An assessment of the effectiveness of issue tracking in risk management in South African Commercial Banks

Stephen O Migiro
migiro@ukzn.ac.za
University of KwaZulu Natal
Graduate School of Business & Leadership

ABSTRACT

The objective of this paper was to ascertain whether or not banks have formal processes for tracking rectification of identified risks. Due to lack of any prior study on this aspect, an exploratory research design and a self-administered questionnaire wereused.

The study revealed that all the participating banks have established processes to track and rectify risk management control weaknesses, and governance of this process is centralised in all the banks in the study. However, ownership and responsibility for the process could not be determined. In addition, the study could not clearly identification taken by management to rectify control weaknesses identified in the risk management process. Nonetheless, all the participating banks agreed that rectifying processes relating to identified risks positively contributed towards risk reduction in banks.

KEY WORDS

Risk Management, Issue Tracking, Internal Controls.

1. INTRODUCTION AND STATEMENT OF THE PROBLEM

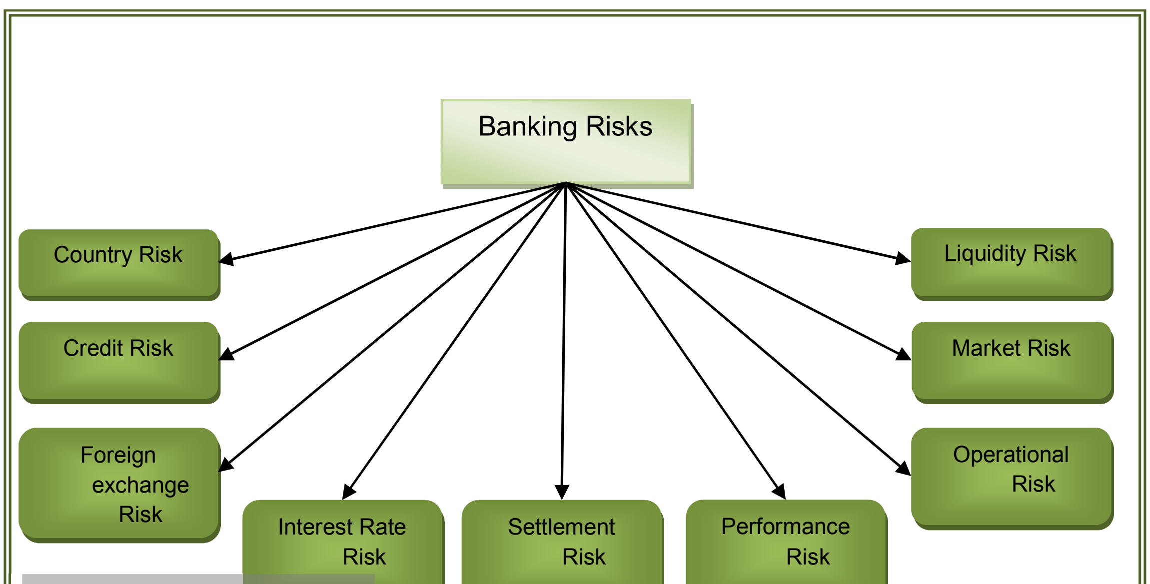
Business enterprises operate in an uncertain environment for rewards (King Committee, 2009). Reward is a function of opportunity and risk. According to Rikhardsson, Green & Rosemann (2006),things we thought could never happen have happened, and things we thought will happen did not. Since all businesses operate in an uncertain environment, the need for effective management of potential risks is imperative. Risk is a function of a likelihood of something happening and the extent of loss that could arise from that incident (Ranong &Phuenngam, 2009). Risk management is a process that involves the identification, assessment and controlling of events that could happen and have a negative or positive impact on the organisation's business objectives (Power, 2009). The keyto managing risk is alertness and responsiveness to emerging trends coupled with limiting vulnerability to mistakes (Grant, 2008:303). To this end, the enterprise risk management (ERM) function in enterprises seeks to facilitate optimisation of the balance between risks and rewards (King Committee, 2009). However, risk management does not rest only in the risk officers of risk management departments. Each employee in the work environment should participate in the management of risk.

ERMis a process, established by an entity's board of directors, management and other personnel, and it is applied in strategy setting and across the enterprise. It is designed to identify potential events that may affect the entity, and to manage risk within the entity's risk appetite. It alsoprovides reasonable assurance regarding the achievement of business objectives (Committee of Sponsoring Organisations of the Treadway Commission(COSO), 2004). Following increasing realisation of the importance of risk management due to increasing uncertainty, an Enterprise Risk Management Framework was developed by COSO, which is now widely accepted as a useful tool in managing risk across enterprises. The framework identifies eight components of enterprise risk management which include,Internal environment (organisational culture, risk appetite and ethical values), business objectives establishing the basis for operations (Havenga, 2006), events that could affect the achievement of the set objectives, assessment of the events and impact on set objectives, risk response, information and Communication, monitoring and control activities.

ERM helps to provide a solid foundation for enterprises to enhance corporate governance and create greater shareholder value. However, very few attempts have come close to fully achieving these objectives (Bowling & Rieger, 2005). An organisation with strong risk management culture should be able to approach high risk situations with confidence and should know when to stop. It is worth noting that there is no universal ideal ERM system. Factors contributing towards variations in ERM systems include environmental uncertainties, industry competiveness, size and complexity of the organisation and board of directors monitoring (Gordon, Loeb & Tseng, 2009).

A study conducted by Fraser & Henry (2007) indicates that the company board is responsible for risk management; however ownership of risk resides with lower managers. The company management is accountable to the board for designing, implementing and monitoring the risk management process and integrating/ embedding it into the daily activities of the organisation. Hence, risk management is the primary responsibility of line management which should be regarded as the first line of defence (King Committee, 2009).

Thus, as a business, banks face risks that are common to all businesses (2002:11). However, there are bank specific risks. These are shown in the framework below.



Source: Bessis (2002:12)

The risk framework identifies risks that are of concern to the banks and is referred to as Lam's Jigsaw framework (Lam 2003:58). These risks may further be categorized as credit risk, market risk, operational risk and business risk (BIS, 2006).

A review of a sample of 2009 annual reports of the South African local commercial banks shows that there is no standardised allocation of risks identified by Bessis (2002:12) in the frameworkbelow. This list is not exhaustive. It does,however ,contain the majority of risks that are common to all the banks. Furthermore, section 39(3) of the regulation relating to Banks (2008) identifies 16 risk types and in addition makes provision for unidentified risks. It is our view that these risks can be categorised into Lam's Jigsaw framework (Lam 2003:58) on the basis of the industry practice as follows:

Table 1 - Classification of bank risks

Operational risk	Credit risk	Market risk	Business Risk
Operational risk	Credit risk	Currency risk	Capital risk
Technology risk	Concentration risk	Equity risk	Compliance risk
	Counterparty risk	Interest rate risk	Liquidity risk
		Market risk	Reputational risk
		Translation risk	Pro-cyclical risk
			Solvency risk

Despite the importance of ERM in financial institutions, there arefew empirical studies on risk management practices in these institutions. Moreover, extant research onenterprise risk management in financial institutions has focused more on the extent of the implementation of risk management practices, in general,at the strategic level, with less focus on specific components of the risk management process such as issues tracking,and control of weaknessesidentified in the risk management process to effect improvements. Thus, this paper contributes to the existing body of knowledge byexploring the extent to which managers in banks track, rectify and control weaknesses in risk management processes within the South African Commercial banks.

1. METHODOLOGY

Due to the dearth of literature on issue tracking in commercial banks, an exploratory research design was considered appropriate for this study (Leedy & Ormrod, 2005). A sample of twelve commercial banks participated in the study. Subsequently, aself-administeredquestionnairewas used to collect data from senior risk management officers working in these banks. The questionnaire contained 25 statements focusing on issue tracking.Response to each statement was represented by a number:1 – Strongly agree; 2 – Agree; 3 – Indifferent; 4 – Disagree and 5 – Strongly Disagree.In addition to these closed statements, respondents were allowed to make general comments about issue tracking through open questions, and data was descriptively analysed.

Table 2. –Questionnairestatements

	STATEMENT
	My bank has an issue tracking system to track control weakness issues identified by **management**
	My bank has an issue tracking system to track control weaknesses identified by **external auditors**
	My bank has an issue tracking system for issues identified by **internal auditors**
	In my bank tracking of issues is centralised at corporate level
	Each **division** of my bank tracks its own issues
	Each manager of a **function** in my bank is responsible for tracking his or her issues
	The Internal audit department is responsible for tracking all the issues
	Rectifying control weakness raised during audit is a balance scorecard item for: **Executive Manager**

	Rectifying control weakness raised during audit is a balance scorecard item for: **Senior Manager**
	Is rectifying control weakness raised during audit a balance scorecard item for: **Junior Manager?**
	Rectifying control weakness raised during audit is a balance scorecard item for: **Staff**
	Rectification of a control weakness in my bank is entrenched into the control environment when **it is included in the staff job description.**
	ectification of a control weakness in my bank is entrenched into the control environment when **it has been updated in the related policy**
	ectification of a control weakness is entrenched into the control environment when **it is communicated by announcement through email or during a staff meeting**.
	All outstanding control weaknesses are reported to executive management regularly.
	Only material control weaknesses are reported to executive management regularly.
	The total number of control weaknesses raised by independent assurance providers during the year has been increasing.
	All recommended control improvements are tracked until implemented.
	There are control weakness issues that have not been rectified for more than twelve months.
	Executive management monitors long -outstanding issues.
	Long -outstanding issues are reported tothe Audit Committee.
	When the issue tracking was upgraded, there were issues that were lost.
	The closing oftracking issues on the system is signed off by aperson who raised them.
	idependent assurance providers follow up on issues that were raised on previous audit and comment on them in their current report.
	Tracking of control weakness issues has positively contributed towards improvement on your organisation's risk management

2. RESULTS

Out of the 12 commercial banks that were selected, one bank could not participate because it had merged with one of the big commercial banks. Consequently it was removed from the sample. Fourother banks declined to participate but. Responses were received from the remaining seven banks. Table 3 shows a summary of responses from the participating banks. To protect their identity, participating banks are identified using anonymous alphabetic letters.

Table 3. Summary of responses

Banks	A	B	D	E	I	K	L		
Statement								**Mode**	**Median**
1	1	2	1	4	1	2	4	1	2
2	1	2	1	1	4	2	2	1	2
3	1	2	1	1	3	2	2	1	2
4	1	2	2	1	1	2	4	1	2
5	2	2	1	5	1	4	4	2	2
6	2	2	1	5	1	4	4	2	2
7	2	1	3	1	5	2	2	2	2
8	3	2	3	4	4	4	2	4	3
9	2	1	3	4	4	2	2	2	2
10	2	1	3	3	4	4	4	4	3
11	2	2	3	3	4	4	4	4	3
12	2	3	2	3	4	4	4	4	3
13	1	4	2	4	2	4	4	4	4
14	3	1	3	1	2	4	4	3	3
15	2	4	1	1	2	3	2	2	2
16	2	2	3	4	1	2	4	2	2
17	3	3	4	3	4	1	3	3	3
18	1	5	2	1	1	4	2	1	2
19	3	1	2	2	2	1	2	2	2
20	1	3	1	1	1	4	4	1	1
21	1	2	1	1	1	2	4	1	1
22	5	1	4	5	2	3	4	5	4
23	1	5	5	1	2	4	2	1	2
24	2	2	1	1	2	3	2	2	2
25	1	1	1	2	1	4	2	1	1

Table 4 presents comments obtained from the open questions. Respondents' comments have been grouped into three themes.

Table 4– Comments from respondents

emes	General Comments from respondents
Challenges and impact of issue tracking process in the organisation	Yes, issue tracking in our bank is not taken serious enough by Management as can be evidenced through the comments that are made which are more to shut up the assurance providers without an effort to improve the control environment. Issue tracking within the organisation is not followed through,often resulting in control weaknesses surfacing regularly. The tracking of issues can work better if it is automated through Key Risk Indicators. Be sure that the issues raised in the first place are well thought

	through. The number of satisfactory audit reports is too few. The bank is well run…therefore is it possible to have so many issues? It would be helpful if care is taken by management to set realistic target dates for more complex matters requiring resolution…this may prevent the extent of overdue items. Audit should never be used to penalise staff unless negligence is evident. The Issues tracking system must be robust with no integrity of information doubts
Role of internal audit	In my bank, we do not close the issues unless issue assurance has been performed by internal audit to ensure that the controls are embedded and are working effectively as intended. The Internal Audit Function of the bank plays an important role in driving issues, monitoring and tracking process.
Balanced scorecard	We do not have a balanced scorecard

3. DISCUSSION OF RESULTS

To determine whether the banks in the study had a formalised system to track and embed improvements in the issue tracking control system, statements in Table 2 were made in the questionnaire and respondents were expected to respond accordingly.

Table 5 – Responses relating to existence of issue tracking

	STATEMENT	RESULT	
		ode	edian
	My bank has an issue tracking system to track control weakness issues identified by **management**	ongly Agree	gree
	My bank has an issue tracking system to track control weakness issues identified by **external auditors**	ongly Agree	gree
	My bank has an issue tracking system to track control weakness issues identified by **internal auditors**	ongly Agree	gree
	l recommended control improvements are tracked until implemented.	ongly Agree	gree

The analysis revealed that 86% of the banks surveyed have issue tracking processes in place. However, bankL did not have established issue tracking processes. Similarly, banks E, I and L indicated that they did not have issue tracking systems to track control weaknesses of issues identified by management or by external auditors and that issues identified were not tracked until implementation. Hence, further enquiry needs to be made to ascertain whetheror not the management of these banks have other methods to ensure continuous improvements in theissue tracking and control environment.

Regarding theexistence of issue tracking systems for issues identified by internal auditors, it was found that managers were more responsive to internal audit reports. These results could be suggesting that there could be more emphasis on tracking control weakness identified by internal auditors as distinct from issues identified by management or external auditors. Practical experience has shown that in some organisations, it is the responsibility of independent assurance providers, internal and external auditors, to monitor and track rectification of control weaknesses, and that management does not take ownership of the process. In this regard, Fraser and Henry (2007) recommended that the ownership of risk in organisations resides with management at lower levels. Furthermore, Principle 4.3 of the Code of corporate governance in King III recommends that line management should not abdicate their responsibility for risk management by contracting risk experts (King Committee, 2009).

This outcome supports Havenga (2006) that South African Commercial banks have established processes to monitor their controls and effect improvements where necessary. Therefore the selected banks did have a process for monitoring rectification of control weaknesses identified by various risk management role players. However, as discussed in the preceding paragraph, ownership and responsibility of the issue tracking process could not be clearly established. The responsibility for tracking these issues could reside in the internal audit department of the institution as opposed to line managers in accordance with the recommendations of King Committee (2009).

To determine the level within the organisation that the issue tracking process is driven in the banks in the study, respondents responded to relevant statements in the questionnaire. Results showed that most of the participating banks have their issue tracking processes centralised at corporate level. This confirms the findings of the Thompson, Strickland & Gamble's (2007: 378-379) study that highly centralised functions allows for top management to retain authority for most strategic and operating decisions and for them to keep a tight rein on responsible heads of business units, departments and key operating units. They indicate that this type of approach allows for strict enforcement of detailed procedures backed by rigorous managerial oversight and is the most reliable way of keeping the daily execution of strategy on track.

Positioning the issue tracking process at corporate level could allow consistent governance of risk and control improvements across the enterprise. This is consistent with the responses that the responsibility of rectifying control weaknesses is cascaded down to divisions and functions of the organisation. This also supports Havenga's (2006) statement that in the South African environment, there has been a paradigm shift within management sphere, where ERM has replaced silo- based risk management, providing an integrated approach to managing risk. This is also supported by Gordon, Loeb & Tseng (2009).

This provides an indication that executive management regularly monitors progress on rectification of control weaknesses through the reporting processes. 71% of respondents agreed that rectifying of control weaknesses formed part of senior managers' performance measurement. However it appears that the respondents were not sure about whether rectifying identified control weaknesseswas a performance measurement item for executive and junior managers and staff. There are manyfactors that could contribute to this observation, including the fact that participants were from second line of defence therefore their interaction was mainly with senior managers. However, lack of knowledge about levels of risk management responsibility by second line of defence did not provide a positive impression about the role of second line defence. This might be indicating some short comings in their effectiveness in their role. One of the respondents indicated that her organisation does not have scorecards, therefore that statement was considered non -applicable.

To evaluate the effectiveness of issue tracking processes in achieving sustainable improvements in the quality of risk management in South African commercial banks, the following were the responses to nine statements in the questionnaire.

Most respondents disagreed with statements in relation to themanner in which control weaknesseswere considered to have been verified in statements 12, 13 and 14. This could be an indication that the research tool did not cover all the possible options that are available or that there is no clear definition of a stage in which control weakness is considered to be finalised. No prior academic study has been conducted into this matter. It was on the basis of practical experience that these options were considered to cover all the possibilities. If one is to take into account the comment made by one of the respondent that some of the control weaknesses sometimes resurface after being rectified, it is possible that the current issue tracking process does not end when the rectification has been fully embedded in the internal control processes of the banks. Experience has shown that some of the control improvements are marked as implemented through temporary changes that are made by management. Once the issues have been signed off, no one is allocated the responsibility to ensure their sustainability. As a result the issues could resurface.

It is suggested that embedding improvements in the control environment, as recommended by Payne (2009), should entail on-going updating of policy and procedure documents with these improvements. These should be followed by allocating responsibility for executing these control changes to a specific employee by including it as part of his or her job description which is directly linked to their individual performance scorecard. This will promote sustainability of control improvements.

Most respondents were indifferent as towhether or not the number of control weaknesses identified by external auditors had been increasing. The indifference about the number of controls raised by external auditors could be a consequence of the independence of external auditors. During the external audit, auditors normally locate themselves in the finance department of the institution, deal with finance managers who are affected by the information they are looking for and report directly to the board audit committee. Therefore there is a strong possibility that issues raised by external auditors do not form part of internal risk management information and statistics. If this is the situation, then it could be an indication of a lack of an integrated approach in tracking rectification of control weaknesses. In addition, the responses to statement 17 contradict responses to statement 2; where most respondents strongly agreed with the statement that there is a process to track issues that are raised by external auditors. The other possibility is that, the current reporting process does not compare the number of issues raised by external auditors to historical information.

It is recommended that an analysis of changes in the number of issues raised on a year to year basis could be a measure of whether the issue tracking process is effective or not in improving the quality of the internal control environment. Most of therespondents indicated that there were control weaknesses that have remained not rectified for more than a year since they were identified. Some issues remain outstanding due to operational challenges within the organisation which makes it difficult for affected management to rectify. Sometimes issues remain unresolved due to management's casual approach towards rectifying control weaknesses. The other possibility is that management agreed to the issue just to "get auditors of their backs" and had no intention of rectifying the weakness. Close monitoring of these issues by boards could assist in minimising long- outstanding matters and in improving the quality of the internal control environment.

Most respondents agree that issue tracking contributes positively towards improving the quality of the control environment. Only one respondent disagreed with the statement and commented that in her bank issue tracking is not taken seriously enough by management resulting in control weakness resurfacing regularly as an issue.

4.1 Content analysis

Comments made by the respondents were grouped into three themes. The first theme was the challenges and impact of issue tracking process. The second was the role of internal audit, and the third, general. Regarding challengeson issue tracking, it was observed that most bank management do not take issue tracking seriously enough and this was demonstrated by their attitudes towards risk management assurance providers. Management in this context refers to managers of operating business units/ functions or departments. This response could be linked to a comment that rectified control weaknesses sometimes resurfaces at a later stage. Management's attitude could be a symptom of some of the factors has been highlighted by previous studies. These includes lack of support by senior management, the fact that risk management culture has not been fully embedded in the institution , as highlighted by Havenga (2006) and thenon-alignment of ERM objectives to business objectives causing managers to underestimate the value of risk management in relation to delivering on their responsibility (Warrier & Chandrashekhar, 2008). If management does not see the importance of internal control environment, they are likely to demonstrate a negative attitude towards it because they see it as a waste of time and company resources.

The second theme emphasised the role of the internal audit department. Theinternal audit department provides independent assurance to stakeholders about adequacy and effectiveness of the risk and control environment. This was confirmed by the responses received from the respondents. This finding is similar to that of Fraser& Henry (2007). The third theme touched on the use of the balanced scorecard. In one of the banks, the balanced scorecard was not used as a performance management tool.

4. CONCLUSIONAND RECOMMENDATIONS

The results of this study have shown that most South African banks have established processes to track issues raised during the risk and control assessment process of ERM. Governance of issue tracking is centralised at corporate level, however further study is needed to establish ownership and responsibility for this process. The study could not establish the stage at which rectification of issue tracking is considered embedded in the internal control system. However, the study established that the issue tracking process is effective in carrying out improvements in the internal control environment.

This study has developed some insight into key information relating to issue tracking and it has prompted the consideration of a few areas for in-depth future research.These include;.

- Accountability for issue tracking in organisations.
- This study obtained responses from risk officers who are in the second line of defence against risk. Opinions from other key stakeholders such as external and internal auditors, first line risk officers and managers and audit committee members could also be covered in future studies that should provide a consolidated view of the impact of issue tracking in commercial banking organisations; and
- A future study could investigate procedures followed by management to ensure that newly implemented controls are embedded in the organisations control environment and that rectified weaknesses do not resurface.

In addition to the above, it is recommended that matters covered in this study should be further studied in detail through case studies of individual banks and open interviews with relevant stakeholders.

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