

## COMPARATIVE ANALYSIS OF INTERNAL CONTROL COVERAGE IN VARIOUS CODES OF CORPORATE GOVERNANCE

### Background

All over the world “code of corporate governance” is issued by the regulator of capital markets to protect the interest of shareholders. As the economies, culture and companies are not stagnant and always go through an evolution phase; so does the requirements to govern the organizations. This series of publications aims to provide a comparative analysis of various Codes across different jurisdictions. It is for the regulators, investors, directors, company’s management and public at large to see where different countries stand in this domain with respect to rest of the world and keep on evaluating any changes that may be required from time to time

The comparison is issued through a series of documents and this particular publication covers the area of “**Internal Control**”. In general Codes of Corporate Governance touch upon Internal Control System, Responsibilities of Audit Committee & Responsibilities of Board of Directors within this domain and the comparative analysis is performed on the same.

While there is no right or wrong, codes of different countries are ranked with respect to details the topic of Internal Control is covered. This ranking is based on an assumption that more the clarity is provided on the expectations from the organizations in the Code, better the chances are that these will be adhered to.

It is worth mentioning here that all the points which are not explicitly mentioned in any “code” are considered as a difference for comparison purposes, though these may have been captured in a broader term.

We hope that this effort will be useful for various stakeholders to develop well governed organization for creating better working lives.

## COMPARATIVE ANALYSIS OF INTERNAL CONTROL COVERAGE IN VARIOUS CODES OF CORPORATE GOVERNANCE FOUNDATIONS OF EFFECTIVE INTERNAL CONTROL SYSTEM

Below are the principles/foundations of an effective Internal Control system as per COSO. (Internal Control Framework) These serve as a guideline the gauge the extent to which Internal Control system is elaborated in various codes

### *Control Environment*

1. The organization demonstrates a commitment to integrity and ethical values.
2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.
3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

### *Risk Assessment*

6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.
8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.
9. The organization identifies and assesses changes that could significantly impact the system of internal control.

### *Control Activities*

10. The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
11. The organization selects and develops general control activities over technology to support the achievement of objectives.
12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.

### *Information and Communication*

13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.
14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
15. The organization communicates with external parties regarding matters affecting the functioning of internal control.

### *Monitoring Activities*

16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.
17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

## COMPARATIVE ANALYSIS OF INTERNAL CONTROL COVERAGE IN VARIOUS CODES OF CORPORATE ASSESSMENT SUMMARY

Jurisdiction	Internal Control Domain		
	Internal Control System	Responsibilities of Board	Responsibilities of Audit Committee
Bahrain			
South Africa			
UAE			
Pakistan			
United Kingdom			
United States of America			
Kingdom of Saudi Arabia			

## Effective Internal Control System

In terms of detail, **United Arab Emirates (UAE)** and The **Kingdom of Saudi Arabia (KSA)** fare highly in describing the what an effective Internal Control System entails as part of their Codes of Corporate Governance.

Corporate Governance in **UAE** legislation tells us that a Precise internal control system aims at developing an assessment of the Company's:

- a) means and methods of risk managements,
- b) sound application of corporate governance rules
- c) verifications of compliance by the company and its employees with applicable laws, regulations and resolutions that govern its operations as well as
- d) internal procedures and policies and review of financial information that is presented to the company's management and used for drafting financial statements.

The Corporate Governance Regulations of Kingdom of **Saudi Arabia** furthers these points with a requirement for Establishing an Internal Control Unit for the purpose of assessment & management of risks. The internal audit unit will also submit a quarterly report regarding its assessment with opinions and recommendations.

The **Pakistani** Code of Corporate Governance describes the usefulness of a basic risk register containing all the different kinds of risks, their impacts and probabilities and recommended responses as well as a company manual that explains these responses in great detail and provides policies on areas like anti-corruption & money-laundering, key operational risks & whistle blowing and regulatory compliance. Furthermore, Procedures that lead to a better Internal Control environment have also been listed like segregation of duties, accounting reconciliations and monitoring of cash flows, budgetary controls and security of premises. Things not touched upon are integrity and ethical values or generation & use of relevant quality information. **United Kingdom's** code is very similar to Pakistan's, in that it also advocates specification of objectives for the identification & assessment of risks, but does not include Internal communication of objectives and responsibilities like mentioned in the prior codes.

On the other hand, Principles of Corporate Governance for the **United States** propagates integrity and ethical values as well as communication of deficiencies and taking corrective actions but fails to mention potential for fraud or accountability for those held responsible. It also does not touch on basics of internal control like establishment of reporting lines and delegation of responsibilities as well as risk management.

Although the appointment of a governance officer to ensure the availability of an internal control system, much like the Internal Audit Unit specified in KSA's Corporate Governance Regulations is unique to the **Bahrain** Code of Corporate Governance, there is very little else that the code describes in terms of what an internal control system entails or why it should be in place.

The code of corporate governance for **South Africa** restricts to giving the audit committee a strong responsibility but does not mention what an effective system is.

Jurisdiction	Effective Internal Control System
Bahrain	
South Africa	
UAE	
Pakistan	
United Kingdom	
United States of America	
Kingdom of Saudi Arabia	

## Responsibilities of the Board

Corporate Governance in **UAE** legislation states that the Board is to issue an internal control regulation. This is then to be implemented by a relevant department whose objectives and duties have also been determined by the Board. The board shall also do an annual review of the internal control system, covering basic control elements, scope & nature and any changes that have taken place since the last review. This system helps the Board identify potential risks and cases of fraud.

The **Pakistani** code of corporate governance also emphasizes the Board's responsibility of risk oversight with a regular review of the board's approach towards internal control and the need for applying Financial Reporting Standards.

The **UK** Corporate Governance Code is again very similar to Pakistan's Code with regards to the responsibilities of the Board. Establishing transparent arrangements for ensuring sound risk management & corporate reporting are at the forefront of its requirements. Also maintaining an appropriate relationship with the company's auditors and an annual review of internal control system (including financial, operational and compliance controls). The annual report is to also include a further report on the board's review of the effectiveness of company's internal controls system.

Corporate Governance Regulations of Kingdom of **Saudia Arabia** gives a very detailed description of the Board's responsibilities with regards to internal controls including; developing a written policy, ensuring integrity of financial statements, ensuring implementation of appropriate control procedures and reviewing the effectiveness of these procedures on an annual basis. It also mentions the role of Senior or Executive Management in implementing Internal control and risk management systems and procedures.

King IV's Report on Corporate Governance for **South Africa** states that the governing body (or the Board) is to assume responsibility for assurance by setting the direction concerning the arrangements for assurance services and functions. These arrangements need to be effective in order to enable a sound internal control environment.

Principles of Corporate Governance for the **United States** highlights the importance of Internal Control procedures designed to detect and deter fraudulent activity. It also stresses that it is the Board's responsibility to establish, maintain and periodically evaluate the company's Internal Controls over financial reporting.

Except for touching on the Board's need to appoint audit committee members with the right expertise, no other responsibilities of the Board have been specified in terms of Internal Control in **Bahrain's** Code.

Jurisdiction	Responsibilities of the Board
Bahrain	
South Africa	
UAE	
Pakistan	
United Kingdom	
United States of America	
Kingdom of Saudi Arabia	

## Responsibilities of Audit Committee

Apart from overseeing the system of internal controls over financial reporting, the principles of Corporate Governance for **US** describes how the committee is to keep a check on the disclosure controls and procedures and periodically review these procedures for maintaining and evaluating the effectiveness of these systems. Steps are taken to correct any significant deficiencies or material weaknesses according to a timetable.

King IV's Report on Corporate Governance for **South Africa** puts strong responsibility on the Audit Committee for enabling an effective internal control environment and giving its views on the design and implementation of these controls as well as the nature and extent of any weaknesses in the design/implementation that lead to material loss or fraud.

The role of the Audit Committee is the only area that has been touched in detail in **Bahrain's** new code. Assessing the internal control system and financial reports as well as giving recommendations is the crux of what the Audit Committee's work entails. Most of the other Codes of Corporate Governance also state the same in addition to the Audit Committee being integral to external audits and the preparations of financial statements.

In **UAE** Corporate Governance legislation, the Audit Committees activities are summarized in reviewing the company's internal controls. It also makes note of the auditing of financial statements as one of the most important work to ensure the effectiveness of the system of internal control. At several instances it stresses the audit committees primary responsibility of checking, discussing and making recommendations to management regarding this.

According to **Corporate** Governance Regulations of Kingdom of **Saudia Arabia**, the Committee needs to be competent in monitoring the integrity and effectiveness of internal control systems and give an opinion with respect to the adequacy of these controls

Under the **Pakistani** code of corporate governance, reviewing the company's internal control systems is the only thing mentioned about the Audit Committee's role.

Similarly in the **UK** Corporate Governance Code , the main role and responsibilities of the Audit Committee is to review the company's internal financial controls and, unless expressed otherwise by the Board.

Jurisdiction	Responsibilities of Audit Committee
Bahrain	
South Africa	
UAE	
Pakistan	
United Kingdom	
United States of America	
Kingdom of Saudi Arabia	