Other

Results:

Figure 28 indicates the outcome of the written assessment that is performed on the effectiveness of internal financial controls.

**Figure 28: Outcome of the written assessment of the effectiveness of internal financial controls**

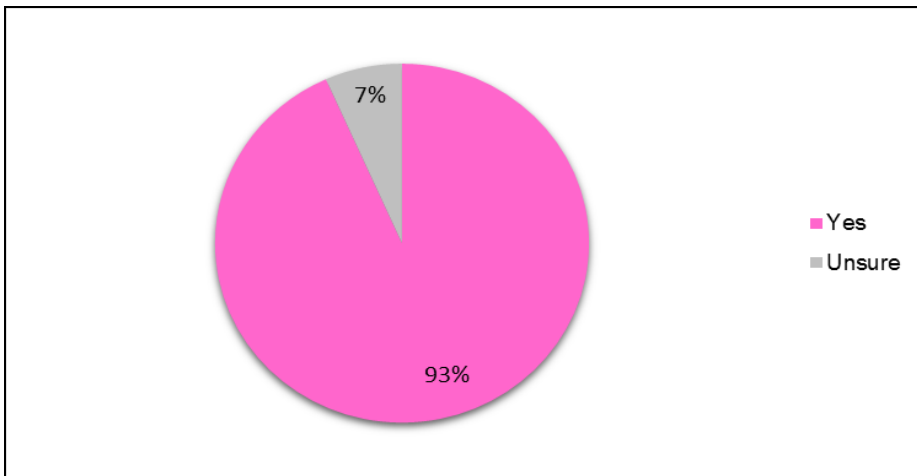


*Is your Internal Audit Activity addressing the significant risks relating to material misstatement pertaining to internal financial controls? (PART C – QUESTION 10)*

Results:

Figure 29 represents the views of the participating CAEs on how the assessment of the effectiveness of internal financial controls is addressing the organisations' significant risks to material misstatement.

**Figure 29: Does the written assessment of the effectiveness of internal financial controls address the organisation’s significant risks pertaining to material misstatement**



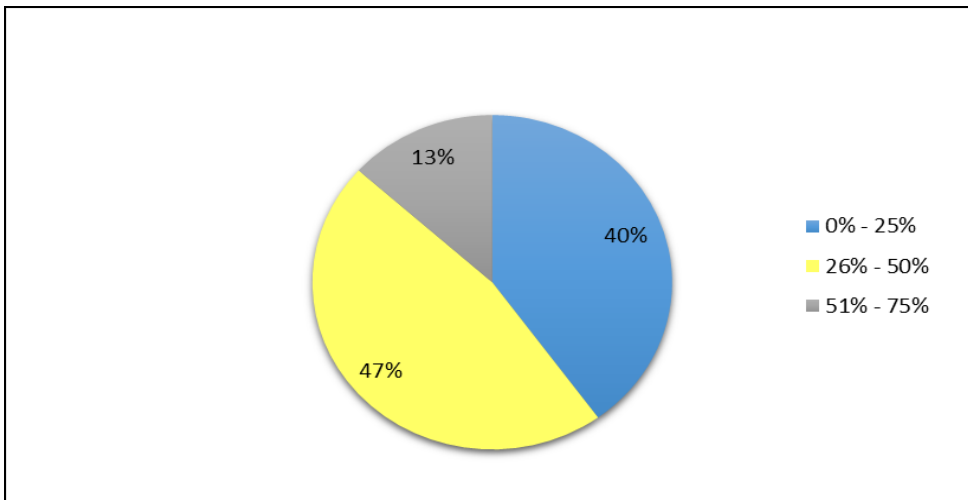
*What percentage of the annual audit plan is spent on the assessment of internal financial controls? (PART C – QUESTION 4)*

- 0-25%
- 26%-50%
- 51%-75%
- 76%-100%

**Results:**

Figure 30 presents the amount of time allocated in the annual audit plan, for the participant’s internal audit activity to spend on the assessment of the effectiveness of internal financial controls.

**Figure 30: Amount of audit time spent on the written assessment of the effectiveness of internal financial controls**

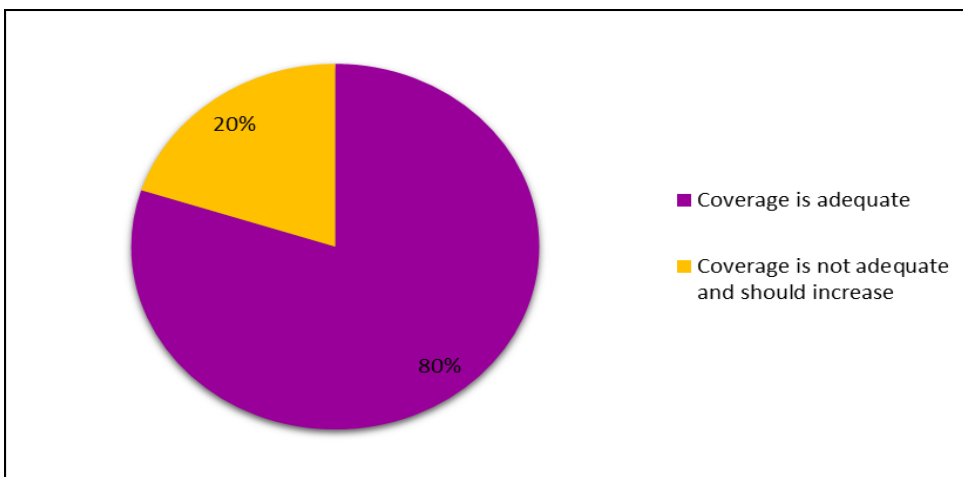


*In your view as the Chief Audit Executive, do you feel that the percentage of coverage of the assessment of internal financial controls is adequate (refer to Question 4, Part C)? (PART C – QUESTION 5)*

**Results:**

Figure 31 presents the views of the CAEs on the adequacy of coverage of the assessment of the effectiveness of internal financial controls within the annual audit plan.

**Figure 31: Adequacy of coverage of the annual audit plan spent on the assessment of internal financial controls**





*In your view as a Chief Audit Executive :(Part C – Question 7e - f)*

- *The written assessment has enough details for a prudent person to reach similar conclusions.*
- *The written assessment is done in a timely manner?*

### Results:

All (100 per cent) of the participants in the research study indicated that the written assessment of the effectiveness of internal financial controls is done in a timely manner and has enough details for a prudent person to reach similar conclusions.

*In your view as the Chief Audit Executive, what are the important skills needed in your Internal Audit Activity to perform the written assessment on the effectiveness of internal financial controls? (PART C – QUESTION 8)*

### Results:

Bearing in mind that the focus of the research study was on the financial services industry, the participants in this research study indicated that the following skills are needed to perform the written assessment of the effectiveness of internal financial controls:

- A combination of financial and operational skills pertaining to the company;
- being subject experts with specifically actuarial backgrounds;
- being subject experts with accountancy backgrounds: i.e., chartered accountants with IFRS knowlegde;
- having sufficient understanding of the audit universe and the organisation's internal financial controls; and
- having financial control knowledge.

*Does external audit rely on the work performed by internal audit pertaining to the assessment of the effectiveness of internal financial controls? (PART C – QUESTION 11)*

### Results:

The majority (93.33 per cent) of the participants in this research study indicated that external audit does rely on the work performed by internal audit, as it pertains to the

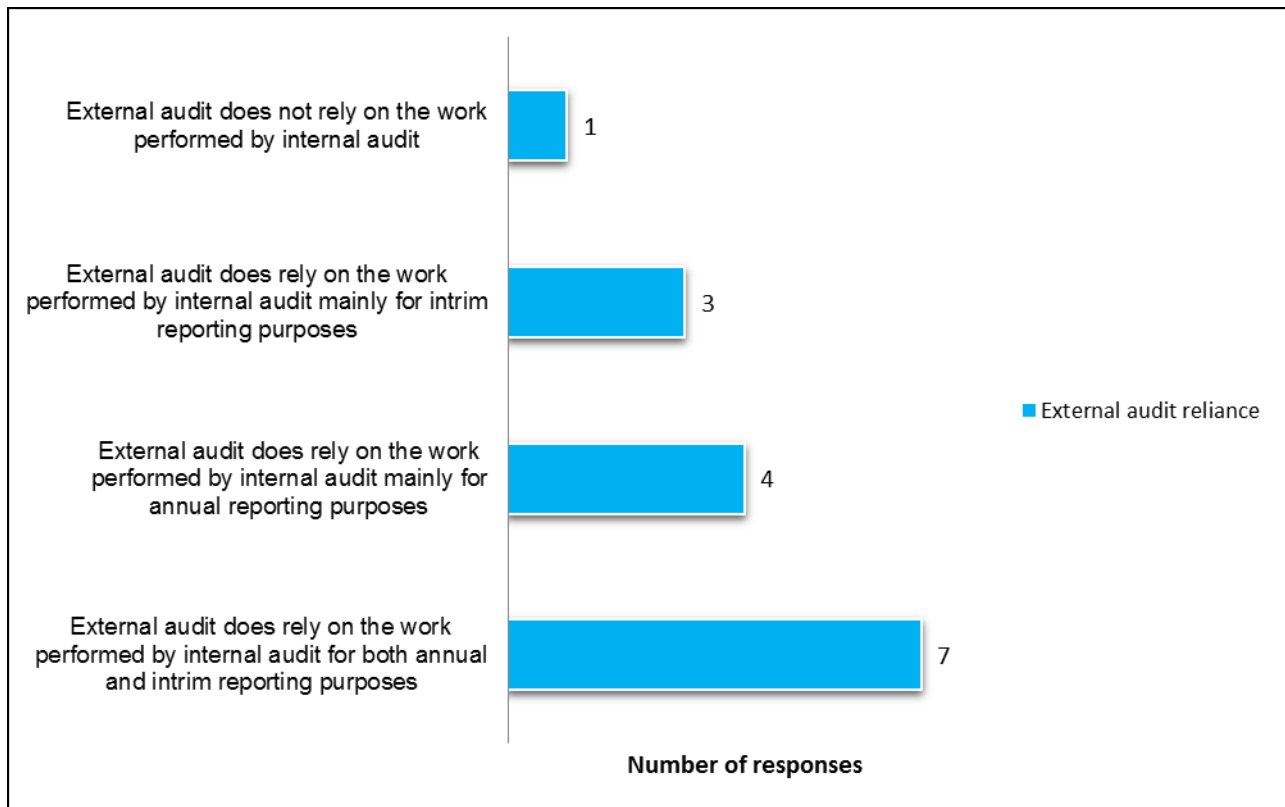
assessment of the effectiveness of internal financial controls. One (6.67 per cent) of the participants indicated that no reliance is placed on the work performed by internal audit pertaining to the assessment of the effectiveness of internal financial controls by external auditors.

*When does external audit place the most reliance on the work performed by internal audit pertaining to the assessment of the effectiveness of internal financial controls? (PART C – QUESTION 12)*

**Results:**

Figure 32 presents the number of respondents whose external auditors place varying degrees of reliance on the work performed by internal audit with regard to the assessment of internal financial controls.

**Figure 32: Reliance placed by external audit on the work performed by internal audit pertaining to the written assessment of the effectiveness of internal financial controls**



**6.3.1.6 Summary and conclusion: the differences in perceived relevance and value of the written assessment regarding the effectiveness of internal financial controls within the financial services industry**

*Summary: the differences in perceived relevance and value of the written assessment regarding the effectiveness of internal financial controls within the financial services industry based on the view of the CAE.*

The majority (93 per cent) of the participants in the study indicated that their internal audit activity **performs a written assessment** on the effectiveness of internal financial controls.

The **results of the written assessment** regarding the effectiveness of internal financial controls are communicated to Senior Management, the Board of Directors, the Audit Committee and External Audit.

The majority (80 per cent) of the participants in this study indicated that the written assessment on the effectiveness of internal financial controls is performed on an **annual basis** and the majority (67 per cent) of the participants in this research study indicated that the written **assessment** of the effectiveness of internal financial controls does in fact become a formal written document (see Figure 27). The written assessment is in the form of a separate report/memorandum/control self-assessment.

The majority (93 per cent) of the participants in this study indicated that they **are addressing the significant risks** relating to material misstatement pertaining to internal financial controls by performing a written assessment.

Sixty per cent of the participants in this research study indicated that the percentage coverage of internal financial controls within the annual audit plan is **between 26 per cent to 75 per cent** and 80 per cent of the participants in this research study indicated that the internal audit plan **coverage** in terms of internal financial controls **is adequate**.

All (100 per cent) of the participants indicated that the written assessment is delivered in a **timely manner**.

The participants in this research study indicated that **financial control knowledge** is one of the most important characteristics required to assess the effectiveness of internal financial controls.

The majority (93.33 per cent) of the participants in this study indicated that **external audit does place reliance** on the work performed by the internal audit activity for **both interim and annual reporting purposes**.

*Conclusion: the differences in perceived relevance and value of the written assessment regarding the effectiveness of internal financial controls within the financial services industry based on the view of the CAE.*

Based on the results noted it may be concluded that it is important and relevant to perform a written assessment on the effectiveness of internal financial controls because it will assist the organisation to mitigate the significant risks relating to material misstatement. It may further be concluded that due to the large amount of the annual audit time spent on this assessment as well as the reliance that is placed by external audit on the work performed by internal audit, the written assessment regarding the effectiveness of internal financial controls is valuable to the organisation.

## 6.4 SUMMARY AND CONCLUSION

To achieve the objective of this study various questions were directed to participating CAEs within the financial services industry. The objective of this study is to analyze the perceived relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment within the financial services industry from the CAE's perspective.

The research questionnaire was divided into three sections namely:

- Participant's profile overview;
- combined assurance; and
- internal financial controls.

Firstly, the participants' profiles were analysed. Based on the results of the demographics it could be concluded that the information presented by the participants, would make their information reliable and appropriate for the purpose of this study.

The sections of the research questionnaire relating to combined assurance and internal financial controls were analysed in the sequence of the study's research questions.

The first research question that was discussed related to the relevance of internal financial controls within combined assurance. It was noted that the IAA plays an important role within the organisation by assessing the effectiveness of internal financial controls based on the combined assurance of the various assurance providers. In other words, the assessment regarding the effectiveness of internal financial controls is relevant and belongs within combined assurance.

The second research question referred to the value of the written assessment of the effectiveness of internal financial controls. Based on these results the view of the participants in this research study indicated that the IAA does add value to the organisation by performing a written assessment of the effectiveness of internal financial controls.

The differences in perceived relevance and value of the written assessment regarding the effectiveness of internal financial controls within the financial services industry was the final research question that was analysed in this study. As discussed in Chapter Four of this study, internal audit performs risk based auditing. It is evident in the results that combined assurance and the written assessment regarding the effectiveness of internal financial controls can be used to address various issues within the organisation and can assist the organisation to mitigate the significant risks relating to material misstatement. There can further be concluded that the written assessment regarding the effectiveness of internal financial controls is seen as valuable because a large amount of the annual audit time is spend on this assessment. It was indicated that 60 per cent of the participants in this research study spent between 26 per cent to 75 per cent of their annual audit time on the written assessment regarding the effectiveness of internal financial controls. It was

further noted by 93.33 per cent of the participants in this study that external audit relies on the work performed by internal audit for interim and/ or annual reporting purposes.

## SUMMARY AND CONCLUSION

“YOU CAN PAINT IT IN ANY COLOUR, AS LONG AS IT’S IN BLACK.” (HENRY FORD).

## CHAPTER 7: SUMMARY AND CONCLUSION

### Abbreviations used in this chapter

Abbreviation	Meaning
CAE	Chief Audit Executive
IAA	Internal Audit Activity
IFC	Internal Financial Controls
IIA	Institute of Internal Auditors

### 7.1 INTRODUCTION

More than 15 million Ford Model T cars were produced during the 18-year period from 1909 to 1927. The objective of the Ford Motor Company was to increase sales by lowering per unit product cost and the profit margin of the company. Before 1909, vehicles were hand built for the wealthy and were seen as a status symbol. The Ford Motor Company was faced with the challenge to improve the effectiveness and efficiency of the vehicle production line. Henry Ford introduced a method to increase productivity by making use of an assembly line technique which increased the speed of assembly of the chassis. By using this method, the average chassis assembly time was reduced by 10 hours and 35 minutes. The average time it took to assemble one chassis was 1 hour and 33 minutes by the end of 1913, and by the end of 1927 the average time taken to complete a motor vehicle (the Ford Model T) was 24 seconds (The Henry Ford Model T, 2003).

The assembly line technique was not the only change that Henry Ford introduced to increase the productivity of the Ford Model T assembly plant. During the period 1909 to 1927 the only colour in which the Ford Model T was available was black. Black paint was believed to dry faster than any other paint and therefore ultimately resulted in increased productivity (The Henry Ford, 2003). The Ford Motor Company formulated 30 different types of black paint that could be used on the Model T (The Henry Ford, 2003). By making these small sustainable changes to the production of the motor vehicle, the Ford Motor Company produced more than 15 million Ford Model T motor vehicles. From being something that could only be owned by the wealthy, the industry was changed and the



focus shifted to producing something that the modern world now cannot imagine being without.

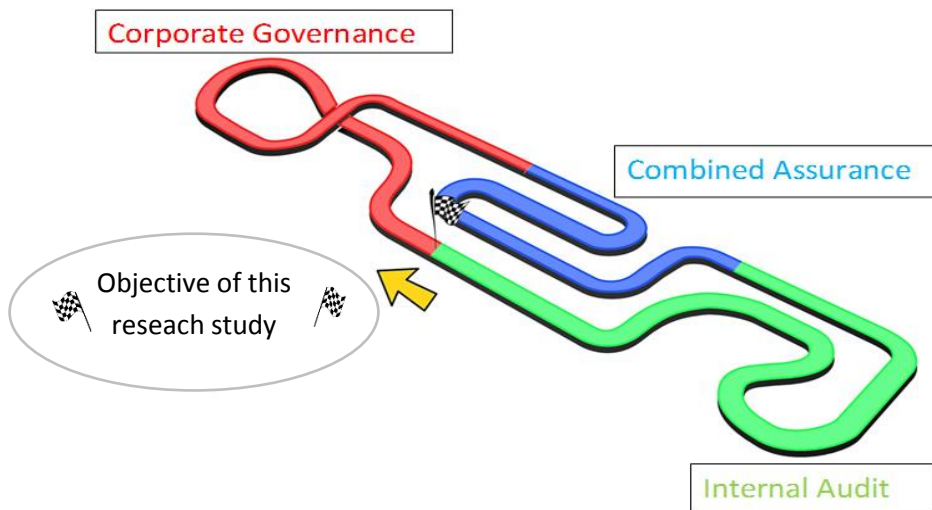
In a manner similar to the way Henry Ford changed the motor vehicle manufacturing industry, there is the potential that the financial services industry could change equally dramatically. The objective of this study was to analyse the relevance and value of the written assessment of the effectiveness of internal financial controls in a combined assurance environment within the financial services industry from the chief audit executive's (CAE) perspective. The financial services industry does not have a chassis assembly line that it can accelerate, nor does it need quicker drying paint. However, a comparison can be drawn between the two industries where the motor vehicle assembly line could be compared to the combined assurance process. The various types of black paint could be compared to the written assessment on the effectiveness of internal financial controls. Giving substance to this comparison, attention needs to be drawn to the following:

- Based on the changes in the financial services industry, and the effect corporate collapses have had on the business world, it is clear that there is a need for a combined assurance process within all organisations. By emphasising the role of the assurance providers within the combined assurance process, the organisation has the potential to obtain input from various stakeholders, and ultimately to enhance the controls in the organisation. In comparison to the chassis assembly line technique, the various stakeholders (management, forensic departments, legal departments, compliance departments, internal audit and external audit) have a responsibility to look at various processes within the organisation, from various perspectives, and to provide a consolidated, combined opinion. Both the chassis assembly line and combined assurance is (or should be) an automated, streamlined process. Both the automated chassis assembly line and combined assurance have resulted in better efficiency and effectiveness in their respective domains.
- As identified in the literature review, the requirement pertaining to the written assessment regarding the effectiveness of internal financial controls can be compared to the various black paints. The reason for this is that the written assessment is customised for each organisation, based on own unique characteristics. Black paint resulted in increased productivity for the Ford Model T. The written assessment,

performed by internal audit, will provide the organisation with an evaluation of the effectiveness of the internal financial controls, which if taken seriously, will improve the effectiveness and efficiency of the organisation.

The analogy that was used in this research study was a motor vehicle which was compared to combined assurance and the objective of this study was compared to the journey of the motor vehicle. Figure 33 indicates the complete road map of this research study.

**Figure 33: Road map of this research study**



## 7.2 ANALYSIS OF THE STUDY

Chapter 1 explained and discussed the objective of this research study. The objective of this study was to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment within the financial services industry from the CAE’s perspective. The study was also limited to the role of internal audit within combined assurance even though there are many different role players within combined assurance.

It was further noted that there are limited published information relating to combined assurance and/ or the written assessment regarding the effectiveness of internal financial controls. A knowledge gap was therefore identified within this research study and as a result the problem and purpose statement was formulated based on the requirement of the King III Report (discussed in detail in Chapter two of this research study).

- The **problem statement of this study** highlighted the fact that there is currently uncertainty how CAEs perceived the relevance and value of the written assessment regarding the effectiveness of internal financial controls. The reason for this is that no other empirical study has been done on the view of the CAE pertaining to the relevance and value regarding the written assessment of internal financial controls. According to the King III Report on Corporate Governance the responsibility of internal audit is stipulated as follows:
  - Principle 7.3.6 p 45: “*Internal audit should provide a written assessment of internal financial controls to the audit committee*” (Institute of Directors Southern Africa, 2009). The research study’s focus was limited to Principle 7.3.6
- The **purpose of the study** was to analyse the relevance and value of the written assessment regarding the effectiveness of internal financial controls in a combined assurance environment, within the financial services industry, from the CAE’s perspective.

Based on the problem and purpose statement of this study, several research questions were developed in order to reach the destination of this study. The study focused on the requirements listed in the King III Report pertaining to internal audit within a South African context. The study also focused specifically on financial services companies, listed on the JSE Ltd and limited to the current role of internal audit pertaining to relevance and value with regard to the assessment regarding the effectiveness of internal financial controls within combined assurance.

The objective of Chapter 2 was to determine the relevance of internal auditing within corporate governance. According to the European Corporate Governance Institute, South Africa was the second country in the world and the first country in Africa that issued their corporate governance code (King I Report) in 1994. South Africa can therefore be seen as

one of the leading countries in the world as well as the leading country in Africa on how to promote sound corporate governance.

The King III Report became a central landmark for any South African organisation's corporate governance structure. It was also noted that the internal auditor's responsibility to provide a written assessment regarding the effectiveness of internal financial controls is an essential component to achieve sound corporate governance. The King III Report changed the perception of internal audit from being merely an **important** part of good corporate governance to being a **critical** aspect of good corporate governance. Corporate governance in South Africa is not governed by legislation. The King III Report merely presents combined assurance as an **acceptable** governance structure – it is not mandatory and internal auditing should add value to the organisation as described in the IIA's definition of internal audit.

Internal auditing should assist the organisation in testing the effectiveness of the governance structure of the organisation, ensuring that risk-based audit plans are in place to address all significant risks faced by the organisation, and to provide a written assessment of the effectiveness of the internal financial controls of the organisation.

Corporate governance should add value to corporate strategy; it should also be monitored and controlled by this strategy. Excellence in corporate governance should be the organisation's objective (separate from business excellence). This is achievable by consistently aligning the organisation's strategy with its developing and changing objectives, and by actively following the business rules and regulations of the country. Corporate governance should be defined specifically for each organisation and should be a priority on the part of the board of directors together with its audit committee. With reference to the vehicle analogy, the organisation's governance vehicle used should be appropriate for the race in which the company is competing.

The relevance of combined assurance in respect of internal auditing was discussed in Chapter 3. According to various authors, the definition of combined assurance is a process of integrating and aligning the various assurance processes with each other and with the organisation's risk appetite. Combined assurance is not a new concept; however, the

relevance thereof was enhanced with the publication of the King III Report on Corporate Governance in 2009.

The business world continues to evolve at an accelerating pace and new risks arise as a matter of course. The combined assurance given by all participating assurance providers can benefit the organisation by mitigating the significant risks with which organisations are faced.

Various models can be used to implement combined assurance. The model that is used should be specific to the organisation's needs and appropriate to the requirements of the industry in which the organisation operates. The King III Report on Corporate Governance was analysed to determine what internal audit's role is with respect to combined assurance. The responsibility of internal audit and the importance of the written assessment on the effectiveness of internal financial controls were highlighted. It was further noted that is the audit committee has a responsibility to the organisation to ensure that the assurance provided by the participating parties is adequate and that it provides enough detail for the audit committee to do its work. It was further noted with regard to the IIA's Standards that the CAE has a responsibility to communicate to the board of directors and to the audit committee the levels of risk exposure the organisation is facing. In addition, the CAE should also communicate the results of monitoring of the identified risks to the directors and audit committee. The CAE has an additional responsibility to coordinate the activities of the different assurance providers.

Because of these different requirements, it is evident that internal audit plays an essential role in combined assurance within the organisation.

Chapter 4 discussed that risk-based auditing is a central concept of the definition of internal audit which should develop a forward-looking approach, which will result in adding value to the organisation.

In terms of the corporate governance vehicle analogy above, the internal audit assurance provider's wheels are essential to keep the corporate vehicle roadworthy. It is the responsibility of internal audit assurance providers to ensure that the wheels keep turning

freely. The internal audit activity can implement various strategies and approaches to ensure the mobility of the vehicle: examples include managing expectations, adding value to the organisation, and identifying and implementing the correct risk-based focus on the organisation's operations.

Internal financial controls are directly related to the organisation's financial statements. Assurance providers should work together to provide feedback regarding the presence and effectiveness of the controls that management has implemented in order to assess the truth of the financial statements.

The written assessment can be seen as the product that is delivered to the audit committee. A possible guiding framework was suggested based on the research performed in this study regarding what the written assessment of the effectiveness of internal financial controls should entail and how these should promote sound corporate governance. The guidance consists of six (6) steps that could be implemented by the organisation (Refer to Chapter Four for more detail in this regard).

Chapter 5 consisted of the research methodology that was used for this research study. Quantitative research was chosen as the best method to use. A questionnaire was developed and sent to 15 CAEs within the financial services industry whose companies appeared on the Top 200 African Listed Companies survey of 2012.

Pilot testing was conducted to determine if the questions were relevant and understandable before the questionnaire was distributed. The pilot testing that was conducted assisted with the following:

- Identified possible problems that the respondents could encounter when completing this questionnaire; and
- identified the amount of time the participants would need to complete the questionnaire.

This information was then communicated to them to ensure that they were adequately informed when participating in this research.

One hundred per cent of the population participated in this research study. The participants were all accredited members of the Institute of Internal Auditors (IIA).

Chapter 6 consisted on the results of this research study. The findings pertaining to the fieldwork that was conducted will be discussed in detail in the following section of this chapter.

### 7.3 FIELDWORK RESULTS

The fieldwork results can be divided into the following two sections:

1. Conclusions relating to the fieldwork can be drawn based on the perceptions of the CAE that participated in this research study; and
2. conclusions relating to the fieldwork can be drawn based on the methods used to perform the written assessment regarding the effectiveness of internal financial controls based on the feedback received from the CAE's that participated in this research study.

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*Conclusions based on the perceptions of the CAEs that participated in this research study.*

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Internal auditing is relevant within combined assurance. Internal audit is perceived to be, (at least in the financial services industry), the most important role player within combined assurance. The King III Report on Corporate Governance emphasises this as part of its guidelines for achieving good corporate governance.

The defence model was identified by the CAE's that participated in this research study as the most popular model being utilised, emphasising, as it does, that internal audit should be seen as the last line of defence.

Even though combined assurance is a new concept, it was noted that internal audit does have a clear understanding of what the requirements of combined assurance are. It was further noted that combined assurance forums and/ or functions are utilised within the financial services industry, and that these create the opportunity for all stakeholders to provide their various perspectives on the risks that the organisation is facing.

By looking at the financial services industry's maturity pertaining to internal financial controls and combined assurance, it was noted that there is still a lot of opportunity to grow. It was further noted that the maturity of the written assessment of the effectiveness of internal financial controls is more advanced than the maturity of the combined assurance process itself.

Internal auditing should manage the combined assurance process in an advisory capacity. The Professional Standards of the IIA (Standard 1100) stipulates that internal audit should be objective and independent while performing their duties (Institute of Internal Auditors, 2013).

Based on the requirement of the Standards and the view of the CAEs within the financial service industry, internal audit is in the best position to perform the written assessment of the effectiveness of internal financial controls.

Internal auditing add value to the organisation by providing the written assessment of the effectiveness of internal financial controls and also indicates that their internal audit functions employ capable and skilled personnel, well-qualified to perform the written assessment of the effectiveness of internal financial controls.

Arising from this research it was noted that the time allocated within the annual audit to the assessment of internal financial controls is perceived by the CAE's to be "adequate" and that it is performed in a "timely manner".



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*Conclusions of the fieldwork can be drawn based on the methods used to perform the written assessment regarding the effectiveness of internal financial controls based on the feedback received from the CAEs that participated in this research study.*

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The written assessment of the effectiveness of internal financial controls is prepared after evaluating agreed and documented internal financial controls pertaining to design, implementation and operation of financial controls.

A formal assessment process is performed on the agreed and documented internal financial controls. The results of the assessment are then communicated to the various stakeholders.

The results of the written assessment are communicated to all the relevant stakeholders of the organisation, including senior management, the board of directors, the audit committee and external audit. Based on the complexity of organisations within the financial services industry, the written assessment is usually performed on an annual basis.

Various mediums are utilised as the end result of the assessment, however, the most popular is a formal written assessment that is published as a separate report/ memorandum/ control self-assessment.

The financial services industry's typical annual audit plan indicates that a specific amount of time is allocated for the assessment of the company's internal financial controls.

External audit places reliance on the work performed by internal audit pertaining to the assessment of internal financial controls, for both interim and annual reporting purposes.

## 7.4 CONCLUSIONS BASED ON THE RESEARCH RESULTS ACCORDING TO THE PERCEPTIONS OF CHIEF AUDIT EXECUTIVES

There are various lessons that can be learnt from this study based on the views of the CAEs. The following may be seen as being the most important:

- Internal auditing should play a critical advisory role within combined assurance;
- based on the “average” assessment of the maturity levels of the combined assurance process, and the similarly “average” maturity of the written assessment on the effectiveness of internal financial controls, the organisations within the financial services industry have a huge opportunity to grow their combined assurance capabilities;
- internal auditing is seen as being sufficiently independent and objective to competently perform the written assessment of the effectiveness of internal financial controls;
- significant risks relating to the financial statements within the financial services industry have been identified and adequate mitigating action can be initiated based on the written assessment of the effectiveness of internal financial controls;
- organisations within the industry have differing perspectives pertaining to the written assessment on the effectiveness of internal financial controls. Each organisation should therefore determine its own blue print of the written assessment process, indicating the following:
  - Amount of time the audit plan should allocate to the written assessment of the effectiveness of internal financial controls;
  - the percentage of the financial controls that should be assessed in order for the written assessment of the effectiveness of internal financial controls to be considered adequate for the organisation to achieve its objectives;
  - the performance of the written assessment regarding the effectiveness of internal financial controls should be completed in timely fashion in order for the external auditing to place reliance on the work performed by internal auditing; and
  - specific skills are needed to perform the written assessment. These are writing in the language of company choice, while the ‘assessment’ aspect requires auditing

and accounting skills. The reporting of the conclusions takes the form of a written document.

## **7.5 CONCLUSIONS RELATING TO THIS RESEARCH STUDY**

The problem statement of this research study consists of two sections:

Firstly, it was noted that there is currently uncertainty as to how CAEs perceive the relevance and value of the written assessment regarding the effectiveness of internal financial controls and how the assessment should promote sound corporate governance and combined assurance. Based on the outcome of the results of the research study, the relevance and value of the written assessment regarding the effectiveness of internal financial controls should be customised for and by every organisation. The most important aspect, firstly, is that the significant financial risks relating to material misstatement of the organisation's financial position are identified. Secondly, that the internal audit activity performs a formal assessment on the effectiveness of the internal financial controls relating to the above mentioned risks, in a written report.

The results of this research study endorse the fact that the King III Report on Corporate Governance emphasises the role of internal audit in combined assurance and corporate governance. It was further noted that internal audit is perceived by the CAEs within the financial services industry as one of the most important role players within an organisation's combined assurance processes. The written assessment of the effectiveness of internal financial controls is seen as the result and/ or final outcome based on Principle 7.3.6 of the King III Report (Institute of Directors Southern Africa, 2009:45). If all the associated stakeholders and/ or assurance providers offer valuable and constructive feedback on how to assess, manage and mitigate the significant internal financial control risks facing the organisation, it has the potential to result in increasingly sound corporate governance for the organisation.

To conclude, according to the CAEs that participated in this research study, internal auditing is in the best position to coordinate the combined assurance process. Internal

auditing will also add value to the organisation by assessing the effectiveness of internal financial controls by providing a (formal) written assessment. Henry Ford stated that you could buy a Ford Model T vehicle in any colour, as long as it was in black. He did not say that there was only one shade of black. The Ford Motor Company invented 30 different shades of black. The written assessment regarding the effectiveness of internal financial controls within the financial services industry has the opportunity to demonstrate similar diversity within apparent uniformity thus addressing the uniquely shaded needs of each specific organisation.

## APPENDIX A

## LIST OF REFERENCES

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## APPENDIX B



# RESEARCH QUESTIONNAIRE

## QUESTIONNAIRE: THE ROLE OF INTERNAL AUDITING IN PROVIDING COMBINED ASSURANCE: ASSESSING INTERNAL FINANCIAL CONTROLS AS PERCEIVED BY THE CHIEF AUDIT EXECUTIVE (CAE)

The King III Report on governance (released on 1 September 2009) became a central landmark for any organisation's corporate governance structure. The King III Report also became more relevant and important because of the new South African Companies Act that focuses on global corporate governance. For an organisation to achieve good and sound corporate governance, there are a number of possible opportunities/requirements to explore and implement. One of these opportunities/requirements is specifically focusing on internal audit's responsibility. According to the King III Report, internal auditors are required to provide a written assessment of the effectiveness of the organisation's internal financial controls. The objective of this questionnaire is to determine what your view, as the Chief Audit Executive (CAE) is on how internal audit is assessing the effectiveness of the company's internal financial controls within the combined assurance that is provided.

For each of the sections below, place a [✓] in the relevant box, unless requested to do otherwise.

### PART A: RESPONDENT'S PROFILE

1. How many years experience do you have as a CAE?



Experience (years)

--

2. Gender?

Male

1

Female

2

3. Do you have any of the following qualifications?

	YES	NO
Certified Internal Auditor (CIA)	1	2
Chartered Accountant (CA(SA))	1	2
Certified Control Self-Assessment Auditor (CCSA)	1	2
Certified Financial Services Auditor (CFSA)	1	2
Certified Government Auditing Professional (CGAP)	1	2
Registered Auditor (RA)	1	2
Certified Information Systems Auditor (CISA)	1	2
Certified Professional Accountant (CPA)	1	2
Certification in Risk Management Assurance (CRMA)	1	2
Other	1	2

**PART B: Combined Assurance**

1. **Do you have a clear understanding of what the requirements of combined assurance are within an organisation?**

Yes Totally	1	Yes Partially	2	No	3	Unsure	4
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2. **How did you become aware of the requirement of the Internal Audit Activity to assess the effectiveness of internal financial controls within combined assurance?**

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3. **Do you have a combined assurance forum and/ or regular meeting in which your Internal Audit Activity actively participates?**

Yes Totally	1	Yes Partially	2	No	3	Unsure	4
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4. **In your view, how important is the role of the following parties within the organisation's combined assurance framework?**

Assurance Parties	Not important <span style="font-size: 2em;">→</span> Extremely important				
Management	1	2	3	4	5
External Audit	1	2	3	4	5
Internal Audit	1	2	3	4	5
Risk Department	1	2	3	4	5
Compliance Department	1	2	3	4	5
Legal Department	1	2	3	4	5
Forensic Department	1	2	3	4	5

5. **Does the Chief Financial Officer and/ or Equivalent sign representation letters to confirm that they are not aware of any material misstatement?**

Yes Totally	1	Yes Partially	2	No	3	Unsure	4
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6. **Which of the following combined assurance models does your Internal Audit Activity make use of in the assessment of the effectiveness of internal financial controls? (Select only one)**

Assurance Model <i>Assurance model can be defined as clear and direct reporting lines that facilitate sound internal financial controls where external and internal audit form the first line of assurance, followed by risk, forensic, compliance and legal, and so forth departments as the second line of assurance. Management will form the last line of assurance.</i>	1
Defence Model <i>Defence model can be defined as clear and direct reporting lines that facilitate sound internal financial controls where management is the first line of defence. Within an organisation the risk, compliance, forensic and legal departments, for example, provide the second line of defence and the internal auditors the third. External audit and government regulators provide the final line of defence</i>	2
Do not make use of any specific model	3
Other Model – Please specify below which model is used	4

**7. What type of assurance does your Internal Audit Activity provide? (Select only one)**

Positive Assurance <i>Internal Audit Activity obtained reasonable assurance that the internal financial controls are operating effectively and efficiently and the financial statements are free from material misstatements.</i>	1
Negative Assurance <i>No notable findings (other than what was reported) have come to the Internal Audit Activity's attention which would suggest that the internal financial controls are not operating effectively and efficiently.</i>	2

**8. In your view as the Chief Audit Executive (CAE), what is the importance of the involvement of the Internal Audit Activity within combined assurance in terms of the assessment of internal financial controls of the organisation (Select one):**

The Internal Audit Activity owns the combined assurance process and is primarily and solely responsible for the combined assurance process.	1
The Internal Audit Activity should assist management in documenting the internal financial controls. Management and the Internal Audit Activity play a dual role in the implementation of internal financial controls and are dually responsible for the combined assurance process	2
The Internal Audit Activity should perform the written assessment on internal financial control and the Internal Audit Activity manages the process of combined assurance in an advisory role capacity.	3
The Internal Audit Activity can be excluded from the combined assurance process	4

**9. In your view as the Chief Audit Executive (CAE), how mature is your combined assurance process? (Please rate the maturity level of your company's combined assurance process where 5 is most mature and 1 least mature)**

	Least	→	Most		
	mature mature				
<b>Combined Assurance Process</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>

**PART C: Internal Financial Controls**

1. Does your Internal Audit Activity provide a written assessment of the effectiveness of the organisation's internal financial controls?

Yes Totally	1	Yes Partially	2	No	3	Unsure	4
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2. To which of the following parties are the results of the written assessment of the effectiveness of internal financial controls communicated?

Senior Management	1
Board of Directors	2
Audit Committee	3
External Auditors	4
Others (Please specify the relevant parties)	5

3. How often is the written assessment performed? (Please select one)

Monthly	1	Quarterly	2	Bi-annually	3	Annually	4
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4. What percentage of the annual audit plan is spent on the assessment of internal financial controls?

0 – 25%	1	26% - 50%	2	51% - 75%	3	76% - 100%	4
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5. In your view as the Chief Audit Executive (CAE), do you feel that the percentage of coverage of the assessment of internal financial controls is adequate (refer to Question 13)?

Coverage of IFC is not adequate and it should increase	1	Coverage is adequate	2	Coverage is extensive and it should decrease	3
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6. What is the end result of the written assessment performed by the Internal Audit Activity of the effectiveness of internal financial controls? (Select only one)

<b>Formal written assessment i.e. in line with the requirements of the King III Report.</b> <i>Formal written assessment in the form of a separate report/memorandum/control self-assessment and so forth specifically in terms of the effectiveness of internal financial controls</i>	1
<b>Informal written assessment i.e. apply judgement based on the audit work performed during the annual audit plan</b> <i>Informal written assessment as part of the risk- based audits performed during the year. The assessments on the effectiveness of internal financial controls are included as a separate section in the audit reports.</i>	2
No written assessment	3
Other (Please specify)	4

**7. In your view as a Chief Audit Executive (CAE):**

		Yes Totally	Yes Partially	No	Unsure
A	Your Internal Audit Activity is providing a written assessment on the effectiveness of internal financial controls.	1	2	3	4
B	Your Internal Audit Activity is adding value to the organisation by providing a written assessment on the effectiveness of internal financial controls.	1	2	3	4
C	Your Internal Audit Activity is significantly removed from management and objective enough to perform this assessment.	1	2	3	4
D	Your Internal Audit Activity is capable and skilled to perform the written assessment on the effectiveness of the company's internal financial controls.	1	2	3	4
E	The written assessment has enough details for a prudent person to reach similar conclusions.	1	2	3	4
F	The written assessment is done in a timely manner?	1	2	3	4

**8. In your view as the Chief Audit Executive (CAE), what are the important skills needed in your Internal Audit Activity to perform the written assessment on the effectiveness of internal financial controls?**


**9. Your Internal Audit Activity written assessment on the effectiveness of internal financial controls is derived from the following:**

		Yes Totally	Yes Partially	No	Unsure
A	The evaluation/ assessment is done on the agreed and documented internal financial controls for effectiveness of design	1	2	3	4
B	The evaluation/ assessment is done on the agreed and documented internal financial controls for effectiveness of implementation	1	2	3	4
C	The evaluation/ assessment is done on the agreed and documented internal financial controls for effectiveness of operation	1	2	3	4
D	The Internal Audit Activity performs specific testing of internal financial controls. These results are then communicated	1	2	3	4

**10. Is your Internal Audit Activity addressing the significant risks relating to material misstatement pertaining to internal financial controls?**

Yes Totally	1	Yes Partially	2	No	3	Unsure	4
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**11. Does external audit rely on the work performed by internal audit pertaining to the assessment of the effectiveness of internal financial controls?**

Yes Totally	1	Yes Partially	2	No	3	Unsure	4
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**12. When does external audit place the most reliance on the work performed by internal audit pertaining to the assessment of the effectiveness of internal financial controls?**

External audit relies on the work performed by internal audit mainly for annual reporting purposes.	1
External audit relies on the work performed by internal audit mainly for interim reporting purposes.	2
External audit relies on the work performed by internal audit mainly for both annual and interim reporting purposes.	3
External audit does not rely on the work performed by internal audit.	4

**13. In your view as the Chief Audit Executive (CAE), how mature is your written assessment process pertaining to the effectiveness of internal financial controls? (Please rate the maturity level of your company's combined assurance process where 5 is most mature and 1 least mature)**

	Least mature  Most mature				
<b>Written assessment on the effectiveness of internal financial controls.</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>

*Thank you for your time and assistance in completing this questionnaire.*

## APPENDIX C

# INFORMED CONSENT FORM



UNIVERSITEIT VAN PRETORIA  
UNIVERSITY OF PRETORIA  
YUNIBESITHI YA PRETORIA

Faculty of Economic and Management  
Sciences

## Informed consent for participation in an academic research study: Dept. of Auditing

### THE ROLE OF INTERNAL AUDITING IN PROVIDING COMBINED ASSURANCE: ASSESSING INTERNAL FINANCIAL CONTROLS

Research conducted by:  
Mrs. I. Lewis (22016067)  
Cell: 082 661 5527

Dear Respondent

You are invited to participate in an academic research study conducted by Izelle Lewis, a Masters student from the Department Auditing at the University of Pretoria.

The purpose of the study is to examine how internal audit is assessing the effectiveness of internal financial controls in a combined assurance situation.

Please note the following:

- This study involves an anonymous survey. Your name will not appear on the questionnaire and the answers you give will be treated as strictly confidential. You cannot be identified in person based on the answers you give.
- Your participation in this study is important to us. You may, however, choose not to participate and you may also stop participating at any time without any negative consequences.
- Please answer the questions in the attached questionnaire as completely and honestly as possible. This should not take more than 30 minutes of your time.
- The results of the study will be used for academic purposes only and may be published in an academic journal. We will provide you with a summary of our findings on request.
- Please contact my supervisor, Prof. H. de Jager (☎ 012 420 6955; ✉ [herman.dejager@up.ac.za](mailto:herman.dejager@up.ac.za)) should you have any questions or comments regarding the study.

Please sign the form to indicate that:

- You have read and understood the information provided above.
- You give your consent to participate in the study on a voluntary basis.

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**Respondent's signature**



## APPENDIX D



6 May 2013

Prof H de Jager  
Department of Auditing

Strictly confidential

Dear Professor de Jager

**Project:** *The role of internal auditing in providing combined assurance:  
assessing internal financial controls*

**Researcher:** I Lewis

**Student No:** 22016067


**Supervisor:** Prof H de Jager

**Department:** Internal Audit

We refer to our previous letters in this matter.

We have received the required letter from the Institute of Internal Auditors, and hereby confirm that the application for ethics clearance has been approved.

Sincerely



PROF BA LUBBE  
CHAIR: COMMITTEE FOR RESEARCH ETHICS

cc: Prof K Barac