

# **Challenges in IFC Reporting (IFC-FR)**

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How many more documents do you think we need to create?



The real challenge is . . . . .

Whether  
anything  
has  
changed  
?

Are we  
saying there  
were no  
controls  
earlier  
?

Were the  
controls not  
being  
checked by  
the auditors  
?



# Who is looking at IFC-FR Report?



Suppliers

Regulators

Bankers

Investors

Customers

Vendors

## Steady change from compliant/historical Reporting to Responsible Reporting

- Sophisticated decision making
- Application of informed judgement
- Use of judgements and estimations

# Overview of key challenges

Lack of segregation of duties

Control environment assessment

Design of management review controls

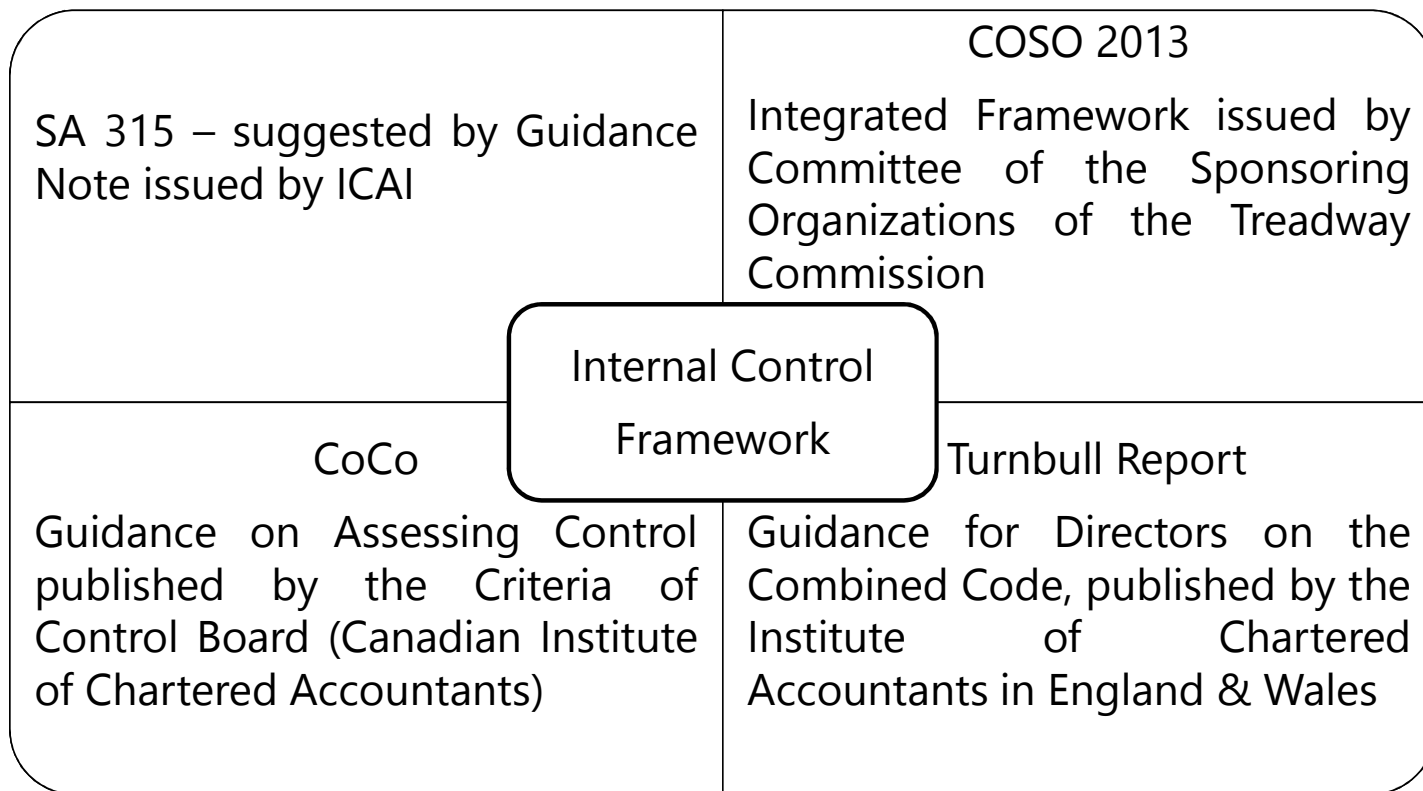
Evaluation of entity level controls

Fraud risk assessment

# **Key Challenges**



# Which framework to adopt ?



- Need to understand the Framework
- Identify key differences & way forward
- Which framework should be adopted?
- Whether any impact on the way business is being conducted?

# Challenges at the planning stage

Identify significant  
Financial Reporting  
objectives and related  
accounts

Identify effectively  
designed key controls  
addressing each  
relevant Financial  
Reporting objective

Decide documentation  
standards at different  
levels of risk

Determine extent of  
evidence required to  
evaluate operating  
effectiveness of key  
controls

Areas, locations, units  
to be included into  
scope

Basis to assess criticality  
of control deficiencies

# Evaluating Control Environment

## Ethics Policy

- Whether properly communicated?
- Whether adequate training is given?
- Check box approach

## Tone at Top

- Attitude and action towards Financial Reporting
- Conservative Approach Vs Aggressive Approach towards selection of accounting policies

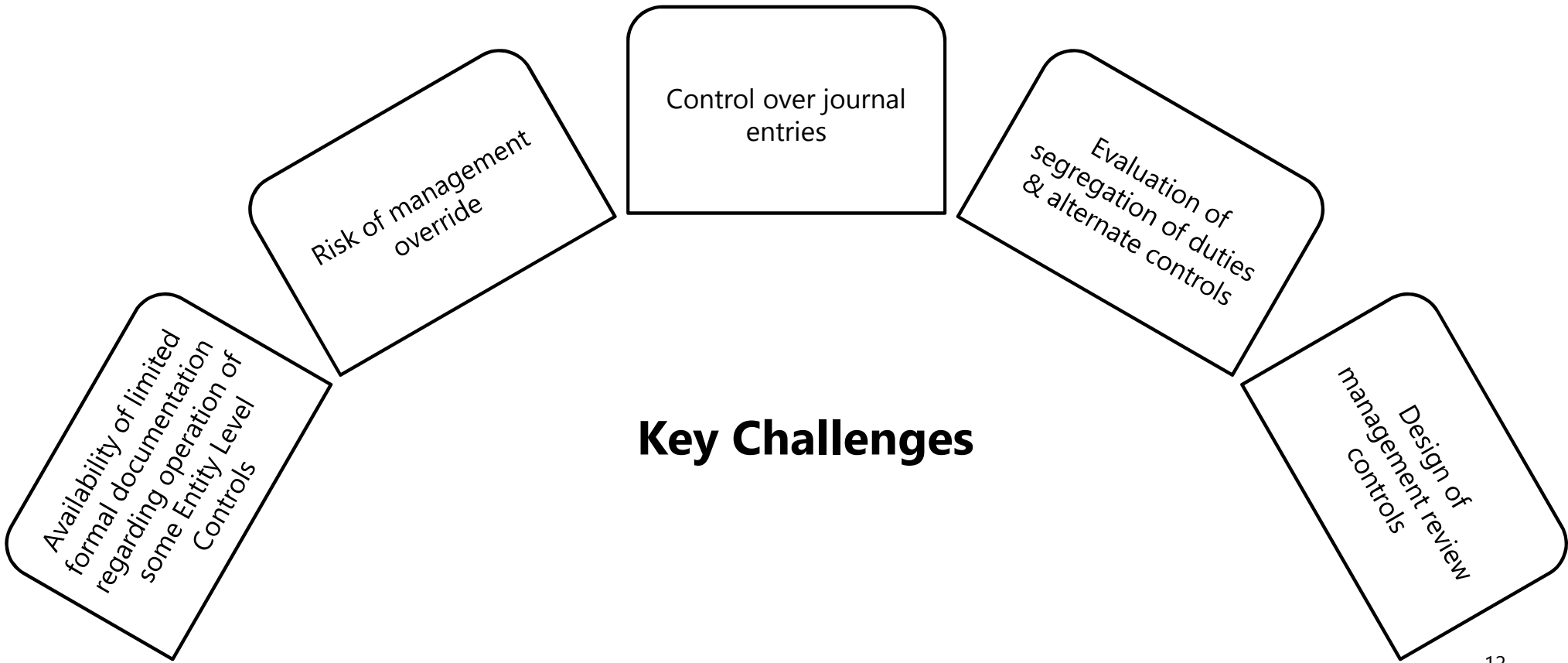
## Effectiveness of Whistle Blower Programme

- Whether proper process have been defined ?
- Whether effectively monitored ?

## Organisation Structure

- Lack of defined organisation structure in many case
- Delegation of authority not formally defined

# Entity Level Controls



# Evaluating audit committee oversight

Subjective  
judgement & hence  
needs experience

Generally based on  
minutes of  
meetings or  
participation in  
meeting

Mitigates risk of  
management  
override

Whether significant  
accounting  
estimates &  
judgement reviewed  
?

# Segregation of duty

Lack of Mitigating Control

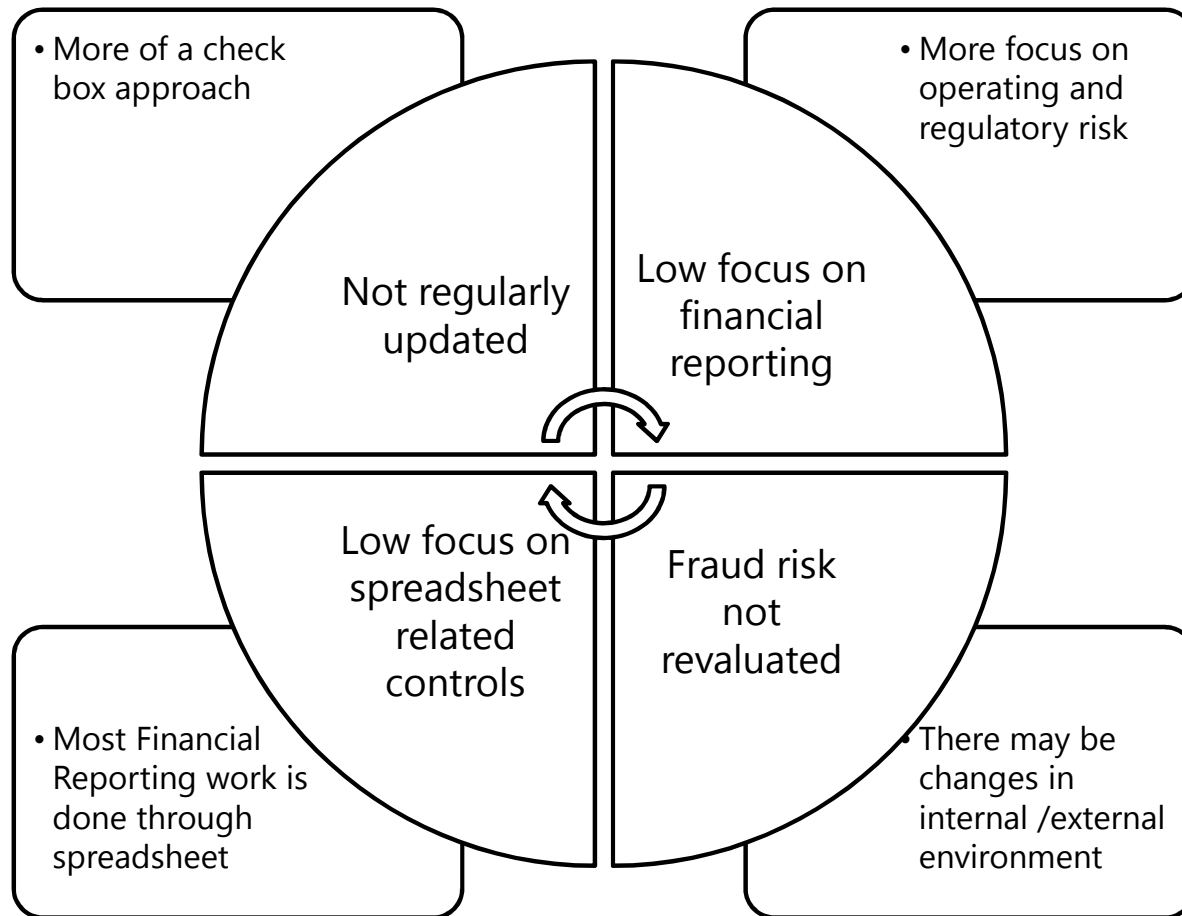
Absence of segregation due to cost constraint

Possess risk of collusion & increase ability to commit fraud

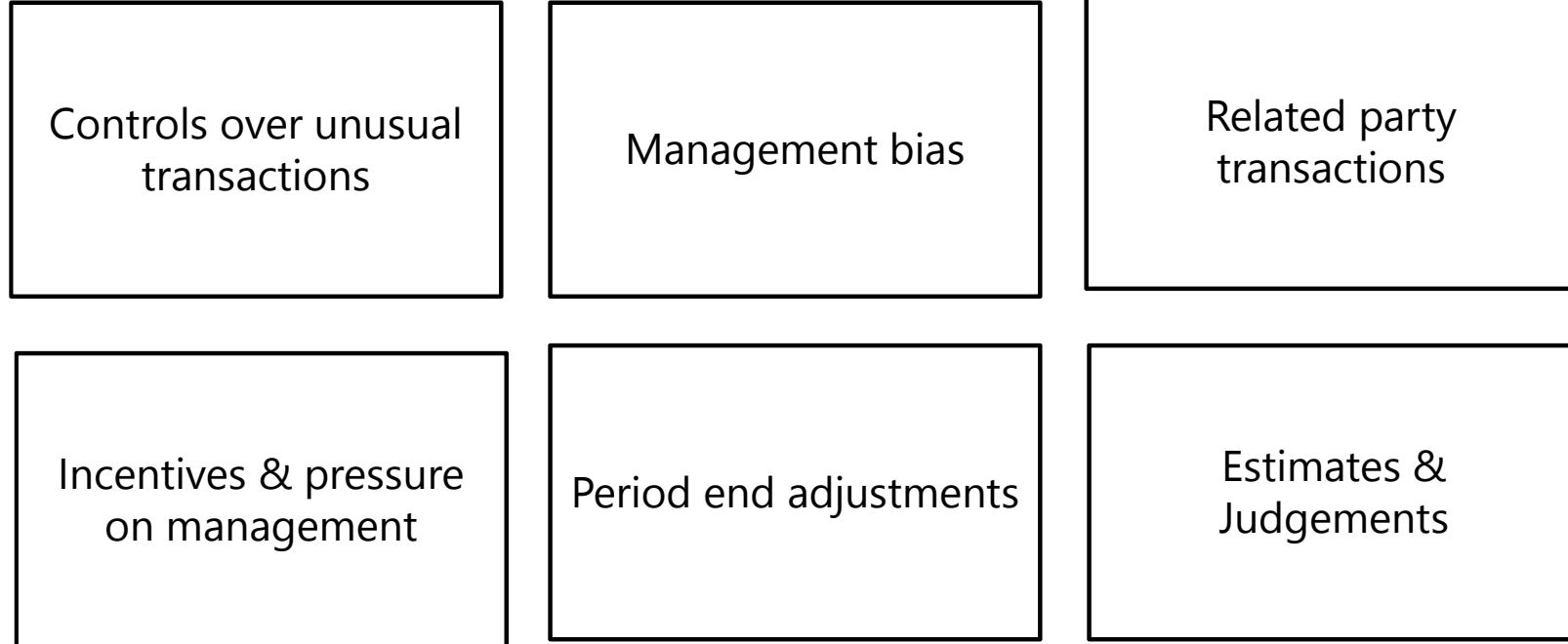
Root cause of material weakness and material act of fraud

Example:  
Reconciliation procedures may not effectively meet the control objectives if they are performed by someone who also has responsibilities for transaction recording or asset custody

# Risk Assessment



# Evaluating risk of material misstatement due to fraud





# Need for clarity between Process & Control

## Process

A Process describes the action of taking a transaction or an event through an established and usually a routine set of procedures or steps.

VS

## Control

A Control is an action or activity taken to prevent or detect misstatements within the process.

### Example :

- Control description: Company engages an Actuary Firm to prepare the actuarial report
- Pitfall: Hiring a specialist may add competency to management's control and is a process, but it is not a control in itself.
- Improved control description: Management reviews and discusses the Actuarial Report, including key assumptions, with the specialist to assess the appropriateness of the assumptions and conclusions reached

# Use of outsourced Service Organisation

- Expectations of integrity and ethical values not communicated
- Lack of understanding about internal processes and controls deployed by the outsourced service organisation
- Failure to identify control and monitor control activities
- Availability of sufficient appropriate audit evidence from the records held at the user organization
- Lack of effective communication or gaps in communication [ex- policies not communicated or changes not intimated]

# Use of Service Organization: Ideal control example

## Example :

An entity outsources the processing of its payroll transactions to a service organisation however, the entity has the following controls in place that are sufficiently precise to address the relevant risks of material misstatement related to payroll and the entity does not only rely on reports or other information it receives from the service organisation to perform these controls.

- Comparing the payroll data submitted to the service organisation with reports of information received from the service organisation after the data has been processed.
- Re-computing a sample of the payroll amounts for clerical accuracy and reviewing the total amount of the payroll for reasonableness.

# Testing of Controls: Common questions

- ❑ Will enquiry alone provide sufficient evidences to support a conclusion about the effectiveness of a control ?
- ❑ Whether control is key or Non-Key ?
- ❑ Which and how many controls to test?
- ✓ Inquiry, observation, inspection of relevant documentation, and re-performance of a control provides sufficient evidences to support a conclusion about the effectiveness of control.
- ✓ Controls which addresses high risk areas are key controls.
- ✓ Auditor should consider following factors when selecting controls to test;
  - Is the control likely to be effective?
  - What evidence exists regarding operation of the control?
  - Generally all key controls should be tested

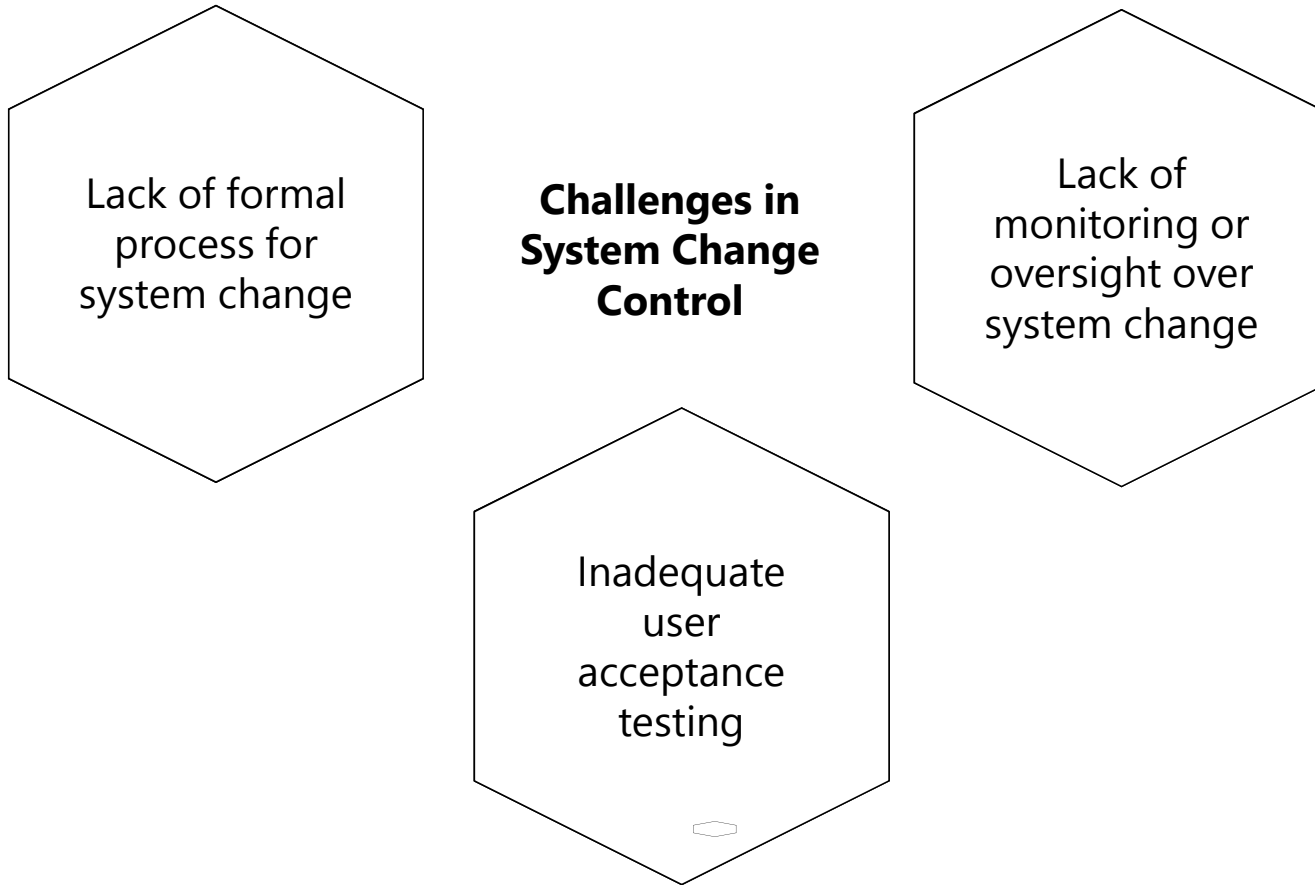
# Testing of Controls: Common questions

- ❑ Period from which samples should be selected for testing of controls?
- ❑ If testing evidences are obtained during interim period then do we need to obtain the same at the time of finalization ?
- ❑ How to obtain evidences wherein no formal documentation is prescribed by the company?
- ✓ Testing performed closer to the balance sheet date provides more evidence than testing performed earlier in the year.
- ✓ When the auditor reports on the effectiveness of controls as of the balance sheet date and obtains evidence about the operating effectiveness of controls at an interim date, he or she should determine what additional evidence concerning the operation of the controls for the remaining period is necessary.
- ✓ Auditor should enquire and understand the process flow and try to get evidences. E.g. copy of e-mail communication

# Challenges in General Information Technology Control's



# Challenges in General Information Technology Control's



# Challenges in Documentation of Evidences



- ❑ How to obtain evidences in case of oral authorization?
- ❑ Collection of evidences in cases wherein no formal documentation process is defined by the management.

## Example :

- Control Description: MIS is prepared by Accounts Manager and reviewed by CFO.
- Process Followed: MIS is prepared and emailed by Accounts Manager to CFO but no sign-off for review is required.
- Evidence: Copy of e-mail communication for the mail sent by Accounts Manager to CFO or reply by CFO.



# Information Produced by Entity (IPE)

- ❑ How to ensure completeness of reports generated through Information System?

If all revenue transactions are not captured in the system, a report of revenue data that is derived from the system would likely be incomplete.

- ❑ How to ensure adequacy and correctness of analyses, schedules and reports prepared manually in large & complex organisation?

Important elements of Financial Statements such as Balance Sheet, Profit & Loss Account and Cash Flow Statement are more often prepared manually using excel spread sheets.

# Information Produced by Entity (IPE)

- ❑ How to ensure correctness of reports generated through Information System?

Example :

1. Data is input incorrectly: SAP maintains a central exchange rate table which is used to translate foreign currency transactions into the local reporting currency. The table is manually updated and therefore subject to human error (e.g., incorrect exchange rates may be input). Therefore, the system-generated report identifying the exchange rates may be incorrect.
2. Report logic is incorrect: System performs a consolidation of the various reporting entities based on company codes. If a new entity is not initially coded correctly, the manner in which it is consolidated into the overall results of all the reporting entities may not be correct.
3. User-entered parameters are incorrect: User-entered parameters related to the date range are required when generating a Debtors aging report. If the user-entered parameters are not entered correctly, the data on the report will not likely be correct (e.g., the report may not contain the expected or intended data).

## Challenges in IFC reporting in case of Consolidation

- What happens in CFS when you consolidate non corporate entities ?
- Applicability to Section 8 Company ?
- Applicability to foreign companies ?

## Challenges in IFC reporting in case of Consolidation

- Consolidation tools (e.g. Hyperion etc.)
- Control over spreadsheets
- Separate RCM to be created for consolidation procedures
- Review of reports submitted by auditors of subsidiary, associate and joint venture

## Common challenges

- Compliance Overkill
- Paucity of resources
- Lack of management resolve
- Deficient skill set and expertise
- Limited IT tools

## 2015 survey of 'International Forum of Independent Audit Regulators '(IFIAR)

- ❑ Deficiencies in Internal Control Testing findings were consistent over years
  - ❑ Failure to test sufficiently Information Technology general and application controls was the most common type of finding for this inspection theme.
  - ❑ Other frequent findings include . . .
    - Failure to obtain sufficient appropriate evidence to support reliance on manual internal controls  
and
    - Failure to adjust testing appropriately as a result of ineffective controls  
(Ex: as indicated by audit adjustments and exceptions identified through substantive testing).

# Tips to address the challenges

1

Planning

2

Constant and effective communication with management

3

Improve business understanding

4

Understanding Financial Reporting risk and mitigation controls

5

Prepare summary of past errors and root cause

6

Apply 80:20 principal

## Resources and systems required

- Goods governance system
- Team with . . . . .
  - Technical knowledge
  - Skills
  - Thorough understanding of the organizations objectives
  - Ability to keep cost of compliance under control
- Constant updation and monitoring of Financial reporting risk and mitigation controls

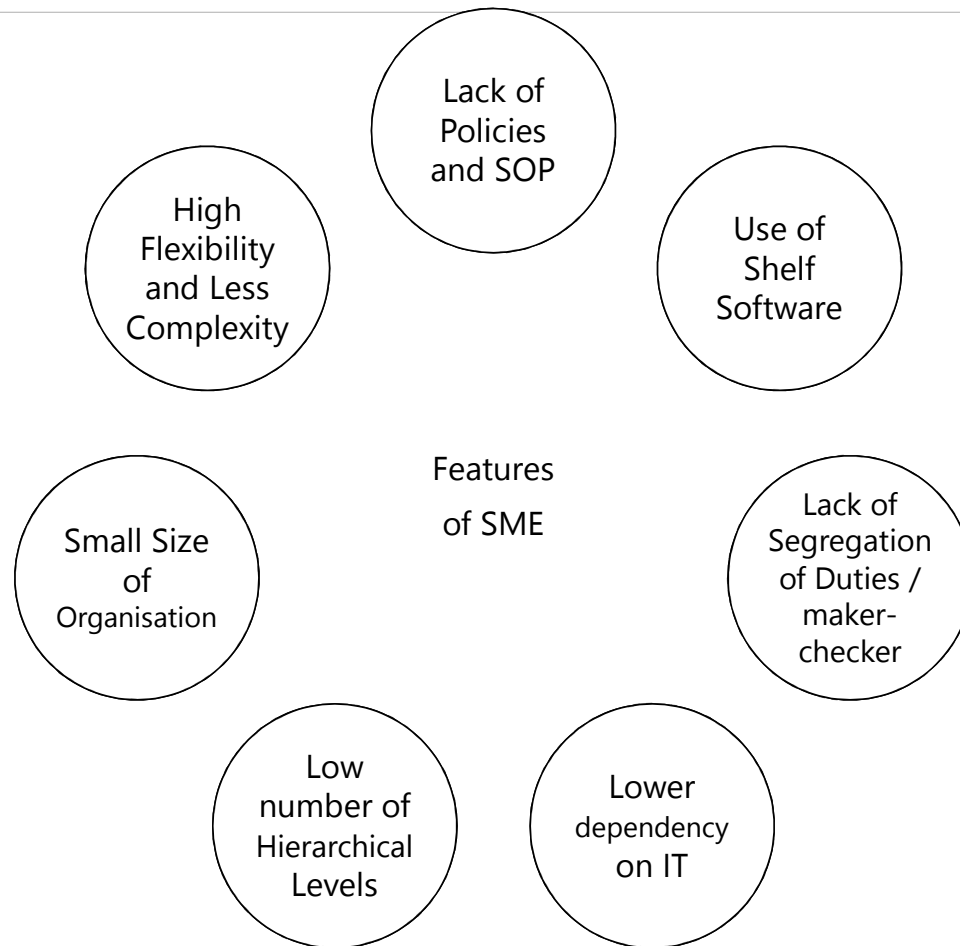
However, no system can prevent errors or misstatement on account of . . .

- Misunderstanding of instructions
- Errors of judgment
- personal carelessness
- Distraction or fatigue



**Execution  
challenges in IFC  
-  
SME Perspective**

# Features of Small & Medium Enterprises (SME)



# Challenges Faced by SME

- Lack of bandwidth for documentation
- Absence of standard Operating Procedures (SOP)
- Cost of Compliance
- Personalized Controls
- Lack of Segregation of Duties
- Lack of IT support or infrastructure
- Manual Controls
- Competency of personnel assigned with specific authority / duty

# Some tips from SME perspective

Focus on material items and material risk

Prepare simple and easy to implement SOP

Prepare a delegation of authority matrix

Document controls over management override

- Oversight by other board members / shareholders
- MIS reporting
- Documenting minutes of internal management meeting

In case of standard or shelf software is used focus on inbuilt controls for example

- Control over deleting entries
- Modification rights, etc.

In area's where there is no segregation of duties identify alternate controls and document them

Testing of controls may be done at a lower frequency for some of the items

# **Overview of Industry Specific Challenges**

# Real Estate Industry

- ❑ Controls over revenue recognition criteria as defined in guidance note
  - Generally working done through spread sheets and high reliance on manual controls
- ❑ Controls over certification of RA bills submitted by contractors
  - Time-lags in certifications and disputes with contractors
- ❑ Evaluating estimates of Project Cost and Project Profit
  - Frequent changes on account of market conditions etc.
  - Completeness
  - Reasonableness of management judgment and estimates
- ❑ Understanding the process requires government approvals and its financial Implications
- ❑ Site level controls (inventory reconciliation, stock records, booking of expenses etc.)
- ❑ Physical verification of inventory (reinforcement steel, sand, loose cement, chemicals etc.)

# Hotel Industry

- ❑ Revenue assurance controls
  - Banquet Sales
  - Liquor sales
  - Cash sales
  
- ❑ Out sourced labour
  - Large number of outsourced labour employed
  - Verification of sub-contractors bills
  - Financial implications of non-compliance with labour law by vendors
  
- ❑ Fixed Assets
  - Completeness of fixed asset register
  - Room-wise costing / location of assets
  - Physical verification and reconciliation with Fixed Asset Register.
  
- ❑ Stock records for liquor
  
- ❑ Multiple operating software's and integration issues

# Q & A Session





**Thank You**

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