

# 29<sup>th</sup> Regional Conference of WIRC

Internal Financial Control -  
Auditors responsibility

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# Companies Act 2013 – Introduction to Internal Financial Controls (IFC)

Scope wider than section 217(2AA) of the Companies Act 1956

## Section 134

As per section 134 (5) (e) of the Companies Act 2013, Directors of a **listed company** need to make 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**

## Section 143

Under section 143 (3) (i), **Statutory Auditors** are required to make a statement in their Auditor's Report, whether **the company** has adequate IFC system in place and the operating effectiveness of such controls

## Section 177

Under section 177 (4) (vii), the duties of the **Audit Committee** include evaluation of internal financial controls

## Schedule IV

Code for Independent Directors clearly 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

## Internal Financial controls defined [explanation to sec 134(5)(e)]

“The policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, safeguarding of its assets, the prevention and detection of frauds and errors, accuracy and completeness of accounting records, and the timely preparation of reliable financial information”

# IFC – Building blocks

Component	Key objectives of coverage
Policies and procedures	<ul style="list-style-type: none"><li>• Assignment of <b>responsibility, delegation of authority, segregation of duties</b> and <b>establishment of related policies and procedures</b> to provide a basis for accountability and controls</li></ul>
Safeguarding of assets	<ul style="list-style-type: none"><li>• Assets and <b>ownership</b> interests exist at a specific date</li><li>• Assets are the <b>rights</b> of the entity at a specified date</li></ul>
Prevention and detection of frauds and errors	<ul style="list-style-type: none"><li>• Enable proactive <b>anti-fraud controls</b> and a <b>fraud risk management framework</b> to mitigate fraud risks to the company</li></ul>
Accuracy and completeness of the accounting records	<ul style="list-style-type: none"><li>• <b>All transactions</b> occurred during a specific period have been recorded</li><li>• Assets, liability, revenue and expense components are <b>recorded at appropriate amounts</b></li></ul>
Timely preparation of reliable financial information	<ul style="list-style-type: none"><li>• Financial items are <b>properly described, sorted and classified</b></li><li>• Financial <b>information is provided as per the timelines</b> defined by the relevant stakeholders</li></ul>

**IFC coverage is beyond Financial Reporting Controls**

# IFC – Key considerations

- Applicability to Unlisted companies
- Restricted to – Reporting on financial services prepared under the Act **and** reported under section 143 not applicable with respect to interim financial services (eg. quarterly/half yearly financial services)
- Control framework to be adopted
  - Integrated framework issued by committee of sponsoring organisations of the Treadway commission (COSO framework)
  - Guidance on accessing Control published by the Canadian Institute of Chartered Accountants (CoCo)
  - Internal Control: Guidance for Directors on the combined code – published by ICAEW
  - Guide to internal controls over financial reporting – ICAI- Internal Audit Standards Board.
- Consolidated financial statements
  - (Sub rule (1) of Rule 8)- matters to be included in board report
  - Rules do not specify the board reporting on IFC for subsidiaries/ associates/ JVs
  - If company is Indian Company – Auditor report under section 143 on IFC already issued
  - Foreign components audited by auditors in those jurisdictions not required to report



A person in a dark suit is seated at a desk, writing in a spiral-bound notebook with a silver pen. In the foreground, another person's hand is visible, also holding a pen over a document. The document contains a table of financial data with columns of numbers and text, and a line graph with multiple colored lines (green, blue, red, purple) plotted on a grid. The background is a blurred office setting.

## Auditor's role under IFC

# Auditor scope and objective (1/2)

## Reporting under Section 143(3)(i) of the 2013 Act

- Dependent on the framework adopted by the management
- Primary responsibility rests with the company's management
- Restricted to internal controls over financial reporting

Scope of reporting wider than reporting under CARO – restricted to adequacy controls over purchase of inventory and fixed assets and sale of goods and services

Definition of IFC in clause 134(5)(e) states it is **only** for the purpose of that clause

2014 Rules requires reporting on IFC with reference to the “financial statements” only

An auditor will not be able to express an opinion on the efficiency or effectiveness with which management has conducted the affairs of the entity

## Auditor scope and objective (2/2)

- To express an opinion on the effectiveness of the company's IFC and the procedures in respect there of are carried out along with an audit of financial services – ie Integrated Audit Approach
- A material weakness in IFC may exist even when the financial statements are not materially misstated
- SA-200 Overall objective of the Independent Auditor
  - Opinion on financial statements – whether financial statements are prepared in all material respect in accordance with applicable financial reporting framework
  - Does not assure of future viability of the entity nor efficiency or effectiveness of conducting the affairs
- Consistency with practices prevailing internationally

**Adequate IFC system operating effectively in all material respects with respect to financial reporting only**



# IFC over Financial Reporting – what would it entail?



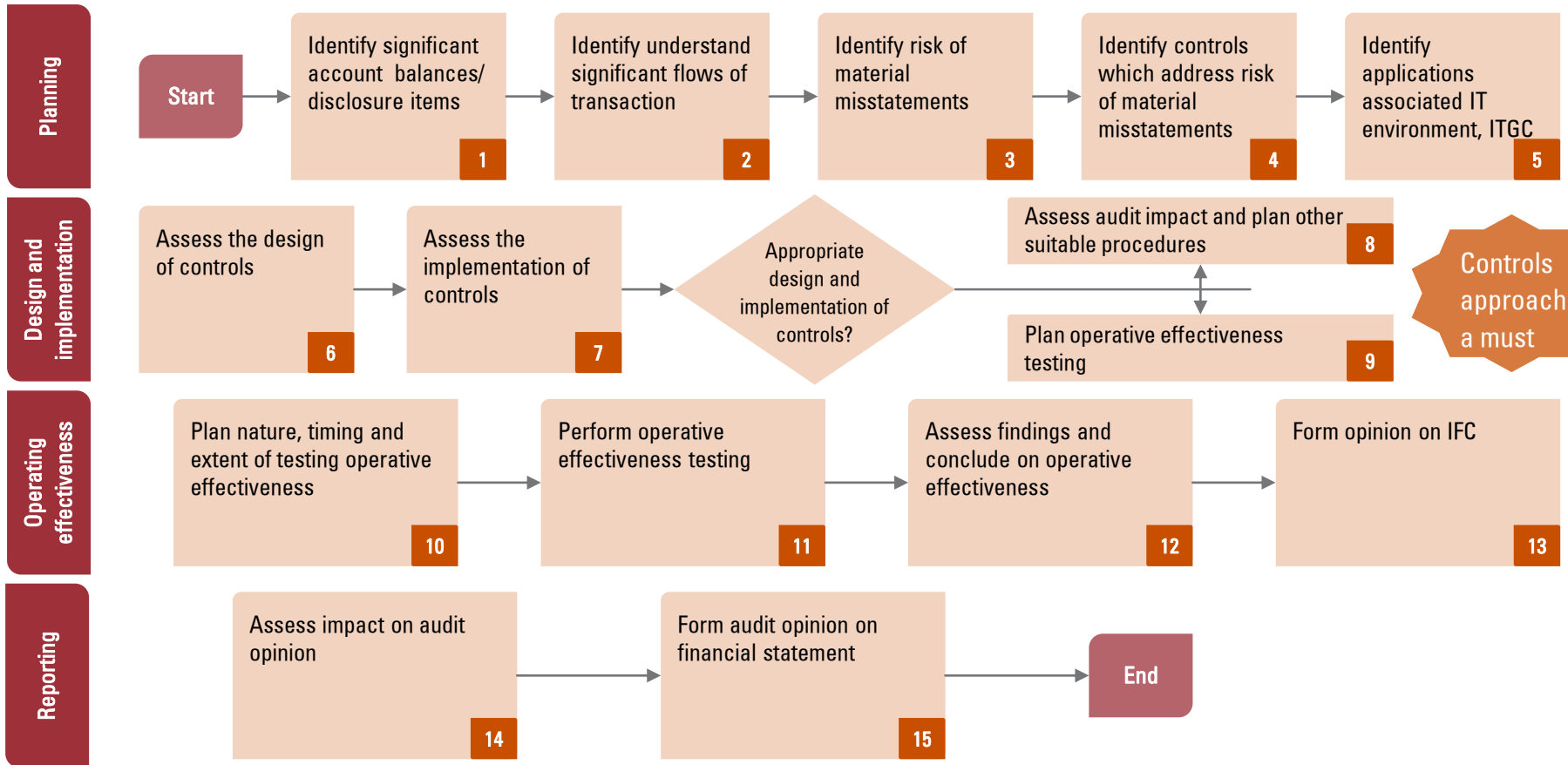
- Process designed to provide reasonable assurance regarding the reliability of financial reporting
- Preparation of financial statements for external purposes in accordance with GAAP
- Maintenance of records in reasonable detail that accurately/ firmly reflect transactions/ dispositions of assets
- Receipts/expenditures – according to authorization matrix
- Provide reasonable assurance – prevention/ detection of unauthorised acquisition/ use/ disposition of assets

**Company has adequate internal control system in place and whether they were operating effectively as at the balance sheet date**

# Auditors approach – Audit of IFC over financial reporting



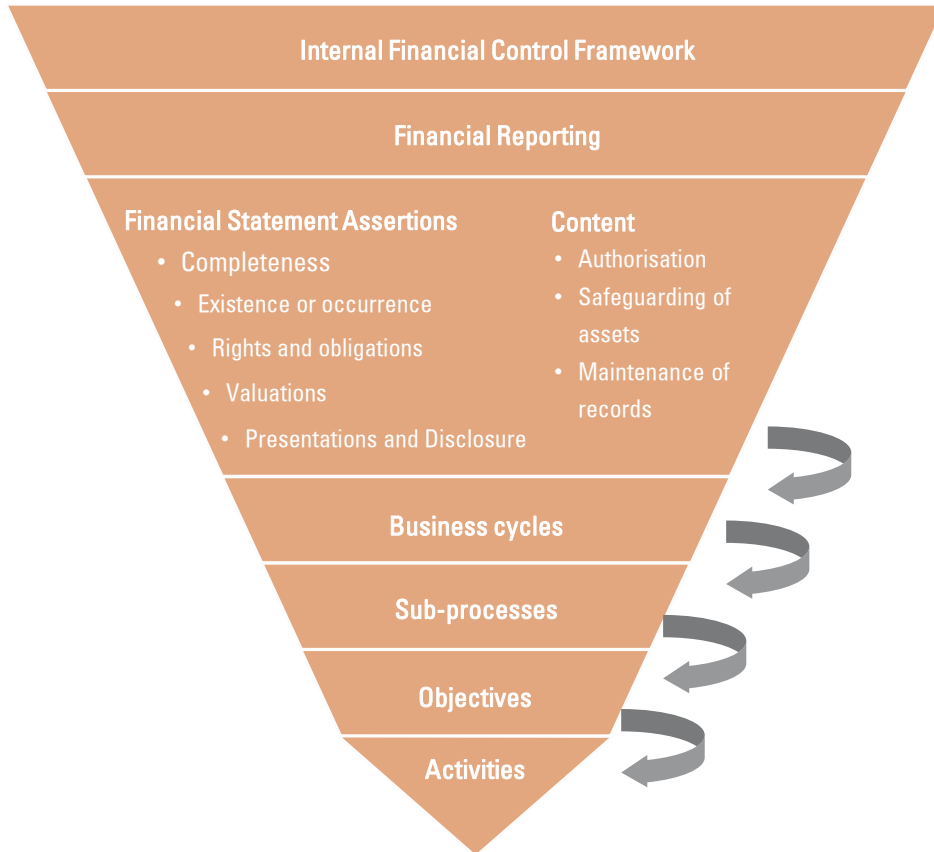
## Assess and Manage Risk/ Manage Audit engagement



Prepare and control audit rotation

Continuous focus on Audit Quality

# Top down-audit approach



## Key considerations

- Entity level controls eg; management override, centralised processing controls, controls over unusual transactions
- Control environment – Management’s philosophy, integrity, values, audit committee/ Board oversight
- Period end Financial Reporting Process (FRAP)
- Selection of accounting polices
- Processing of JE
- Non recurring adjustments

**CEAVOP – Assertions**

## Other considerations

- SA-315: Identifying and Assessing the Risk of material misstatement through understanding the entity and its environment. Eg; matters affecting industry, business, organization structure, legal and regulatory matters
- SA-330: Auditors response to Risk identified under SA 315 - Nature, timing and extent of audit procedures
- SA-230: Audit documentation – documenting understanding of internal controls (flowcharts etc.)
- SA-240 – Auditors responsibility relating to fraud
  - Controls over significant, unusual transactions, JEs
  - Adjustment made at period end
  - Related party transactions
  - Significant management estimates
  - Pressure on management to falsify/ inappropriately manage results
- SA-620: using work of others - responsibility not reduced by the auditors use of work of internal auditors
- SA-230: Materiality- eg classes of transactions/ account balances

# Reporting (1/2)

## Deficiency

- When design/ operating of a control does not allow to prevent or detect misstatement on a timely basis. eg:

## Significant Deficiency

- A deficiency or a combination of deficiencies that is important enough to merit attention to those charged with governance – reasonable possibility that a material misstatement will not be prevented/ detected on a timely basis. eg;

## Material weakness

- Is a deficiency/ a combination of deficiencies - reasonable possibility that a material misstatement will not be prevented/ detected on a timely basis eg:

## Deficiency in design

- Control necessary to meet the control objective is missing eg:
- An existing control is not properly designed eg:

## Deficiency in operating effectiveness

- Properly designed control does not operate as designed eg:
- Person performing the control does not possess necessary authority or competence. eg:

## Indicators of material weakness

Identification of fraud (whether or not mentioned) by senior management

Framework of control

Errors observed in previously issued financial services

Auditors responsibility – reference to ICAI, Guidance note on IFC

Identification by the auditor of a material misstatement

Meaning of IFCOFR

Ineffective oversight of the company's external financial reporting/ IFCOFR by audit committee

Inherent limitations eg; Collusion/ future periods

Management's responsibility



Modified reports (qualified/adverse) eg:  
(In conjunction with guidance mentioned in SA-700)



# Guidance for small or medium enterprises



- Applicability of IFC to unlisted companies as well (Rule 8(5)(viii))
- Small or medium enterprises - qualitative factors to be considered
  - Straight forward/ uncomplicated transactions
  - Simple record keeping
  - Few lines of business/ few products
  - Few internal controls
  - Few levels of management
  - Few employees

-  Sarbanes-Oxley Act (SOX) – PCAOB AS (5)
-  Financial instruments and Exchange Act (J-SOX)
- Key features:
  - Combined audit of IFC over financial reporting and Financial Statements
  - Sufficient audit evidence to support opinion on IFC at year end
  - Sufficient audit evidence to support control risk assessments for the purpose of the audit of financial statements
  - Opinion evaluating and opining on managements assessment of the effectiveness of IFC (J-SOX)
  - Opinion on ICOFR (USA SOX)
- Opinion on the Financial statements



*cutting through complexity*

Thank  
you

