

Draft

Internal Financial Control
Integrated reporting

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IFC VS. IFC-FR

Meaning of IFC vs IFC-FR?

Whether a new concept in India?

Whether it applies to listed or unlisted companies?

Whether it applies to small and OPC?

Whether opinion on IFC is in addition to and distinct from opinion on FSs?

Whether it is applicable to CFS?

Whether it is applicable for interim FSs?

Whether it is applicable to overseas companies during consolidation?

What is the date for reporting on adequacy and operating effectiveness of IFC over FSs?

Applicability in case of joint or branch audit?

If a material weakness exists in the IFC, what is the fate of report on FSs?

– Explanation to section 134(5) (e)

the directors, in the case of a **listed** company, had laid down IFC to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Explanation.—For the purposes of this clause, the term “IFC” means the policies and procedures adopted by the company for ensuring

the orderly and efficient conduct of its business, including adherence to company’s policies,

the safeguarding of its assets, the prevention and detection of frauds and errors,

the accuracy and completeness of the accounting records,

the timely preparation of reliable financial information.

– *Rule 8(5) (viii)*

Board report of ALL
companies to state the
details of adequacy of IFC
with reference to FSs.

– Section 143(3)(i) – mandatory since 01/04/2015

Whether the company has
adequate internal financial
controls system in place and
the operating effectiveness of
such controls

-C) defined by SA 315 indentifying/assessing RoMM

the process *designed, implemented* and *maintained* by TCWG, management & other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of FR, ***effectiveness & efficiencies of operations***, safeguarding of assets and compliance with applicable laws & regulations.

Appendix I to SA 315 indentifying/assessing RoMM

COMPONENTS OF IC

Control Environment

Entity's risk assessment process

Control activities

Information system and communication

Monitoring of controls

200 – PARA 1 – rescuing auditors

the auditor's opinion on FSs deals with whether the FSs are prepared, in all material respects, in accordance with the applicable FR framework, common to all audits of FS

the auditor's opinion therefore does not assure, for example the future viability of the entity nor the efficiency and effectiveness with which management has conducted the affairs of the entity.

VS. IFC-FR

Whether a new concept in India

ARO needs comments on IC on purchase of inventory & FA and sale of goods and services

Clause 49 of the listing agreement CEO/MD/Manager/WTD and CFO certification on IC over financial reporting

Section 217 (2AA) of the Companies Act 1956 in DRS required to report that “Directors have taken proper & sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the Act, for safeguarding the assets of the company and for preventing & detecting fraud and other irregularities.

FR – Clause 49 (IX)[C] CEO & CFO Certificate -BOD

They accept the responsibility for establishing and maintaining IC for FR and they have evaluated the effectiveness of IC systems of the company pertaining to FR and they have disclosed to the auditors and audit committee, the deficiencies in the design and operation of such IC, if any of which they are aware and steps they have taken or propose to take to rectify these deficiencies.”

IFC: REGULATORY FRAMEWORK - COMPANIES ACT, 2013

PROVISIONS	REQUIREMENT	COMPANIES
Directors' Responsibility Statement: Sec. 134(5)(e)	Board to confirm that IFCs are <i>adequate</i> and <i>operating effectively</i>	<i>Listed</i>
Board Report: Rule 8(5) of Companies (Accounts) Rules	Board report to state the details in respect of the <i>adequacy</i> of IFC with reference to the financial statements	ALL
Code for Independent Directors: Sec. 149(8) and Schedule IV	Independent Directors to satisfy themselves on the integrity of financial information and that financial controls are robust and defensible	Companies having Independent Directors

IFC: REGULATORY MANDATE UNDER COMPANIES ACT, 2013

PROVISIONS	REQUIREMENT	COMPANIES
Audit Committee Sec. 177	Evaluation of IFC & risk management system May call for comments and observations of the auditors with regard to IC	Companies having an Audit Committee
Auditor's report: Sec. 143(3)(i)	Auditors to report if the company has adequate IFC systems and that they are operating effectively.	All companies

Internal Financial Controls reporting covers not just financial reporting aspects, but also the strategic and operational aspects of business and the efficiency with which those operations are carried out

**INTERNAL FINANCIAL CONTROLS
(MEANS THE POLICIES AND PROCEDURES)**

	DIRECTORS RESPONSIBILITY	AUDITORS RESPONSIBILITY
Orderly and efficient conduct of its business	✓	✗
Adherence to company's policies, the safeguarding of its assets	✓	✓
Prevention and detection of frauds and errors	✓	✓
Accuracy and completeness of the accounting records	✓	✓
Timely preparation of reliable financial information	✓	✓

INTERNAL FINANCIAL CONTROLS (as per Companies Act of India)



Board of Directors:

- Lay down adequate and effective IFCs and include it in Directors' Responsibility Statement.
- Independent Directors to satisfy themselves on the strength of financial controls.



CEO/ CFO:

- Responsible for establishing & maintaining internal controls for financial reporting.
- Responsible to disclose deficiencies in the design or operation of such internal controls to the Auditors and the Audit Committee.

INTERNAL FINANCIAL CONTROLS (as per Companies Act of India)



Audit Committee:

- Evaluate IFC systems.
- Review Auditors' comments/observations with respect to controls before submission to the Board.
- Discuss issues with Management or Internal/Statutory Auditors.



Auditors:

- Report on adequacy of IFCs system.
- Report on operating effectiveness of such controls.

REGULATORY REQUIREMENTS AND GUIDELINES

Guidelines for Listed Entities

Combined Code: Turnbull	UK	1998/99 Amended 2003
Code on Corporate Governance (Part I & II)	Malaysia	2000
King II	South Africa	2002
Sarbanes-Oxley Act	US	2002
ASX Good Corporate Governance (Principle 7)	AUS	2003/04
Clause 49	India	2000 Amended 2004, 2014
Code on Corporate Governance (Principle C2)	HK	1 July 2005
J-SoX	Japan	2005

BUILDING BLOCKS OF AN ICFR AUDIT

ASSESS AND MANAGE RISK - MANAGE AUDIT ENGAGEMENT

PLANNING

START

Identify
significant
account
balances/
disclosure
Items

Identify &
understand
significant
flows
of
transactions

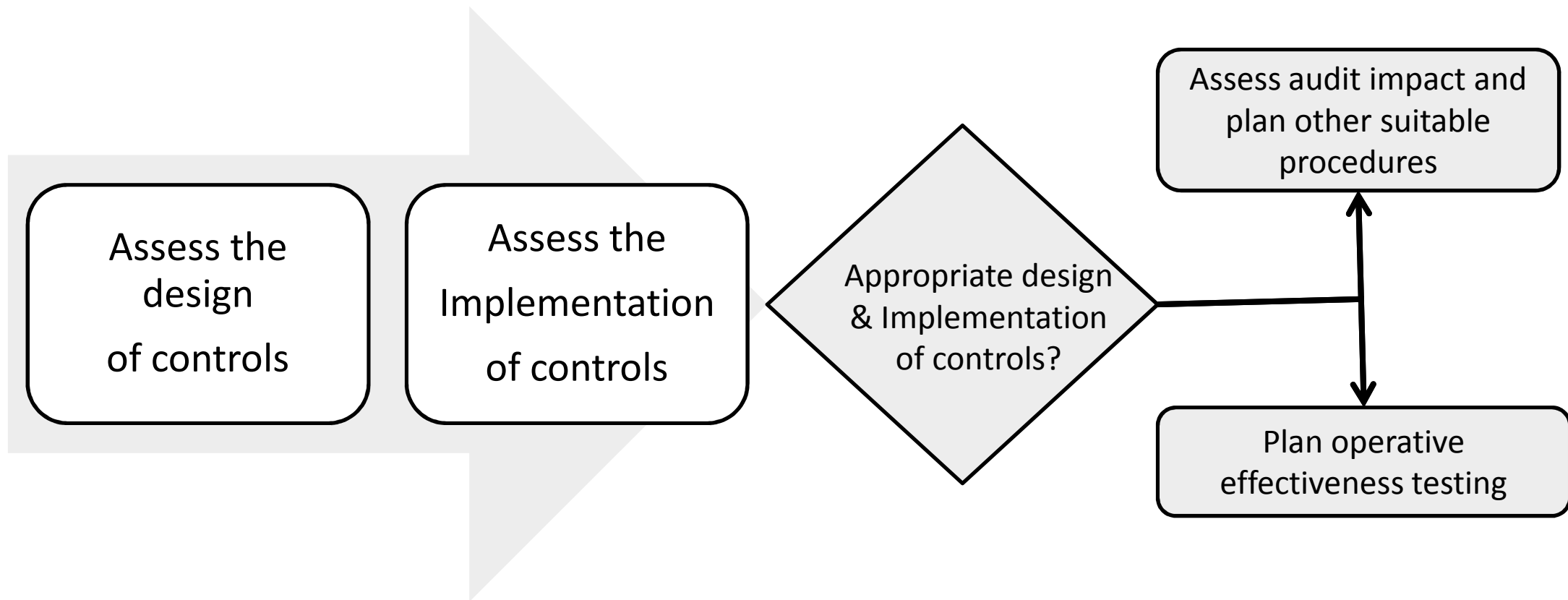
Identify risk of
material
misstatement
s

Identify
controls
which address
risk
of material
misstatement
s

Identify
applications,
associated IT
environment,
ITGC

BUILDING BLOCKS OF AN ICFR AUDIT

DESIGN & IMPLEMENTATION



BUILDING BLOCKS OF AN ICFR AUDIT

OPERATING EFFECTIVENESS

Plan nature,
timing
and extent of
testing
operative
effectiveness

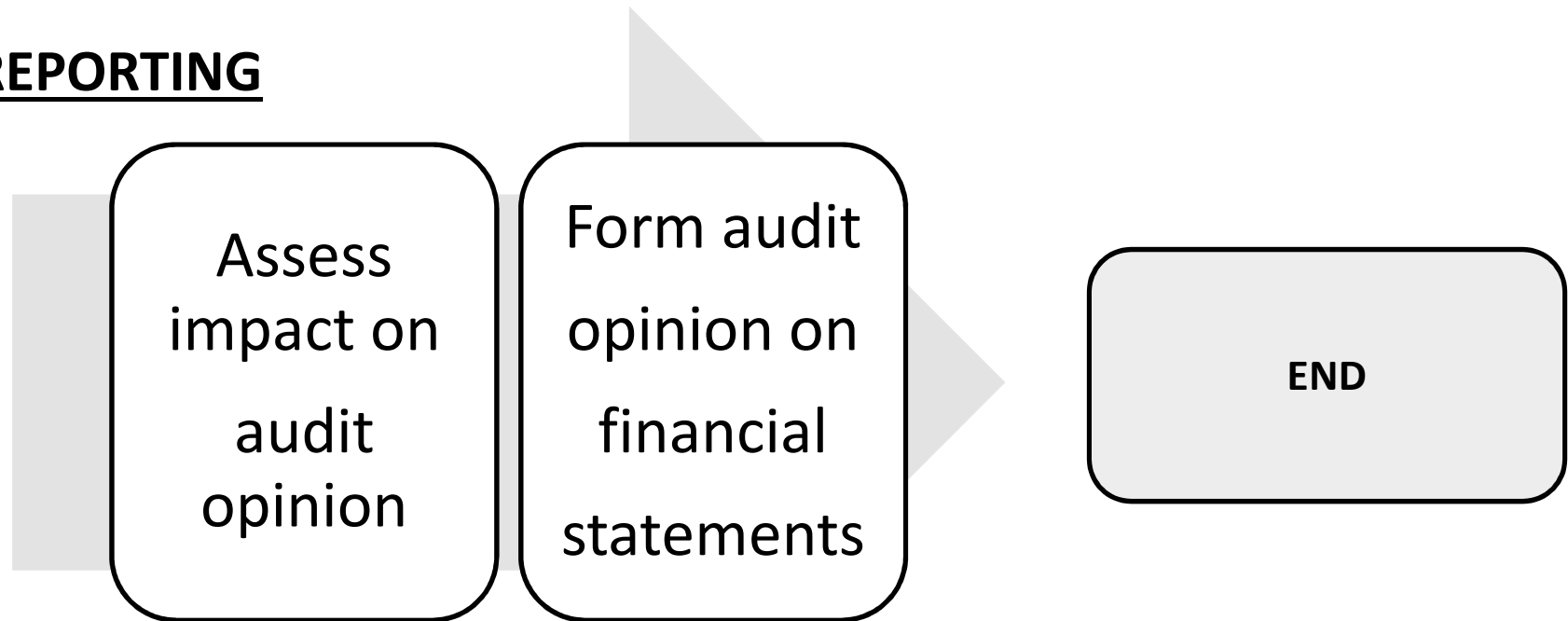
Perform
operative
effectiveness
testing

Assess findings
and
conclude on
operative
effectiveness

Form opinion
on
IFC

BUILDING BLOCKS OF AN ICFR AUDIT

REPORTING



Prepare and Control Audit Documentation - Continuous Focus on Audit Quality

INTERNAL FINANCIAL CONTROLS – WHAT TO DO ?

OPERATIONS OBJECTIVE

IFC OBJECTIVE

- Efficiency & Effectiveness in Operations
- Prevention & Detection of fraud & error.

IFC REQUIREMENTS

- Defined Policies & Procedures to ensure effective and efficient operations.
- Effective Delegation of Authority
- Preventive controls to address Fraud Risk.
- Mechanism for timely detection of fraud & errors.

WHAT TO DO ?

- Define & ensure Compliance to appropriate policies, procedures & Delegation of Authority.
- Define appropriate Entity Level Controls.
- Define & monitor operating effectiveness of appropriate controls over various activities.
- Fraud Risk Management.

OPERATIONS OBJECTIVE

IFC OBJECTIVE

- Safeguarding of assets

IFC REQUIREMENTS

- Adequate control over asset movement, storage, loss or theft.
- Risk identification and mitigation plan to reduce loss of asset.

WHAT TO DO ?

- Define appropriate asset movement controls.
 - effective asset verification program.
-

REPORTING OBJECTIVES

IFC OBJECTIVE

IFC REQUIREMENTS

WHAT TO DO ?

➤ Accuracy and completeness of Accounting Records.

- Controls over accurate and timely update of accounting records.
- Control over completeness of accounting records.

➤ Defined effective controls and ensure operating effectiveness .

➤ Reliability of Financial Reporting.

- Timely preparation of financial reports.
- Adequate controls over preparation of financial reports.

➤ Defined appropriate controls over preparation of financial reports.

➤ Adequate review mechanism.

COMPLIANCE OBJECTIVES

IFC OBJECTIVE

- Compliance with applicable laws and regulations.

IFC REQUIREMENTS

- Adequate framework to ensure compliance to applicable laws and regulations.
- Adequate framework to monitor the compliance.

WHAT TO DO ?

- Legal Compliance Framework.
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INTERNAL CONTROLS - GLOBAL PERSPECTIVE

INDIA

USA

UK

SCOPE

ICFR + Policies/Procedures
+ Fraud + Safeguarding
Assets

Internal Control over
Financial Reporting (ICFR)

All material controls,
including financial,
operational and
compliance controls.

FRAMEWORK

Components of Internal
Controls as per SA 315

COSO

The UK Corporate
Governance Code

GUIDANCE

ICAI Guidance Issued in
August 2015

AS-6

UK Combined Code /
Turnbull Guidance

INTERNAL CONTROLS - GLOBAL PERSPECTIVE

INDIA

USA

UK

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

COMPARISON SOX VS IFC

DESCRIPTION	SOX	IFC
Applicability	Parent company and major consolidated subsidiaries, affiliated companies.	Every listed company registered under Companies Act.
Entity Level Controls Assessment	Applicable	Applicable
Assessment of business processes	Assess business process relating to material financial statement accounts	Assess business process relating to material financial statement accounts.
Assessment method of business processes	<ul style="list-style-type: none">•Understand and classify business processes•Document business process in the form of flowchart and process narratives.	<ul style="list-style-type: none">•Understand and classify business processes•Identify risks and controls(RCMs)•Evaluate design effectiveness of internal controls

COMPARISON SOX VS IFC

DESCRIPTION	SOX	IFC
Assessment method of business processes	<ul style="list-style-type: none">•Identify risks and controls (RCMs)•Evaluate design effectiveness of internal controls•Evaluate operational effectiveness of internal controls	<ul style="list-style-type: none">•Evaluate operational effectiveness of internal controls.
Evaluation of controls over IT environment	<ul style="list-style-type: none">•IT General Controls•Business processing IT controls	<ul style="list-style-type: none">•IT General Controls•Business processing IT controls
Auditors Opinion	Express opinion on management's evaluation of the effectiveness of internal controls.	<ul style="list-style-type: none">•Report on adequacy of IFC system•Report on operating effectiveness of such controls.