THE BOARD’S ROLE AND RESPONSIBILITIES OVER THE CONTROL ENVIRONMENT
Road Map of Presentation

- Review of the key responsibilities of the Board - the direct links to the IC System & IA function

- Analyze the internal control system’s definition, objectives and elements

- Distinguish IC System from the IA Function

- Analyze the internal audit function’s definition, organization and structure

- Overview of External Audit and Compliance

- Audit Committee role, responsibilities and detailed duties
Key Functions of the Board

• Reviewing and guiding corporate strategy and risk policy

• Monitoring effectiveness of the company’s governance

• Monitoring and managing potential conflicts of interest

• Ensuring the integrity of the firm’s accounting and financial reporting systems, including the independent audit and that appropriate controls are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

• Overseeing disclosure and communications

OECD Corporate Governance Principles Section VI
## Division of Responsibilities

<table>
<thead>
<tr>
<th>Board of Directors</th>
<th>Management</th>
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</thead>
<tbody>
<tr>
<td><strong>Oversee</strong> the development and implementation of an adequate internal control systems</td>
<td><strong>Establish</strong> and maintain an adequate and effective system of internal controls</td>
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<tr>
<td><strong>Monitor</strong> the independent assurance function</td>
<td><strong>Develop</strong> a system to monitor and control risks</td>
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Internal Control Definition

• A process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives.

• Operating objectives

• Reporting objectives

• Compliance objectives

COSO – Integrated Framework, May 2013
BASEL FRAMEWORK FOR INTERNAL CONTROL SYSTEMS IN BANKING ORGANIZATIONS (1998)

1. Management oversight and the control culture.
2. Control activities and segregation of duties.
4. Information and communication.
5. Monitoring activities and correcting deficiencies.

COSO INTERNAL CONTROL - INTEGRATED FRAMEWORK (2013)

1. Control Environment - The set of standards, processes, and structures that provide the basis for carrying out internal control across the organization.
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring Activities

Mandatory Elements
IT Controls and Emerging Trend of the Board Technology Committee

COBIT 5: Framework for IT Internal Controls

- COBIT 5 (Control Objectives for Information and Related Technology), as published by ISACA in 2012, provides comprehensive framework to assist enterprises in the governance and management of IT.

- Recognizes the expanded role of IT as an integral part of the business.

- Used as the basis for the framework for managing operational and information risk in the context of Basel.
Key Questions to Ask about Internal Controls

• What is the role of the audit committee and the board in ensuring that proper internal controls are maintained, risks are managed and that the company is in compliance with all relevant laws and regulations?

• Describe how the company’s internal controls (operational, financial and compliance, including IT systems) are designed and maintained?

• Are internal controls risk based?

• Were there any significant problems in internal controls in the past 5 years? Please describe.

• Does the board monitor that management responds to the deficiencies identified in Management Letters?

• Are internal controls designed in accordance with a relevant framework, e.g., COSO, COBIT, Basel?
Internal Control System | Internal Audit Function

Internal Control systems are the means by which:

• Operations are conducted in accord with prescribed policies and procedures.
• The enterprise is in compliance with applicable laws and regulations.
• The enterprise’s assets and information are protected from improper use.

Internal audit provides the board and management with reasonable assurance that these systems are adequate and functioning well.

Independent, objective assurance and consulting activity designed to add value and improve an organization’s operations.

It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
IN YOUR ORGANIZATION CURRENTLY, WHAT AREAS ARE INTERNAL AUDIT’S TIME AND RESOURCES PRIMARILY APPLIED TO?

Internal Audit Objective and Tasks

OBJECTIVE: To provide the board and management with reasonable assurance that the organization has a sound system of internal control to protect against loss

- Evaluate the system of internal controls, risk management and CG
- Assess risks / component of risk management
- Test operations of systems (including IT)
- Communication, recommendations for improvement and follow up
Internal Audit’s Assessment of Risk Management Function

Polling Question: In your opinion, how mature is your organization’s risk management function?

0%  A. We do not have a formal program or resources

0%  B. In the development stage

0%  C. Immature

0%  D. Implemented, but requires additional work and resources

0%  E. Robust and embedded framework and resources in place
Internal Audit Assessment of Risk Management Function

In your opinion, how mature is your organization's risk management function?

- 41% Robust and embedded framework and resources in place
- 20% Implemented, but requires additional work and resources
- 19% Immature
- 11% In the development stage
- 9% We do not have a formal program or resources

Key Features
The Internal Audit Function

- Continuity
- Independence
- Impartiality
- Professional competence
- Scope of activity
- Internal audit charter

Basel, The Internal Audit Function in Banks (2012)
### CG Structure: Internal Audit Roles and Functions

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<td><strong>Oversee</strong> the development and implementation of an adequate internal control systems</td>
<td><strong>Establish and maintain</strong> an adequate and effective system of internal controls</td>
<td><strong>Assist</strong> management in the efficient and effective discharge of their responsibilities</td>
</tr>
<tr>
<td><strong>Monitor</strong> the independent assurance function</td>
<td><strong>Develop</strong> a system to monitor and control risks</td>
<td><strong>Advise and make recommendations</strong> on internal control, risk management and corporate governance</td>
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Internal Audit helps to monitor the Internal Controls

Board, in particular, the Audit Committee oversees

Managers have primary task to design and maintain controls

Monitoring the Internal Control Process

Internal audit function evaluates

External auditors assess and opines on
Outsourcing: Where Internal Audit Gets the Talent they Need

Polling Question: Do your outsource your internal audit?

0% A. Entirely
0% B. Partially
0% C. Not at all
0% D. I don’t know
Outsourcing: Where Internal Audit Gets the Talent they Need

Corporate Governance Relationships

- Board of Directors
  - Risk Committee
  - CEO / Management Board
  - Audit Committee
  - Other Committees
  - External Auditor
  - Internal Audit Function
  - Compliance Function

- CRO
- CIO/Other
- COO
- CFO

Control Environment

International Finance Corporation (IFC)
Internal Audit Reporting

Polling Question: How frequently does your internal audit committee interact with the board of directors?

0%  A. Monthly
0%  B. Quarterly
0%  C. Annually
0%  D. I don’t know
Internal Audit Reporting

How frequently does your internal audit committee interact with the board of directors?

- 61% Annually
- 17% Quarterly
- 12% Monthly
- 6% Ad hoc
- 2% Not sure
- 2% Weekly

Future of Internal Audit Function: Trusted Advisor

Key Questions to Ask about Internal Audit

• To whom does the Chief Internal Auditor report? How is the IA chief hired/fired and does the CIA privately meet with the board or the audit committee?

• What is the relationship between IA, the Chair, CEO, CFO, CRO, CIO and external auditor?

• Are the IA work plans reviewed by the audit committee or the board?

• Does the board monitor management’s response to deficiencies and weaknesses identified by the IA function?

• Are internal audits risk based?

• Were there any significant problems with internal audit in the past five years? Please describe.

• Is corrective action taken, followed-up on?

• What are the audit standards applied by IA, e.g., IIA Standards?

• Does the external auditor rely on the work of internal audit in conduct of the annual financial statement audit?

• How are conflicts of interest with internal auditors handled?
External Audit

- Audit committee/board in charge of selecting an auditor
- Auditor independence (attention to non-audit services)
- Regular contact with the auditor (through audit committee/board)
- Evaluation by the audit committee/board of the auditor’s quality
- Invite representatives of the auditor to the shareholders meetings
- Follow up on management letters issued by the auditor
- Disclosure of the audit report (annual report, web-site)
- Auditor/lead partner rotation
Changes in Audit Reporting – IAASB Exposure Draft

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements¹

Opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, (or give a true and fair view of) the consolidated financial position of ABC Company and its subsidiaries (the Group) as at December 31, 20X1, and (of) their consolidated financial performance and their consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

We have audited the consolidated financial statements of the Group, which comprise the consolidated statement of financial position as at December 31, 20X1, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group within the meaning of [indicate relevant ethical requirements or applicable law or regulation] and have fulfilled our other responsibilities under those ethical requirements. (see Question 11) We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters (see Questions 1-8)

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements. Key audit matters are selected from the matters communicated with [those charged with governance], but are not intended to represent all matters that were discussed with them. Our audit procedures relating to these matters were designed in the context of our audit of the consolidated financial statements as a whole. Our opinion on the consolidated financial statements is not modified with respect to any of the key audit matters described below, and we do not express an opinion on these individual matters.

The four specific topics and content presented below are purely for illustrative purposes. This section would be tailored to the facts and circumstances of the individual audit engagement and the entity. Accordingly, the IAASB has intentionally drafted these examples in a manner that illustrates that Key
Key Questions to Ask about External Audit

- Who, formally and in practice, selects the external auditors and to whom are they accountable?
- What is the relationship between EA, the Chair, CEO, CFO, CRO, and CIA?
- Is there the policy to rotate the external auditors or the lead audit partners?
- Has the Audit Opinion ever been a Qualified, Disclaimer or Adverse Opinion? Why?
- Does the board monitor management’s response to accounting and reporting control deficiencies and weaknesses identified by Management Letters and IA?
- Is there the policy to rotate the external auditors or the lead audit partners?
- What are the accounting standards used to report results (IFRS, GAAP)? What are the audit standards used by the external auditor (ISA, GAAS)? Any disparities with local standards and international standards?
- Does the external auditor rely on the work of internal audit in conduct of the annual financial statement audit?
- Does the external auditor provide any other services besides the external audit?
Compliance and Whistleblowing: How is compliance related to corporate governance?

Source: Frame of reference for integrated GRC; Racz, Weippl, Seufert, 2010
Key Questions to Ask about Compliance

- Is there a compliance function? Is it separate department/unit (centralized or decentralized)? Independence?

- What is the relationship between CCO, the Chair, CEO, CFO, CRO, and CIA?

- Is there a code of ethics?

- Please describe the company’s compliance program or procedures including training of employees, auditing and monitoring systems, company “hotline” for reporting violations?

- Is there a Compliance Register?

- Are instances of non-compliance followed up on with corrective action?
Audit Committee Structure

Charter or bylaws

Co-ordination with and information links to full board

Composition

- >= 3 members
- Independence
- Financial literacy and financial expertise

Meetings – At least quarterly

- Frequency of audit committee meetings is expected to vary according to the stage of development of oversight activities in the company
- “Normal” schedule of audit committee meetings that may be expanded when critical issues arise
Audit Committee Role and Responsibilities

- Appoints the external auditor and key contact point
- Recommends the audit fee to the Board and approves any non-audit services provided by the external auditor
- Discusses with the external auditor, the nature and scope of the audit and reviews the auditors quality control mechanisms

- Monitors and reviews the activities of internal audit
- Ensures that the internal audit is adequately resourced and has sufficient standing within the company
- Maintains the independence of IA and provides necessary resources
- Considers management response to IA recommendations

- Ensure that a comprehensive internal controls framework in place
- Ensures the presence of a risk management policy document

- Reviews significant reporting issues and accounting policies
- Reviews company’s semi-annual and annual financial statements
- Reviews formal announcements made to the shareholders
- Reviews relevant regulatory returns filed and disclosures made by the company
- Reviews the going concern assumption of the company
- Monitors and approves material related-party transactions
Expanding Role and Expertise of the Audit Committee

In addition to “financial expertise,” what other in-depth experience or expertise currently resides on your AC?

- Risk/risk management: 61%
- Industry: 59%
- Legal/regulatory compliance: 58%
- M&A: 39%
- International: 32%
- Tax: 27%

- Technology: 26%
- Other: 6%
- No additional expertise on the audit committee: 4%

In what areas would you favor additional reporting/communication from AC to investors?

- Audit committee’s role in risk governance: 30%
- Significant financial statement/audit issues and how they were addressed: 22%
- Oversight/evaluation of external auditor (including independence and objectivity, non-audit services, rationale for reappointment, etc.): 25%
- Oversight of the CFO/finance team: 15%
- Effectiveness of audit process: 24%
- Oversight/evaluation of internal auditor: 14%
- Audit committee’s effectiveness (qualification of members, performance evaluation, etc.): 23%
- Audit committee meetings (number, attendees, etc.): 22%
- None of the above: 40%
- Other: 1%

Source: KPMG ACI Global Audit Committee Survey, (2014)
CASE: Banco Navarra III: What is the Role of the Audit Committee?

• Read the case

• Pair or three-group analysis of the case
  • Summarize the situation, from Carlos’ perspective:
  • What should Carlos do?

• Table groups: Identify CG issues (2-3)

• Report to whole group & discuss
Key Messages

• The Board has responsibility for an adequate control environment

• Adequate internal controls and a well-functioning internal audit function are the Board’s best friend in this regard
Thank you!