



**Internal Controls Over Financial Reporting (ICoFR) –  
Overview and Practical Aspects**

## What is Internal Financial Control (IFC) ?

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- ▶ As per Section 134 of Companies Act, 2013

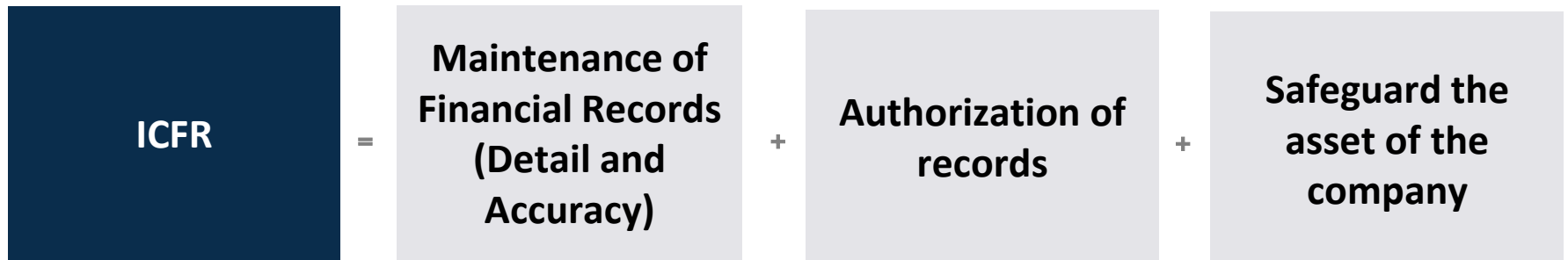
Internal financial controls (IFC) means the policies and procedures adopted by the company for ensuring,

- Orderly and efficient conduct of its business, including adherence to company policies
  - safeguarding of assets,
  - prevention and detection of frauds and errors,
  - accuracy and completeness of accounting records, and
  - timely preparation of reliable financial information.
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# What is Internal Control over Financial Reporting?

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- 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 generally accepted accounting principles*



# IFC – What it means?

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## Understand IFC



# Examples

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- ▶ *Purchase procedure – Below activities are being done by same person*
    - ▶ *Requisition of material*
    - ▶ *Vendor Finalisation*
    - ▶ *Material Receipt*
    - ▶ *Payment to Vendor*
  - ▶ *In accounting system*
    - ▶ *Accounting vouchers can be approved by purchase head as well*
    - ▶ *Adjustment entries in Bank can be entered without approvals*
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# Statutory requirements – What led this?

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- ▶ *Corporate frauds in India*
  - ▶ *Regulatory concerns of a mechanism to ensure better Internal control in the corporates*
  - ▶ *Cue from developed countries like US, Japan etc*
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# Statutory requirement

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## *Requirements on Internal Finance Controls (IFC) as per the Companies Act 2013*

Directors

- Sec 134(5) - an assertion in **Directors Responsibility Statement** that they have laid down internal financial controls to be followed and that such IFCs are adequate and operating effectively. Applicability – listed entities only

Audit Committee

- Sec 177 (4) (vii) the duties of the **Audit Committee** include evaluation of internal financial controls and to make a report to the board

Board

- Rule 8(5)(viii) of Companies (accounts) Rule, 2014 requires the Board of Directors' report of all companies to state in details the adequacy of internal financial controls with reference to the financial statements

Statutory Auditor

- U/s143(3)(i), **Statutory Auditors** are required to make a statement in their Auditors Report, whether the company has adequate IFC system in place and the operating effectiveness of such controls

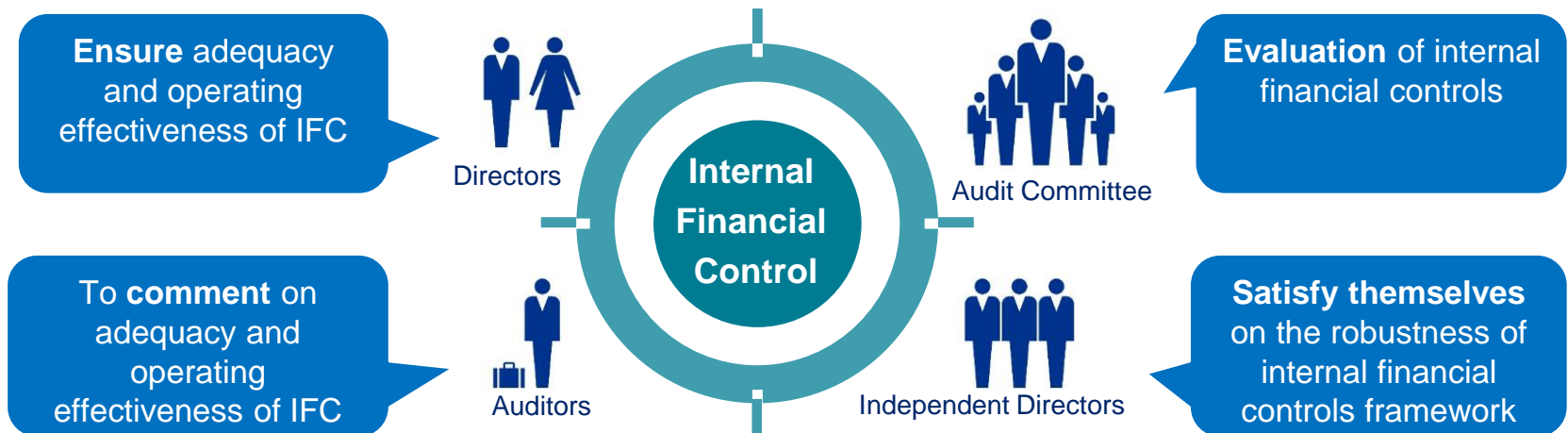
Independent Directors

- **Schedule IV** of The Companies Act 2013 state that **independent directors** shall satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible
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# Statutory requirement

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*Companies Act 2013 casts responsibility to ensure existence and operating effectiveness of Internal Financial Controls for various stakeholders*





# Statutory requirement

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- While the requirements on internal financial controls had been prescribed in Clause 49 of the listing agreement, **the Companies Act 2013** has broadened the canvas significantly.

## Listed Companies

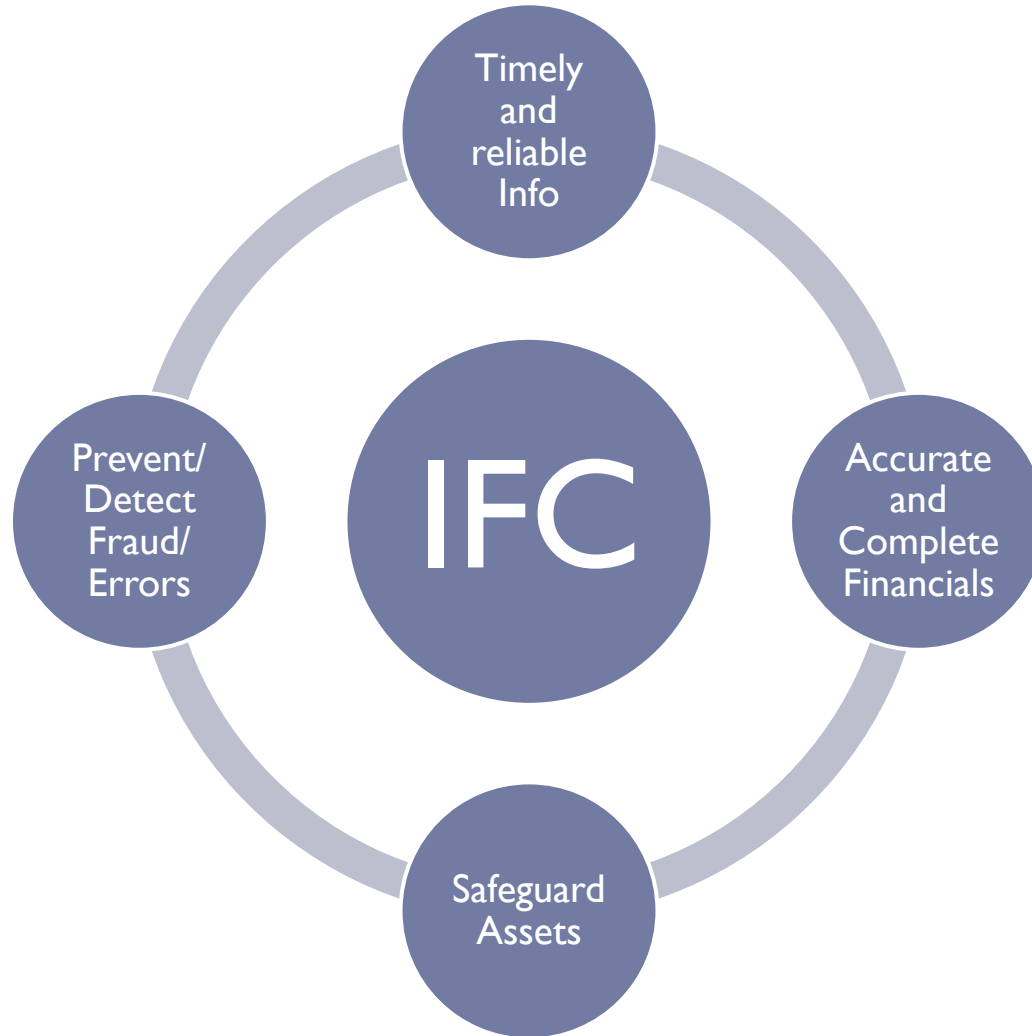
- **Coverage expanded** from Internal Control over Financial Reporting (ICOFR) to 'ICOFR and Operating Controls'
- **Responsibility** of ensuring adequate IFCs moved from CEO/ CFO to Board of Directors
- **Independent Directors** also given responsibility to satisfy themselves on financial controls.
- **Auditors** to report on adequacy and effectiveness of IFCs from FY 2015-16 instead of a limited CARO requirement earlier

## Unlisted Companies

- **Coverage significantly expanded** from limited requirements under CARO to setting up an adequately designed and effectively operating ICOFR framework
- **Responsibility** of ensuring adequate IFCs put directly on Board of Directors.
- Requirement to have **Independent Directors** added for certain unlisted companies and IDs given responsibility to satisfy themselves on financial controls.
- **Auditors** to report on adequacy and effectiveness of IFCs from FY 2015-16 instead of a limited CARO requirement earlier.

# IFC – The outcome!

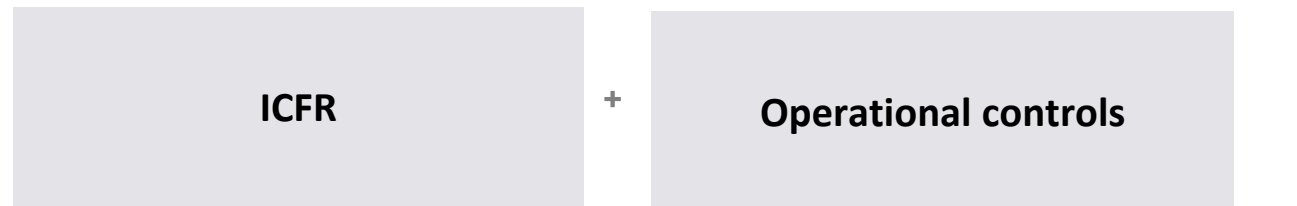
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# IFC – implication on listed/unlisted entity!

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## Understand IFC



*...and it's applicability on companies*

A dark blue horizontal bar containing the italicized text "...and it's applicability on companies". A white arrow points downwards from the center of the bar.

Public listed



Unlisted public



Private

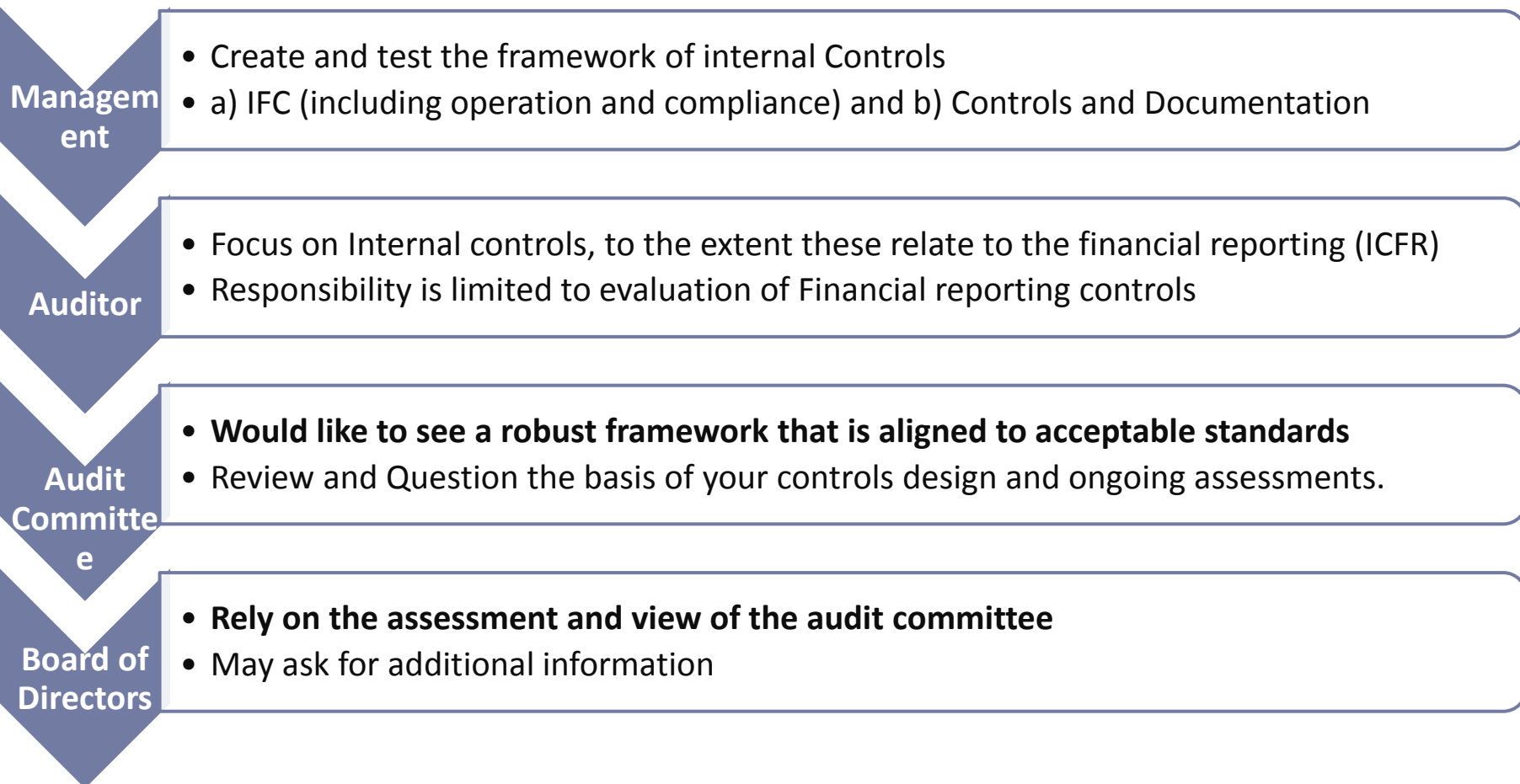


A starburst graphic with a jagged, multi-pointed outline. Inside the starburst, the text reads: "Measures for Operational Control and Fraud Prevention is not required for a Private Company". A gold checkmark is positioned above the starburst.

# How would stakeholders react to it?

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## Expected response of each stakeholders



# What does it mean for business?

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*In case of unlisted companies, the IFC is restricted to Internal Control over Financial Reporting only and hence Directors are responsible to establish, maintain and evaluate the operating effectiveness of all such IFC over financial reporting.*

## Impact for not adopting

- **Qualification of financials** by statutory auditors
- Non compliance to Section 134 of the Act may also lead to **penalty and punishments** for the Directors (Applicable only to listed companies)

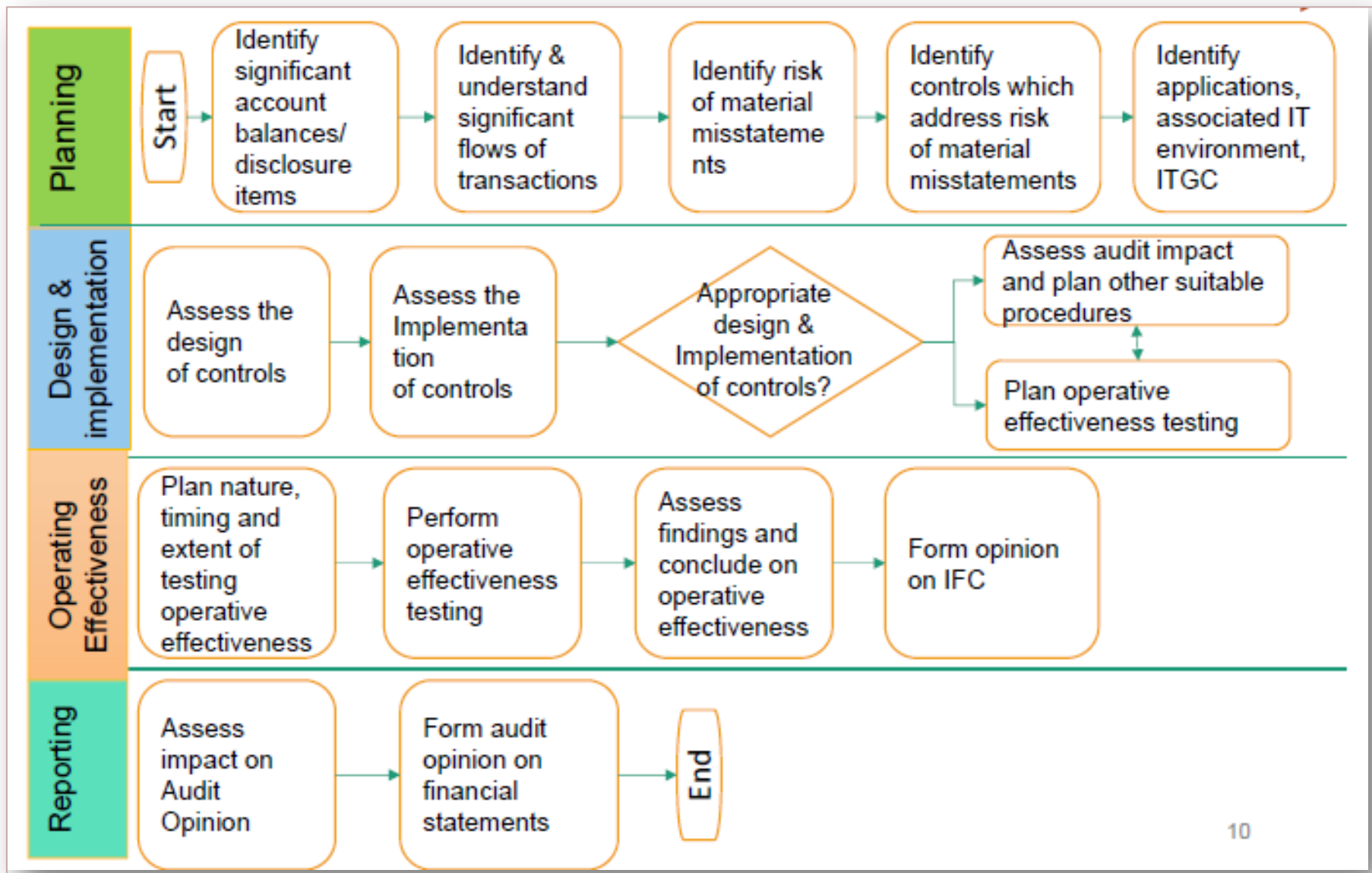
## Benefits

- Greater confidence in **the organization's ability to identify, analyze and respond to risk** and changes in the business and operating environments
- **Lower Risk of fraud**
- **Greater confidence in the board of directors' oversight** of internal control systems and compliance.
- **Integration of Global Key Controls testing** requirements with this framework

*Further, Companies Act 2013 has clearly spelt out that the IFC is required at stand alone financial statements and thus responsibility for establishing IFC on the subsidiaries, joint ventures, associates, etc. may not rest with the Board of parent Company but with the management of respective component (Rule 8 of Companies (Accounts) Rules 2014)*

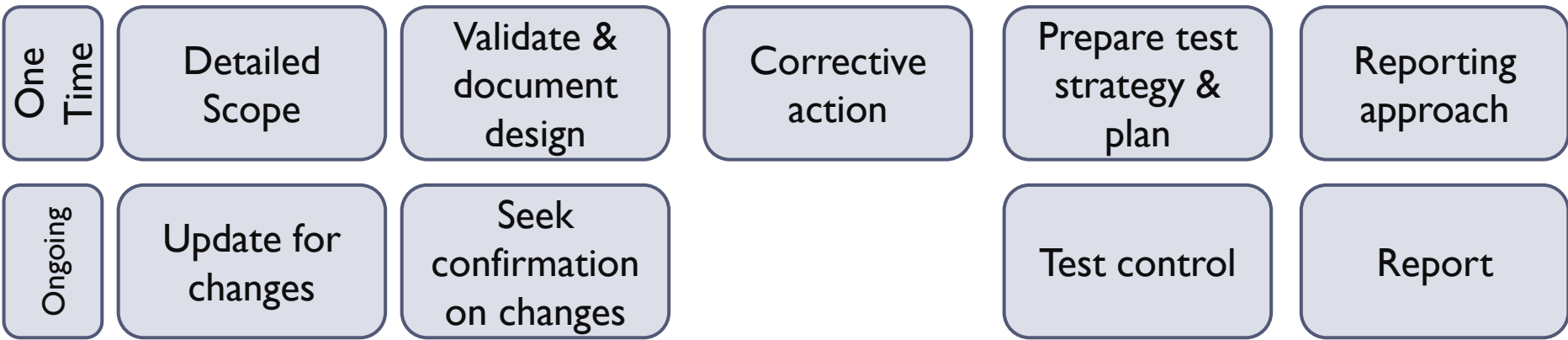
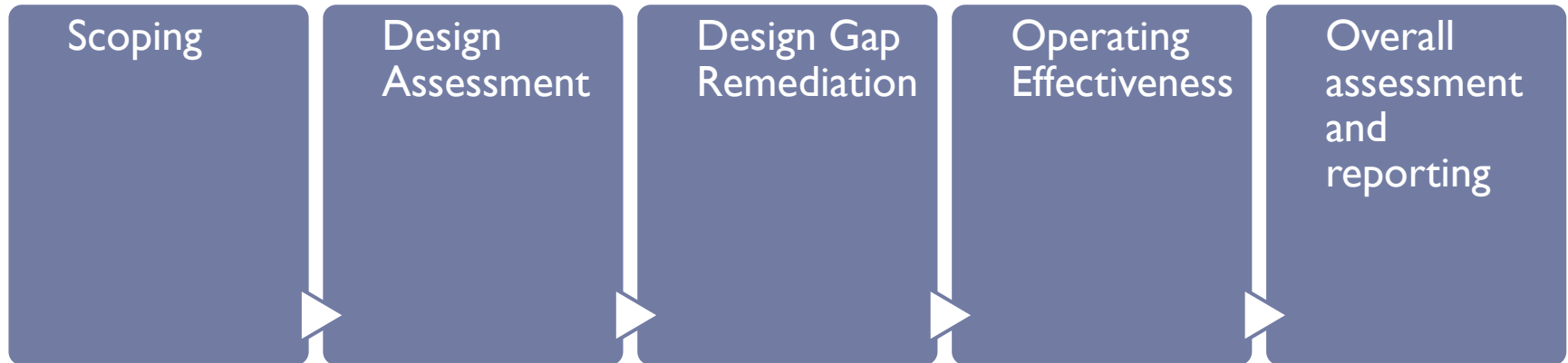
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# The process – As per ICAI guidance



# Practical Approach to IFC framework

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# Scoping

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## **Plan the scope of work**

- Identify significant accounts – Map the Trial Balance
    - review of trial balance and chart of accounts
    - review of balance sheet and profit & loss statements
  - Identify significant class of transactions – Materiality
  - Segregate scope between Business Process and IT
  - Finalise scope exclusion and validate with auditors
  - Finalise process owners across each process/location and conduct workshops
  - Perform and document walkthroughs
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# Design Assessment

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- Document process maps with input, output, risk/control, IPE
  - Segregate controls into Entity / Process / IT
  - Identify controls into Manual, Automated, IT dependent, Preventive/Detective
  - Document ITGC (IT General Control)
  - Perform segregation of duties analysis
  - Identify design gaps based walkthroughs, interviews, discussion etc
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# Gap remediation

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## **Plan the scope of work**

- Prioritize financial gaps into Material / Non-Material
  - Prioritize operational / reputational gaps (if any) into H/M/L impact
  - Co develop remediation plan with owners & implementation timelines
  - Periodic monitoring of remediation plans
  - Enhance or optimize IT controls
  - Enhance SOP / MIS / DOA etc
  - Interim testing to confirm remediated gaps
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# Operating Effectiveness Testing

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## TOE

- Align sampling techniques with the auditors
  - Prepare testing plans & templates
  - Timing of testing – Mid year and toll forward testing
  - Finalize resources – Competency & independence/objectivity
  - Document testing results
  - Prioritize testing gaps into material / non-material
  - Identify mitigation / compensating controls for material gaps
  - Co-develop remediation plans for testing gaps including owners and implementation timelines
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# Test of Operating Effectiveness - Sampling

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Control Frequency	Number of Samples - High Risk of Failure	Number of Samples - Low risk of Failure
Annual	1	1
Quarterly	3	2
Monthly	5	3
Weekly	8	5
Daily	25	15
Recurring	40	25

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# Difference between TOD and TOE

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<b>Design Effectiveness</b>	<b>Operating Effectiveness</b>
Objective – To determine if deficiency in design exists	Objective – verify if a control is operating as designed
Deficiency – control doesn't meet its objective	Deficiency – control doesn't operate as designed
Coverage – all controls	Coverage – excludes controls that are not properly designed
Sample size – One sample	Sample size – apply sampling guidance (2-40 samples)

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# Assessment of reporting

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- Finalize material weakness and update Executive management
- Report to Audit Committee (AC) and board

# ICFR – Practical Approach

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- ▶ Lets talk practical now

# ICFR – Practical Approach

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- ▶ Key Things to do
    - ▶ Know the Business
    - ▶ Know the processes
    - ▶ Know the process owners
    - ▶ Brainstorm the implication of process and the possible impacts
    - ▶ Follow the documentation
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# ICFR – Practical Approach

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▶ Process Narratives

▶ Risk Control Matrix

Process	Sub-process	Control objective	Risk Definition	Risk Ref.	Control Definition	Control Ref.	Frequency	Key Control (Yes/No)	Control category (O = Operational, F = Financial, C = Compliance)	Control type (Preventive/Detective)	Manual/automated/combined	Control owner
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# Risk and Control Matrix

## Illustrative Deliverable - Risk And Control Matrix

Sl. no.	Major process	Major process level Risk description	Sub process	Risk description	Risk Category and Risk Rating			Control description	Control category				Control ownership	Gap analysis and Recommendation	
		Overall risk description		Detailed risk description	Fraud risk (Yes/No)	Risk type (ref sheet 'Guide')	Risk rating	Control description	Type of control (Manual/Automated)	Type of control (Preventive/Detective)	Control category (ref sheet 'Guide')	Control frequency (ref sheet 'Guide')	Control owner (Role)	Process Design Gap (Yes/No)	Control recommendation
IM1	Inventory Master management	- Incomplete or inaccurate information in the item master - Dummy/ redundant/ duplicate codes in the item master	Inventory categorization	Incorrect classification of spares in ROL, General, Insurance & Project spares leading to incorrect accounting & monitoring	No	Residual	Low	The material code is created by Stores Head based on the email received from user department. The request is approved by HoD of user department who provides the category of the proposed material code	Manual	Preventive	Management Review Segregation of duties	As and when/ Event based	Head- Plant Commercial & Stores	No	Maker checker control to ensure the levels defined as per the process are captured in the system
IM2	Inventory Master management		Inventory categorization	Incorrect grouping of codes into various categories e.g. Raw material, SFG etc. leading to incorrect reporting of inventory	No	Residual	Medium	The material code is created by Stores Head based on the email received from user department. The request is approved by HoD of user department who provides the category of the proposed material code	Manual	Preventive	Management Review Segregation of duties Authorisation	As and when/ Event based	Head- Plant Commercial & Stores	No	Maker checker control to ensure the levels defined as per the process are captured in the system

# GAP Summary

## Illustrative Deliverable - Gap Summary

Consolidated Deficiency Tracker							
S. No	Process	Control No (As per RCM)	Gap (Brief Description or Explanation)	Management Action Plan	Personnel Responsible	Target Date	RCM/ TOD/ TOE
1	Financial Closure	FC.1.01.C	<p>1) System access rights review is not carried out on periodic basis to identify conflicting access rights.</p> <p>2) Currently, there is no process to ensure that access rights are provided to designated personnel only. Further, there is no process of periodic review of access rights provided to company personnel.</p>	Access rights shall be restricted to designated personnel, and sign off from department heads to be taken for SOD as an interim measure.	SAP Head	31-Jan-14	RCM Gaps
2	Financial Closure	FC.1.04.C	Schedules prepared as a supporting to the manual JVs are prepared in Excel, which is not password protected. Further, the same is not signed off by an independent authority.	<p>1) A checklist shall be maintained specifying the activity done , document no for the entry so passed, folder path for the working and duly signed off by maker and reviewer.</p> <p>2)All users input and workings are saved in a folder along with checklist, and critical spreadsheets shall be password protected.</p> <p>3)Folder structure is defined for shared folder to ensure access control to maker and checker.</p> <p>4) Month end log of entries shall be generated and signed off by the line manager of the person passing the entry.</p> <p>5) Month end checklist shall be maintained , which shall be reviewed and signed off by the finance head on quarterly basis.</p>	Finance Head	13-Dec-13	TOD Gaps
3	Financial Closure	FC.1.04.E	<p>1) No process to document the reasons as well as to seek approval of HoD / authorized personnel prior to reopening the closed period. Further, there is no process of independent review of the entries posted after reopening the period.</p> <p>2) DoA to be formally defined authorizing the personnel eligible to request / approve reopening the period.</p>	<p>Corporate: Approval through email will be taken by Band 1 from Band2 for reopening of the period Audit trail to be maintained Trial balance before and after to be reviewed Period shall be reopened only for the user who has requested reopening. HOD will authorize through email person eligible to approve the reopening the period. DOA to be implemented</p>	Manager Finance	28-Feb-14	RCM Gaps

# Management Summary

## Illustrative Deliverable - Management Summary

### Summary of Business Process wise Control deficiencies

Location and Process Areas Documented	Number of Controls				Control Design Gaps				Testing Results				Key Control Remediation Status		
	Non-Key	Key	Total	% of Key Controls	Non-Key	Key	Total	% of Total Controls	Number of Controls Tested	Number of Tests Pending	Number of Exceptions	Percentage of Exceptions	Remediation Owners Not Identified	Remediation Plan Developed	Date of Latest Remediation
<b>Corporate Office</b>															
<b>Routine Transactions</b>															
Procurement	30	25	55	45%	10	10	20	36%	15	0	3	20%	0	0	TBD
Fixed Assets	10	15	25	60%	5	5	10	40%	10	0	5	50%	0	0	TBD
Inventory Measurement	15	10	25	40%	5	5	10	40%	15	0	5	33%	0	0	TBD
Inventory - MandS	20	30	50	60%	5	10	15	30%	10	0	2	20%	0	0	TBD
Crude Oil Procurement	30	30	60	50%	10	5	15	25%	15	0	5	33%	2	0	TBD
<b>Corporate Office TOTALS:</b>	105	110	215	51%	35	35	70	33%	65	0	20	31%			
<b>Midwest Division</b>															
<b>Routine Transactions</b>															
Inventory - MandS	12	10	22	45%	1	4	5	23%	4	2	1	25%	0	0	TBD

# ICFR from article's perspective

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- ▶ How to go about it ?
  - ▶ ICFR framework
  - ▶ ICFR testing
- ▶ How much is it worth?



**Thank You!**

**Head Office:**

22B, Tower B2, Spaze IT Park, Sohna Road,  
Gurgaon, Haryana

**Contact Details - +91-124-4387967 / [info@finsq.in](mailto:info@finsq.in)**

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