GUIDANCE ON THE **CEO/FD SIGN-OFF** ON INTERNAL FINANCIAL CONTROL

IN TERMS OF JSE LISTINGS REQUIREMENT 3.84(k).

AUGUST 2020

SAICA

THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS

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PREFACE

This guide has been developed by the South African Institute of Chartered Accountants (SAICA) and is intended as a guideline to assist members with conforming to the JSE's Listings Requirement 3.84(k) the Chief Executive Officer (CEO) and Financial Director (FD/CFO) attest statement.

This discussion guide does not deal with all aspects of the JSE's Listings Requirements but deals with those aspects related specifically to Listings Requirement 3.84(k). The guide is laid out as follows:

1 Introduction and objectives
2 Background
3 An analysis of Listings Requirement 3.84(k)
4 The internal control environment
5 Internal financial control
6 The reporting process
7 Appendices

This guide is non-authoritative and is neither a standard nor a piece of legislation. It has been compiled as a reference tool to aid affected members when complying with JSE Listings Requirement 3.84(k).

This guidance does not impose requirements on practitioners beyond those in the International Standards which are included and referred to throughout the guidance. It also does not change the practitioner's responsibility to comply with the requirements of any standards, codes, other pronouncements, and laws and regulations that may be applicable. Although specific references to various International Standards may have been included in the guidance, the practitioner is required to have an understanding of the entire text of each applicable standard to assess how it is relevant to a particular process, project or engagement and to enable the practitioner to comply with all the relevant requirements.

Every effort has been made to ensure that the advice given in this guide is correct. Nevertheless, the advice is given purely as guidance to members of SAICA to assist them with particular problems relating to the subject matter of the guide and SAICA will have no responsibility to any person for any claim of any nature whatsoever which may arise out of or relate to the contents of this guide.

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1 OBJECTIVE

The objective of this document is to provide Chief Executive Officers (CEOs) and Chief Financial Officers[1] (CFOs) with principles-based guidance as to how senior management (CFO/CEO) of a listed entity can be in a position to attest to an adequate internal financial control environment in compliance with the Johannesburg Stock Exchange's (JSE) Listings Requirement 3.84(k) published in November 2019.

2 BACKGROUND

The JSE has incorporated a new paragraph in its Listings Requirements as a result of its April 2018 Consultation Paper with a view of strengthening the regulation of its primary listings. It requires a higher level of accountability from executive management in order to conform with the enhanced regulations. Amendments were published during April 2019 for comments and these were formalised with the release of the revised JSE Listings Requirements on 5 November 2019.

This guidance document refers specifically to Section 3 – Continuing Obligations with reference to paragraph (para) 3.84(k) of the Listings Requirements, which reads as follows:

(k) The CEO and the financial director responsibility statement must be made by them after due, careful and proper consideration of same as follows:

(i) The directors, whose names are stated below, hereby confirm that –

(a) the annual financial statements set out on pages [...] to […], fairly present in all material respects the financial position, financial performance and cash flows of the issuer in terms of IFRS;
(b) no facts have been omitted or untrue statements made that would make the annual financial statements false or misleading;
(c) internal financial controls have been put in place to ensure that material information relating to the issuer and its consolidated subsidiaries have been provided to effectively prepare the financial statements of the issuer; and
(d) the internal financial controls are adequate and effective and can be relied upon in compiling the annual financial statements, having fulfilled our role and function within the combined assurance model pursuant to principle 15 of the King Code. Where we are not satisfied, we have disclosed to the audit committee and the auditors the deficiencies in design and operational effectiveness of the internal financial controls and any fraud that involves directors, and have taken the necessary remedial action.

Signed by the CEO and the financial director.

3 ANALYSIS OF PARAGRAPH 3.84(K) OF THE LISTINGS REQUIREMENTS

The CEO and the financial director responsibility statement must be made by them after due, careful and proper consideration of same, as follows:

(i) The directors, whose names are stated below, hereby confirm that –

(a) the annual financial statements (AFS) set out on pages [...] to […], fairly present in all material respects the financial position, financial performance and cash flows of the issuer in terms of IFRS …

This requirement is unchanged from previous requirements. This is in line with the objective of financial statements with reference to International Accounting Standards (IAS) 1 which requires the financial statements to be prepared in accordance with a recognised framework (IFRS) for comparability purposes. The term '*material*' suggests that a user can use the Annual Financial Statements (AFS) to make economic decisions with confidence based on the information presented. In the JSE guidance letter dated 17 July 2020, the JSE too clarified that the reference to materiality in paragraph (a) must be interpreted in the context of IFRS.

The JSE also seeks to reinforce that the term '*after due, careful and proper consideration*' requires the directors to take active steps as would be expected of any executive director in exercising their fiduciary duty. This term does **not** imply a more passive approach such as 'to the best of our knowledge, or without further information'.

In summary, executive management attest to the fact that the AFS have been prepared in accordance with the accounting framework and are suitable for reliable economic decision-making.

*(b) **no** facts have been omitted or untrue statements made that would make the annual financial statements false or misleading …*

It is suggested that point (b) be read in context with point (a) above. The term '***no***' attests with certainty that the AFS are not false or misleading, i.e. they can be relied on for decision- making. It also suggests that in the event that a fact, transaction or circumstance may have been omitted, then this would not impair the decision-making ability of the user or render the AFS to be not a fair representation. In other words, in the event of an omission or perhaps a misstatement, these are not considered material. The term '***no***' therefore does not attest to one hundred per cent accuracy and completeness but rather that the CFO and the CEO are satisfied that the AFS achieve fair presentation in all material respects (see (a) above).

In the JSE guidance letter dated 17 July 2020, the JSE too clarified that the term 'no' does not mean one hundred per cent factual correctness but rather that after due, careful and proper consideration the directors agree that no facts have been omitted or untrue statements made that would make the AFS materially false or materially misleading in terms of IFRS.

*(c) **internal financial controls** have been put in place to ensure that **material** information relating to the issuer and its consolidated subsidiaries have been provided to **effectively** prepare the financial statements of the issuer; and …*

The CEO and CFO take ultimate responsibility for the functioning of the internal controls over financial reporting, whilst the board of directors remain ultimately accountable. The Conceptual Framework for Financial Reporting describes an amount as being ***material*** if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports.

In terms of the IFRS Practice Statement 2, materiality is specific to the reporting entity, i.e. two similar size entities that are dissimilar in nature could potentially conclude on two very different materiality levels. The term '*material*' should be considered not only in the context of financial reporting but also, financial and business risks to the extent that they could affect financial reporting. Therefore, materiality is a pervasive concept and requires judgement. The word '**effectively**' (practically, virtually, adequately) reinforces this notion of fair presentation within the bounds of materiality.

As noted above, In the JSE guidance letter dated 17 July 2020, the JSE too clarified that the reference to materiality must be interpreted in the context of IFRS and the presentation of financial statements.

> *(d) the internal financial controls are* ***adequate*** *and* ***effective*** *and can be relied upon in compiling the annual financial statements …*

This re-emphasises point (c) above that the internal financial controls are fit for purpose and can be relied upon to produce fairly presented AFS. The term '*adequate*' suggests that the internal financial controls are relevant and appropriately designed and executed to prevent or detect material misstatements/omissions/obscuring of financial information and related disclosures.

The term '*effective*' suggests that the internal financial controls are sufficiently rigorous to ensure that the required and appropriate level of reliance can be placed on them in producing the information and disclosures found within the AFS, i.e. the internal financial controls are achieving their purpose. The JSE has clarified in their guidance letter of 17 July that not all restatements would point to a weakness in internal financial control and would need to be determined on a case by case basis. In this regard, issuers' attention is also drawn to Practice Note 3/2017 which deals with obligations of issuers to report restatements to the JSE.

The JSE too has clarified in their guidance letter published 17 July 2020 that internal financial controls clearly link to the preparation of the AFS. Furthermore, the CEO and FD sign-off is not limited to the annual financial statements and would cover other periodic financial statements including interims, provisional, preliminary financial statements and forecast requirements under the Listings Requirements.

In this regard, preparers are again reminded of the JSE requirement of due, careful and proper consideration, as outlined above.

> *… having fulfilled our role and function within the combined assurance model pursuant to principle 15 of the King Code.*

Principle 15 of the King Code states that: "The governing body should ensure that assurance services and functions enable an effective control environment, and that these support the integrity of information for internal decision-making and of the organisation's external reports."
It requires the CEO and CFO, as part of their roles and responsibilities, to implement internal financial controls that are adequate and effective.

This is in line with previous requirements which charge the ultimate governance of a company to the directors of the company. Per the Companies Act, directors have a fiduciary duty to act with care, skill and diligence in good faith and for a proper purpose and in the best interest of the company at all times.[2] King IV indicates that a combined assurance model incorporates and optimises all assurance services and functions so that, taken as a whole, these enable an effective control environment, support the integrity of information used for decision-making by management, the governing body and its committees, and support the integrity of the organisation's external reports. While the combined assurance components play a vital role in the effectiveness of the internal financial controls (IFC), the ownership remains with the CEO and the CFO.

> *Where we are not satisfied, we have disclosed to the* ***audit committee*** *and the* ***auditors*** *the deficiencies in design and operational effectiveness of the internal financial controls …*

This statement is an important one. This requires the CEO and CFO to attest that if, in their opinion, there were elements of the IFC that were identified in the monitoring process and upon their further investigation, were not adequate or effective (i.e. weaknesses were found) and therefore may not have produced reliable financial information, then these have been disclosed to both the internal structures (audit committee) and the external adjudicators (external auditors) and have either subsequently been remediated or necessary suitable actions to remedy these deficiencies, such as compensating controls, have been put in place. The JSE has clarified in their guidance letter published 17 July 2020 that this requirement does not place an obligation on these parties to ensure that the remedial action is fully implemented and effective at the time of signing the statement and that it would be unreasonable to expect an issuer to delay releasing their results in order to test the effectiveness of the remedial action. The JSE also notes that remedial action is an ongoing process.

There should be a plan for control remediation that has as its ultimate outcome that the control environment will ensure that the control failure will not occur again. It suggests that the CFO and CEO have taken proactive steps to strengthen or enhance these elements of the internal financial controls. This should prevent problems from occurring in the future. This statement is therefore one of transparency. It also implies that if a situation arises where deficiencies are found, then CEOs and CFOs appear to have fulfilled their fiduciary duties, or management responsibilities, as long as these deficiencies have been reported and disclosed to the above-mentioned structures and adequate steps have been taken to remediate them. It is suggested that the aim of this is to continually improve both the qualitative and quantitative elements of corporate reporting. It should also be noted that this Listings Requirement does not require an external auditor sign-off on the control environment.

> *… and any fraud that involves directors, and have taken the* ***necessary*** *remedial action.*

With reference to the above point, the emphasis is on transparency and proactive monitoring by the CEO and CFO that improvements have taken place in the event that control deficiencies were found to have occurred. This, in the spirit of forward-looking improvement suggesting that if these events did occur, then necessary suitable actions to remedy these deficiencies have been put in place. Remedial action has and is being taken and controls strengthened to ensure that they will not occur again. It is important that the financial information be remediated and that a control plan be put in place for the ultimate remediation of the control environment. With reference to risk assessment and documentation below, it is strongly recommended that detailed records of any fraud or intentional errors detected are maintained and included in the minutes of meetings with the audit committee and both internal and external audit. The term '*necessary*' implies that reasonable corrective action appropriate to the circumstances has and is taking place.

> *Signed by the CEO and the financial director.*

The CEO and FD take ultimate responsibility for the functioning of the IFC, whilst the board of directors remain ultimately accountable. Note this is a new aspect to the regulations. This sign-off is by the CEO and CFO in their capacity as individual directors. It is with them that the ultimate responsibility is entrusted. This statement should be consistent with that of the audit committee. It should be noted that in this regard the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Framework discusses a management sign-off that would include a Chief Operating Officer (COO) and a Chief Risk Officer (CRO). More information about the COSO Framework can be found in Appendix 3 of this guide.

MODIFICATIONS TO THE WORDING OF THE CEO AND CFO SIGN-OFF

The JSE has clarified in their guidance letter published 17 July 2020 that the sign-off must be made exactly as set out in the requirements and that amending of the wording is not permitted. However, the JSE accepts that issuers may wish to include additional supplementary information, such as what controls it has in place or what

deficiencies were found. To this end, the JSE will permit such or similar wording to be included on a standalone basis but only provided that this does not attempt to nullify the meaning and intention of the CEO and FD sign-off. This should be seen in the context of allowing for enhanced transparency by executive management and not as a mechanism of trying to disassociate from any of the requirements of the attest statement.

4 INTERNAL CONTROL AND THE CFO'S AND CEO'S RESPONSIBILITY

Internal control is a process effected by an entity's personnel and management (and overseen by the board of directors) designed to provide reasonable assurance regarding the achievements of objectives relating to operations, reporting and compliance. (https://www.coso.org/Documents/990025P-Executive-Summary-final-may20.pdf).

A company's internal financial control (IFC)[3] is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.[4] A company's IFC includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. (https://www.coso.org/Documents/990025P-Executive-Summary-final-may20.pdf)

Internal control, and therefore IFC, is not a fixed or stagnant process but rather one that is dynamic and integrated. Each organisation may choose to apply IFC differently according to its size, complexity and risks. A smaller entity's IFC may be less formal and perhaps less structured, but that does not necessarily mean the system is less effective. It is suggested that this is the reason why the JSE has not elected a fixed framework approach.

IFC is the backbone of an effective reporting environment and it is recommended that this be monitored and attested to on a regular basis and form part of the focus by management. The IFC environment of an entity ought to be seen in the context that the ultimate responsibility for an entity's Annual Financial Statements (AFS) rests with the CEO and FD and that the Companies Act of South Africa deems that the directors are the custodians of trust for the entity, its reporting and its responsibility towards its stakeholders.

There are certain fundamental concepts inherent to internal control and its definition. These include, but are not limited to:

- Internal control is a process of ongoing tasks and activities.
- It is effected by people – these are not simply policies and procedures in a documented form but are about personnel and the actions taken by personnel at every level within the organisation. In this light, the ethical behaviour of both staff and management is a fundamental pillar. The culture of the entity and management should also support ethical behaviour and decision-making with a strong emphasis that anything other than ethical behaviour, decision-making and processing will not be tolerated.
- With reference to the above, it is not possible to separate internal controls and internal financial controls from the people charged with implementing and monitoring these controls. Stated otherwise, the adequacy and functionality of an internal control environment is mutually dependent on the rigour of the system as well as those whose responsibility it is to monitor, manage and ultimately attest to it.

With specific reference to the Listings Requirements, it is the CEO's and CFO's obligation to ensure that the internal financial controls are effective. The JSE in its guidance paper of 17 July 2020 has clarified that *the IFC as stated in paragraph (d) of the LR clearly link to the preparation of the AFS, and are those internal controls which ensure that material information is reported in accordance with IFRS and that no material information, required by IFRS, is omitted*.

From the above points, a system of sound financial controls consists of more than merely a financial system but rather one that incorporates information technology, human resource management and operational effectiveness.

INHERENT LIMITATIONS

Because of its inherent limitations, IFC may not always prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. A common inherent limitation is the cost of its implementations versus benefits, meaning a constraint in any IFC environment may be how much the entity is prepared and/or able to invest in its internal financial control environment and what its tolerable risk/certainty appetite may be. Other possible inherent limitations of internal control are as follows:

- ***Collusion:*** Two or more people who are intended by a system of control to keep watch over each other could instead collude to circumvent the system.
- ***Human error:*** A person involved in a control system could simply make a mistake, perhaps forgetting to use a control step. Or, the person does not understand how a control system is to be used or does not understand the instructions associated with the system. This may be caused by the assignment of the wrong person to a task.
- ***Management override:*** An individual on the management team who has the authority to do so could override any aspect of a control system for his/her personal advantage.
- ***Insufficient segregation of duties:*** A control system might have been designed with insufficient segregation of duties so that one person is performing too many functions within the control system.

Given these inherent limitations of IFC, it is important to acknowledge the requirement to *report* any deficiencies in design and operating effectiveness to the audit committee and auditors, encouraging the necessary transparency and remediation. Preparers are again reminded of the requirement that the '*due, careful and proper consideration*' be applied by the CEO and FD.

Internal financial control is the backbone of effective internal control over the financial reporting (ICOFR) environment and it is recommended that this be monitored and attested to periodically in response to changes in circumstance and risk assessments (such as changes in accounting standards adopted by the entity, in personnel, in the business structure, acquisitions or disposals of assets) and in response to the entity's dynamic risk assessment and forming part of the focus by internal management. An internal control system should not be static but rather evolve as the business and its technologies, processes and operations evolve.

From the above points, a system of sound controls over financial reporting consists of more than merely a financial system but rather one that incorporates information technology, human resource management and operational effectiveness. This should consist of policies and procedures to provide stakeholders with *reasonable (and not absolute) assurance* over the IFC environment.

This guide suggests that a comprehensive and well-documented risk management system could and potentially should be considered/adopted. This would allow the company to identify opportunities for improvement and draw up recommendations and good practices that can be used as a benchmark to develop or strengthen

their internal control systems and enhance the reliability of their financial statements. This would assist management in reaching the required due care and careful consideration requirement of Listings Requirement 3.84(k). This echoes King IV's principle that combined assurance enables a control environment that supports the integrity of the information used for internal decision-making and supports the integrity of the organisation's external reports. Combined assurance also includes self-assessment, using indicators designed by management. It is the macro management of risk to within acceptable levels. Therefore, combined assurance is not just testing, it is an overall evaluation that should be signed off by management, including the CEO and FD, on a periodic basis.

It should also be noted that this Listings Requirement does not require an external auditor to express an opinion on the control environment. In this regard, SAICA encourages its members to refer to the SAICA Frequently asked questions: JSE Listings Requirements: CEO and financial director responsibility statement - The auditor's perspective guide on all assurance matters relating to the audit implications of Listings Requirements 3.84(k).

5 INTERNAL FINANCIAL CONTROLS

5.1 HOW BEST TO IMPLEMENT INTERNAL FINANCIAL CONTROLS IN ORDER TO PROVIDE COMFORT FOR CEO AND CFO

In order to support making the required attestation, management may, under the guidance of the CFO[5] and CEO, consider performing and implementing the following:

- Review adequacy of the organisational control environment policies and procedures including delegation of authority and accountability over financial reporting controls.
- Consider standardised entity-level controls over financial reporting that need to be applied on a periodic basis for internal and external financial reporting.
- Calculate group materiality for financial reporting using principles in IAS 1.
- Identify operational process controls that could affect the reporting environment.
- Identify all business processes that affect IFC (which may include, for example, revenue, accounts payable, cash and bank, and inventories). These may be broken down into further sub-processes and document the narrative over these processes. Link accounts balances (e.g. revenue, payables, inventory) to these business processes.
- Perform a risk assessment on these processes – i.e., what could go wrong from a financial reporting perspective – and rank these risks according to likelihood and impact. (An example of a risk grading matrix can be found in Appendix 1.)
- Design **key** controls which adequately address these **key** risks and implement them. Key controls must be designed and implemented in such a way that they will prevent or detect on a timely basis, potential material misstatements related to the identified financial statement assertions.
- Taking cognisance of the inherent limitations within a control environment as discussed in section 4 (above), identify limitations within the key controls and design compensating controls to overcome these.
- For all controls establish a standard of what initiators and reviewers must do and how to evidence that they have performed the control or review (e.g. sign-offs and reconciliations, ensuring documentation is properly retained). This requires staff training and supervision. The evidencing of these controls will play a significant part in allowing the CEO and FD to reach the required levels of attestation.
- Design a group control framework that sets internal financial reporting controls requirements at component level throughout the group, based on risk assessments.
- Implement a monitoring process to confirm and report that control procedures have been completed together with a mechanism to identify and report deficiencies and remedial actions
- Design a combined assurance programme to regularly test the design and effectiveness of financial reporting controls based on risk assessments with reporting of deficiencies and required remedial action.
- Implement a system to regularly report deficiencies and track remediation to designated management levels based on materiality and risk assessments to appropriately monitor compliance and report deficiencies to the audit committee and external auditors.

5.2 RISK AND CONTROL MATRIX

To assist CFOs and CEOs and to assist with the documenting/evidencing of IFC, it is recommended that the entity prepares a risk and control matrix that identifies and classifies each of the risks within the IFC environment that supports the transactions. It is important to note that the risk matrix must pay particular attention to financial reporting controls, as well as from an operational or compliance perspective.

The risk and control matrix must also include fraud risks. Fraud risks could include management override of control, misconduct by management and involved employees, and misappropriation of assets. Fraud risks must be assessed in terms of whether opportunities exist for fraud to be committed (e.g. ease of management override of controls), incentives and pressures to produce fraudulent financial reporting (e.g. remuneration based on stringent objectives that be achieved in the short term) and attitudes and rationalisation. In particular, key controls must be identified to mitigate the risks identified. It is up to each entity to determine which controls may be key or not, and here the application of materiality in the context of overall financial reporting is critical. A control can be considered key if its failure could result in a material deviation in the financial reporting outcome of the transaction. A key control is usually the only control that covers a risk of material misstatement and is indispensable to cover its control objective.

The matrix should be used to determine the adequacy of controls in place relative to the risks identified. Regular reporting processes should be established where this matrix is continuously monitored and updated where and when appropriate. The risk and control matrix can also be used to design a combined assurance process to test the design and operational effectiveness of controls.

Areas that are identified as higher risk from an operational and compliance perspective will most likely lead to higher financial reporting risk. In other words, there is a high probability that operating and compliance risks correlate to financial reporting risks and there should be adequate internal financial controls in place to correct, detect and evaluate these risks.

As an example, the awarding of credit to a potential customer can be considered an operational or commercial risk. This credit risk should be controlled through a credit-worthiness process to ensure recoverability of the instrument. This too may impact the disclosure and necessary expected credit loss calculation creating financial reporting risk. Therefore, this document proposes that areas identified as having risk from an operational and compliance perspective ought to be evaluated from an internal financial reporting perspective too.

The risk and control matrix should be updated and reviewed on a regular basis. As stated earlier, an internal control system should not be static but rather evolve as the business and its technologies, processes and operations evolve.

In a group environment, it is recommended that a group risk and control framework

be established and this framework then be implemented and monitored. Care should also be taken when the group is expanded by way of acquisition of subsidiary companies. It is important that these new subsidiaries conform to the overall IFC of the existing group and particular attention be paid by management into the evaluation of the new acquisition's IFC environment and reported on accordingly.

An example of a control risk and financial reporting risk assessment can be found in Appendix 2.

5.3 DOCUMENTATION AND INTERNAL COMPLIANCE

In order for CEOs and CFOs to attest to the adequacy of the internal controls over financial reporting, the system is required to be clearly and accurately documented. As CEOs and CFOs may not be involved operationally in the system, they would require a method of ensuring that their staff who transact within the environment on a daily basis are adhering to all required process controls. As noted above, this point talks to the ethics of the staff and the culture of the overall environment.

In particular, it is suggested that a comprehensive gap analysis over the adequacy of internal financial reporting controls/control framework be performed on a regular basis with a view to continuous monitoring and improvement over time. The gap analysis may also serve as evidence of due process being followed by the CFO and CEO and assist them with reporting deficiencies to the audit committee and auditors if and when required.
As referred to elsewhere in this document, it is worth noting that there are globally recognised frameworks that assist with the development of appropriate control environment, risk assessment, control procedures, communication and monitoring such as COSO. These may be of benefit to preparers. Please refer to Appendix 3 for more information.

6 THE REPORTING PROCESS

As noted above, the reporting process is an important element for CFOs and CEOs to consider. In this regard, it is recommended that a systematic reporting, monitoring and communication process be implemented in order to ensure that compliance and any deficiencies and findings are routinely reported to management, the audit committee and external auditors as required. Reporting tools that can enable such functionality are widely available for commercial implementation.

The following advantages could be achieved with this:

- The reporting tools can be relatively inexpensive and integrated with existing systems.
- It can provide systematic reporting of identified deficiencies as opposed to slow and cumbersome manual reporting.
- The system provides evidence that the matter has been reported to/by management, the audit committee and, if required, to the auditors.
- It forces appropriate management to apply their mind to the extent of the deficiency noted and to perform a risk assessment in order to assist with the categorisation of the risk and apply and track appropriate remedial actions as required.

NOTES

1 The JSE Listings Requirement states 'Financial Director'. This term is the equivalent of Chief Financial Officer (CFO) and is used as an equivalent sporadically throughout this document.

2 Companies Act 2008, section 76(3).

3 The COSO framework uses the term 'ICOFR' which has been replaced with 'IFC' for the purposes of alignment with the JSE's Listings Requirements.

4 IFRS has been used as this is the accounting framework applicable to the JSE's Listings Requirements.

5 In larger entities, these risks may fall under the portfolio of the Chief Risk Officer (CRO). Within this process, the CRO plays a pivotal role, but ultimate accountability rests with the CEO and the Financial Director.

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APPENDIX 1: RISK GRADING MATRIX ILLUSTRATION

It is suggested that this be applied in principle to guide management as to how to monitor and evaluate the specific financial reporting risks with reference to each entity.

It is suggested that the higher the risk, the higher the level of required controls, documentation and disclosure within the financial reports. The consequence labelled below is the consequence on financial reporting.

	CONSEQUENCE				
Likelihood	Insignificent	Minor	Moderate	Major	Critial
Rare	LOW Accept the risk Routine management	LOW Accept the risk Routine management	LOW Accept the risk Routine management	MEDIUM Specific responsibility and treatment	HIGH Quarterly senior management review
Unlikely	LOW Accept the risk Routine management	LOW Accept the risk Routine management	MEDIUM Specific responsibility and treatment	MEDIUM Specific responsibility and treatment	HIGH Quarterly senior management review
Possible	LOW Accept the risk Routine management	MEDIUM Specific responsibility and treatment	MEDIUM Specific responsibility and treatment	HIGH Quarterly senior management review	HIGH Quarterly senior management review
Likely	MEDIUM Specific responsibility and treatment	MEDIUM Specific responsibility and treatment	HIGH Quarterly senior management review	HIGH Quarterly senior management review	EXTREME Monthly senior management review
Almost certain	MEDIUM Specific responsibility and treatment	MEDIUM Specific responsibility and treatment	HIGH Quarterly senior management review	EXTREME Monthly senior management review	EXTREME Monthly senior management review

Consequence on financial reporting

APPENDIX 2: CONTROL RISK AND FINANCIAL REPORTING RISK ASSESSMENT

Financial risk	Financial reporting risk	Effect of the risk	Effect of the financial reporting risk	Impact	Mitigating control for financial risk	Mitigating control for financial reporting risk	Compensating controls	Date contril tested	Findings	Matters artising	Sign off
Credit worthiness of debtors	IFRS 9 impairment adjustment is incorrect	Debtors may become irrecoverable	The expected credit loss calculation may be inadequate	Moderate	Credit bureau tests performed on all debtors exceding R5000	Credit rating and security categorisation according to IFRS 9 verified and signed off by management prior to impairment test calculations	Legal right to repossess goods reduces the potential loss	Jan 2020	Control functioning as documented	None noted	Credit manager

APPENDIX 3: THE COSO FRAMEWORK

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a joint initiative of five private sector organisations and is dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal control and fraud deterrence. COSO's Internal Control – Integrated Framework[6] enables organisations to effectively and efficiently develop systems of internal control that adapt to changing business environments, mitigate risks to acceptable levels, and support sound decision-making and governance of the organisation.

An effective system of internal control demands more than rigorous adherence to policies and procedures: it requires the use of judgement. Management use judgement to daily to select, develop and deploy controls across the entity and apply judgement as they monitor and assess the effectiveness of the system of internal control.

The framework assists management in their respective duties regarding internal controls without being overly prescriptive. It does so by providing both understanding of what constitutes a system of internal control and insight into when internal control is being applied effectively.

It provides the following for management:

- A means to apply internal control to any type of entity, regardless of industry or legal structure, at the levels of the entity, operating unit, or function
- A principles-based approach that provides flexibility and allows for judgement in designing, implementing, and conducting internal control – principles that can be applied at the entity, operating and functional levels
- Requirements for an effective system of internal control by considering how components and principles are present and functioning and how components operate together
- A means to identify and analyse risks, and to develop and manage appropriate responses to risks within acceptable levels and with a greater focus on anti-fraud measures
- An opportunity to expand the application of internal control beyond financial reporting to other forms of reporting, operations, and compliance objectives
- An opportunity to eliminate ineffective, redundant, or inefficient controls that provide minimal value in reducing risks to the achievement of the entity's objectives

The framework provides three categories of objectives: operations, reporting and compliance objectives.

- The ***operations objective*** pertains to the effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss.
- The ***reporting objective*** relates to internal and external financial and non-financial reporting to stakeholders which would encompass reliability, timeliness, transparency or other terms as established by regulators, standard setters, or the entity's policies.
- The ***compliance objective*** pertains to adherence to laws and regulations to which the entity is subject

THE COSO FRAMEWORK HIGHLIGHTS THE FOLLOWING FIVE COMPONENTS OF INTERNAL CONTROL AS WELL AS 17 PRINCIPLES.

COMPONENTS	PRINCIPLES
Control environment	1 Demonstrate commitment to integrity and ethical values 2 Ensure that board exercises oversight responsibility 3 Establish structures, reporting lines, authorities and responsibilities 4 Demonstrate commitment to a competent workforce 5 Hold people accountable
Risk assessment	6 Specify appropriate objectives 7 Identify and analyse risks 8 Evaluate fraud risks 9 Identify and analyse changes that could significantly affect internal controls
Control Activities	10 Select and develop control activities that mitigate risks 11 Select and develop technology controls 12 Deploy control activities through policies and procedures
Information and Communication	13 Use relevant, quality information to support the internal control function 14 Communicate internal control information internally 15 Communicate internal control information externally
Monitoring activities	16 Perform ongoing or periodic evaluations of internal controls (or a combination of the two) 17 Communicate internal control deficiencies

The framework acknowledges that whilst internal controls provide reasonable assurance of achieving an entity's objectives, limitation exists. Internal controls cannot prevent bad judgement or decisions, or external events that can cause an organisation to fail to achieve its operational goals. Limitations may arise from:

- Suitability of objectives established as a precondition to internal control
- The reality that human judgement in decision-making can be faulty and subject to bias
- Breakdowns that can occur because of human failures such as simple errors
- The ability of management to override internal controls
- The ability of management, other personnel, and/or third parties to circumvent controls through collusion

NOTES

6 https://www.coso.org/Documents/990025P-Executive-Summary-final-may20.pdf – the executive summary is attached. The framework is available for purchase.

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