




















Internal Financial Controls

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The Companies Act 2013 – Who All Are Responsible?

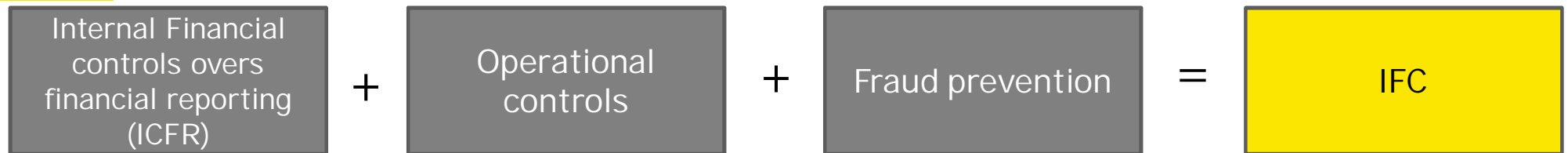
ICF	Section 134	Director's Responsibility Statement	<ul style="list-style-type: none">▶ In the case of a listed company, the Directors' Responsibility states that directors, have laid down IFC to be followed by the company and that such controls are adequate and operating effectively.
ICFR	Section 143	Auditor Report	<ul style="list-style-type: none">▶ The auditor's report should also state whether the company has adequate IFC system in place and the operating effectiveness of such controls
ICFR	Section 177	Audit Committee	<ul style="list-style-type: none">▶ Audit committee may call for comments of auditors about internal control systems before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company
ICFR	Sch IV	Independent Directors	<ul style="list-style-type: none">▶ The independent directors should satisfy themselves on the integrity of financial information and ensure that financial controls and systems of risk management are robust and defensible.

The Companies Act 2013 – Who All Are Responsible? (contd.)

 Requirement (as per previous slide)	Public Listed	Public un-listed			Pvt Cos pd up share capital >= INR 20 Cr
		Paid-up share capital >= INR 10 Cr	Turnover >= INR 100 Cr	Loans, Borrowing in aggregate >= INR 50 Cr	
1 Director's Responsibility Statement (134) IFC					
2 Auditor Report (143) ICFR					
3 Audit Committee (177) ICFR					
4 Independent Directors (Schedule IV) ICFR					
5 Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 - BOD report - Financial Statements only (ICFR only) ICFR					

What is Internal Financial Control (IFC) ? (Sec 134)

Components



Example

Sales realization is correctly recorded in the Financials

Discount on sale is offered as per DOA and adherence to DOA is monitored

Unauthorised change in price master (access controls)

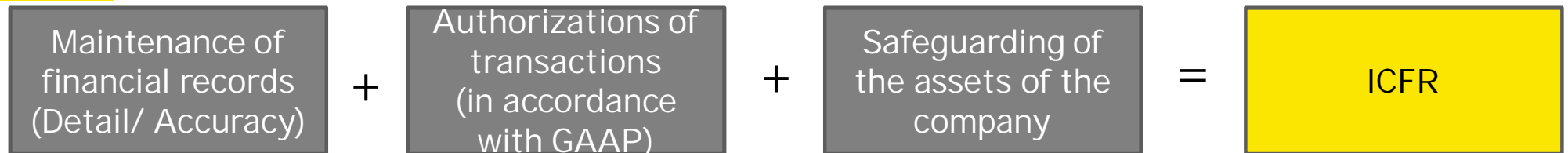
Definition

As per Section 134 of the Companies Act 2013, the term 'Internal Financial Controls' means the policies and procedures adopted by the company for ensuring:

- ▶ orderly and efficient conduct of its business, including adherence to company's policies,
- ▶ safeguarding of its assets,
- ▶ prevention and detection of frauds and errors,
- ▶ accuracy and completeness of the accounting records, and
- ▶ timely preparation of reliable financial information.

What is Internal financial controls over financial reporting (ICFR) ? (Sec 143 - as per ICAI Nov 2014 guidelines)

Components



Definition

“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”. A company's internal financial control over financial reporting includes those policies and procedures :

1. Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;
2. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company; and
3. Provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.”

Internal Controls – Global Perspective

	India	USA	UK
Scope	<u>ICFR + Policies/Procedures + Fraud + Safeguarding Assets</u>	Internal <u>Control over Financial Reporting (ICFR)</u>	All material controls, including <u>financial, operational and compliance controls</u>
Framework	Components of Internal Controls as per SA 315	COSO	The UK Corporate Governance Code
Guidance	ICAI Guidance Issued in November 2014	AS-6	UK Combined Code/Turnbull guidance
Control assessment	Yes – CEO/CFO, Board	Yes	Yes
Auditor attestation	Yes – ICFR	Yes – ICFR	Yes
Rigour of implementation	Past precedent – low Now - expected to be high	High	High

Expected response of stakeholders



Company Management

Create & test the framework of internal controls

- ▶ IFC (including operational & Compliance)
- ▶ Controls documentation



Auditors

Focus on internal controls, to the extent these relate to the financial reporting (ICFR)

Auditors responsibility limited to evaluation of 'Financial reporting controls'



Audit Committee/
Independent Director

- ▶ Would like to see a robust framework that is aligned to acceptable standards
- ▶ Review & question the basis of your controls design and ongoing assessments



Board of Directors

- ▶ Would rely on the assessment and view of the Audit Committee
- ▶ They may ask for additional information

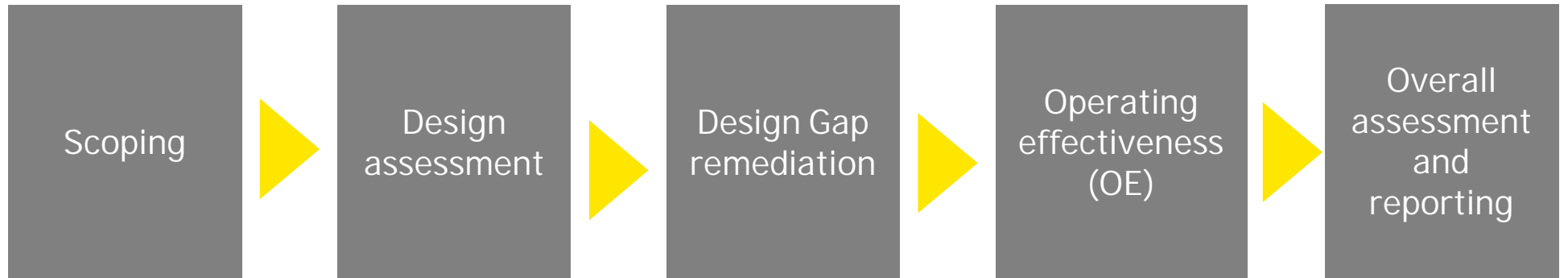
How will IFC help beyond compliance ?

- ▶ Helps in business process re-designing to plug revenue leakages & cost containment opportunities
- ▶ Helps in rationalizing the number of controls across organization – moving to smart and automated controls
- ▶ Helps in standardizing policies and procedures for multi-location/ multi-business Companies
- ▶ Fosters a control conscious work culture for people behind controls
- ▶ Provides assurance to the CEO/ CFO as well as improves business performance
- ▶ In some instances, also serves as a base for blue print of optimal procedures while thinking about ERP



Aimed at strengthening the processes to further improve business, identify cost containment opportunities as well as drive growth

Expressing an opinion on internal control – how will you do it



One time

Detailed scope

Validate & document design

Corrective action

Prepare test strategy & plan

Reporting approach

Ongoing

Update for changes

Seek confirmation on changes

Test controls

Report

Leverage 'Technology' for effective enablement of controls

Scoping

Design assessment

Gap remediation

Operating effectiveness

Assessment and reporting

Key worksteps/ considerations for Scoping:

- ▶ Map/ Identify significant accounts, processes and key locations
- ▶ Segregate scope between Business Process and IT
- ▶ Discuss/ align the scope with External Auditors
- ▶ Define materiality – Key/ non-key Risks
- ▶ Finalize scope exclusion and validate with auditors
- ▶ Define scope of processes/ activities performed by third parties
- ▶ Nominate IFC Champion across processes/ locations
- ▶ Set up a Steering Committee to review progress/ remediation plans
- ▶ Align Audit Committee and Board
- ▶ Finalize templates, documentation standards, reporting packs
- ▶ Conduct Training/ workshops with process owners



Key Highlights (ICAI note)

- Significantly larger than CARO
- IFC (Sec 134) Vs. ICFR (143)
- IFC includes Operational while ICFR is only reporting
- Does not apply to consolidated financial statements
- SOCR reporting from third parties

Scoping

Design assessment

Gap remediation

Operating effectiveness

Assessment and reporting

COSO 2013 framework

Codification of 17 principles embedded in the original framework



COSO 2013 Framework

1. Control Environment

1. Demonstrates commitment to integrity and ethical values
2. Board of directors demonstrates independence from management and exercises oversight responsibility
3. Management, with board oversight, establishes structure, authority and responsibility
4. The organization demonstrates commitment to competence
5. The organization establishes accountability

2. Risk Assessment

6. Specifies relevant objectives with sufficient clarity to enable identification of risks
7. Identifies and assesses risk
8. Considers the potential for fraud in assessing risk
9. Identifies and assesses significant change that could impact system of internal control

3. Control Activities

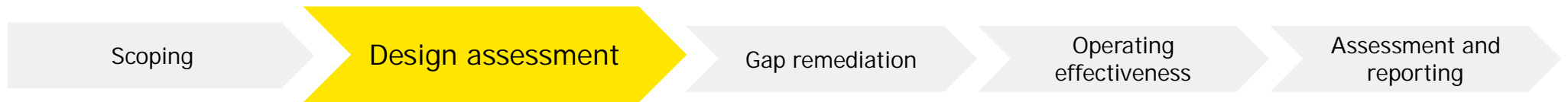
10. Selects and develops control activities
11. Selects and develops general controls over technology
12. Deploys through policies and procedures

4. Information & Communication

13. Obtains or generates relevant, quality information
14. Communicates internally
15. Communicates externally

5. Monitoring

16. Selects, develops and performs ongoing and separate evaluations
17. Evaluates and communicates deficiencies



Key work-steps/ considerations for Design assessment:

- ▶ Finalize Process Owners across each process/ location
- ▶ Perform & document walkthroughs (recommended)
- ▶ Document process maps with input, output, risk/ controls, IPE
- ▶ Segregate controls into Entity/ Process/ IT
- ▶ Identity controls into Manual, Automated, IT dependent, Preventive/ Detective
- ▶ Segregate controls into Document Risk & Control matrix with control description, owner, frequency, control evidence etc
- ▶ Document IT General Controls (GITCs)
- ▶ Perform Segregation of Duties analysis
- ▶ Identify design gaps based on walkthroughs, interviews, discussion etc
- ▶ Benchmarking of IFC controls – consolidate, remove redundancy,



- Key Highlights (ICAI note)*
- *Perform Walkthroughs*
 - *Document Process Flows*
 - *Entity/ Transaction level*
 - *GITC*
 - *Segregation of Duties*
 - *IT System overview Diagram*
 - *IPE documentation*
 - *Controls Benchmarking*

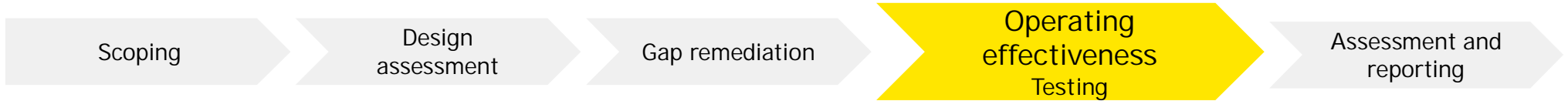


Key work-steps/ considerations for Gap remediation:

- ▶ 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/ optimize IT Controls
- ▶ Standardized/ centralize processes (wherever possible)
- ▶ Enhance SOP/ MIS/ DOA etc
- ▶ Interim testing to confirm remediated gaps



- Key Highlights (ICAI note)*
- *Material weakness*
 - *Test of Design (TOD)*
 - *Remediation plans*



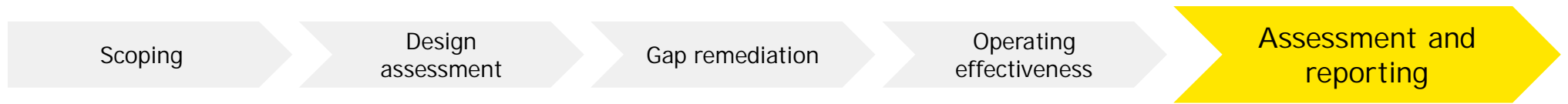
Key work-steps/ considerations for Operating Effectiveness:

- ▶ Align sampling strategy with auditors
- ▶ Prepare testing plan & templates
- ▶ Timing of testing – Mid year and roll 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



Key Highlights (ICAI note)

- *Sampling methodology*
- *JE CAATs*
- *Linkage with ELCs*
- *Timing of testing*
- *Extending sample size*
- *Analysis of error in the sample - Tolerable error etc*



Key work-steps/ considerations for Gap remediation:

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



Key Highlights (ICAI note)

- *Opinion on IFC*
- *Material weakness*