

Internal Financial Controls (IFC) / Internal Controls Over Financial Reporting (ICFR) & Proposal Drafting

June 2020

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Disclaimer:

- This document is not an advertisement of my professional attainments or services. This is purely an academic discussion / awareness session for the benefit of young Chartered Accountants & Professionals
- This document is prepared ONLY for the purpose of introductory knowledge transfer to young Chartered Accountants & Professionals (Through Links, Templates, Presentations and Discussions etc.)
- This document is not intended to offer any Advisory (In any form whatsoever) and the Panelists do not have any sort of commercial interest in conducting this webinar
- This webinar is not intended to solicit professional work directly or indirectly or solicitation of clients in any form or manner whatsoever
- This document is only a brief outline and does not cover the topic / technical aspects in detail – due to the time constraints and for the benefit of the larger audience
- **One size does not fit ALL** – this is a generic & introductory presentation and not specific to a business or business scenario. The citations in this are not specific to any Company, Firm or Organization etc.
- This presentation is only for the purpose of this webinar and not for public circulation

Ground Rules:

- Humble request to all the participants to mute their microphone and please send the questions / queries via the **Zoom chat box**
- All questions / queries will be addressed in the later part of the session and in case any queries remain unaddressed, you are free to reach out over email / call to both Anurag & Deep
- We will not be discussing or deliberating any Company / Organization specific issues
- The templates shown at the end of the session are generic templates – for the purpose of illustration only and those allowed for download are available on the LinkedIn Page
- If some of your queries are not answered during the time slot, please feel free to reach out to Anurag or Deep over whatsapp or email (as per below details)
- Anurag Nahta – anuragnahta@gmail.com +91-97177-02876
- Deep Mendiratta – dkm995@gmail.com +91-99900-30666

Before we Begin:

One size
does **NOT**
fit all.



Learning Objectives:

- To **simplify the concept** – so that “Theory to Practice” becomes easier and effective
- **Extending our thinking** – making use of “What we already know” and thinking in terms of “**Business Problems**” and “**Practical Solutions to Business Problems**”
- **Becoming more resourceful** – to Plan, Manage & Execute your ICFR related work in a cost-effective manner
- Help you to **structure your ICFR templates to solve multiple objectives** (Leveraging the same templates for Internal Audit, IFC / ICFR, Risk & Control Self-Assessment)
- Sharing some useful tips for better understanding of the topic and for managing your ICFR projects
- **Looking at ICFR beyond the Compliance aspect** and getting more out of ICFR
- Learning about wider solution offering within the domain of Internal Audit

Common Pitfalls:

- ICFR is just for documentation Compliance to the provisions of the Companies Act 2013 and to ensure that Statutory Auditors get the clean documentation
- IFC and ICFR are one and the same thing and both came in with the Companies Act 2013 only
- Some Companies adopt the approach of **"Suit the Budget"** for documentation rather than **"Solve the Internal Control Problems"**
- ICFR reviewed multiple times without any tangible results / improvements coming out from ICFR (e.g. Reviewed by Internal Auditors, External Consultants, Statutory Auditors, Management Personnel etc.)
- Not prioritizing testing of controls for separate busines units / factories etc. within one legal entity
- Not leveraging the Risk & Control Matrices for multiple purposes or creating multiple documents for same controls within the Organization
- Inadequate support / focus from Top Management and Inadequate resources / staffing with the Chief Audit Executives

Key Definitions:

Reference	Requirements
Definition of Corporate Governance	<p><i>Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined</i></p> <p>Whenever a principal has to rely on agents to handle his or her business, governance issues arise</p>
SA 260	Communication with those charged with Governance
ISA 260	Auditors are required by ISA 260 to communicate audit matters of governance interest to those charged with governance
SIA 370	Dissemination of the results of internal audit and reporting the findings to management, and <u>those charged with governance</u> , is an essential part of any internal audit
SIA 370	The overall objective of Reporting Results is to highlight the effectiveness of internal controls and risk management processes to enhance governance in line with the Internal Audit Charter (or Terms of Reference, in case of external service provider).

For above, Sponsorship & Support become very important for Internal Audit & ICFR Engagements

Key Definitions:

Reference	Definition of Risk
ISO 31000 Guide	<i>Effect of Uncertainty on objectives. Note that an effect may be positive, negative or a deviation from the expected. Also, risk is often described by an event, a change in circumstances or a consequences</i>
	What can go Wrong – Everything?
IRM	Risk is the combination of the probability of an event and its consequence. Consequences can range from positive to negative
IIA	The uncertainty of an event occurring that could have an impact on the achievement of the objectives, Risk is measured in terms of consequence and likelihood
ICAI SA 315	Business Risk - A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies
Basel II	Operational Risk is defined as the risk of loss resulting from inadequate or failed processes, people and systems and from external events. This includes legal risk but excludes strategic and reputational risk

For above, getting the **context** & expectations clear is very important for IFC / ICFR engagements

Key Definitions:

Reference

Requirements

Definition of Internal Audit

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

ICAI - SIA

Internal audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organizational objectives.

Definition of Control

Any action taken by management, the board and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Management plans, organizes and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved

Control Processes

The policies, procedures (both manual and automated) and activities that are part of a control framework, designed and operated to ensure that risks are contained within the level that an organization is willing to accept

Key Definitions:

Reference	Requirements
Defining Internal Financial Controls (IFC as per the Companies Act 2013)	<p>"Internal Financial Controls" has been defined in the Companies Act 2013 Section 134(5), as to mean policies and procedures adopted by the company for ensuring:</p> <ul style="list-style-type: none">▪ The orderly and efficient conduct of its business▪ The safeguarding of assets▪ The prevention and detection of frauds and errors▪ The accuracy and completeness of the accounting records▪ The timely preparation of reliable financial information
Internal Controls Over Financial Reporting (ICOFR / ICFR)	<p>"Internal Controls Over Financial Reporting" shall mean "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 control over financial reporting includes those policies and procedures that:</p> <ul style="list-style-type: none">▪ Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company▪ 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 authorizations of management and directors of the company; and▪ Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements

Key Definitions:

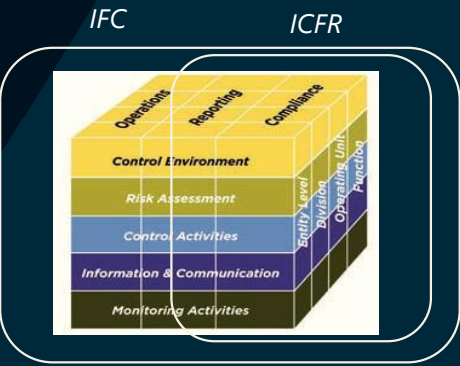
Reference
Internal Controls Over Financial Reporting (ICOFR / ICFR)

Requirements

The definition of the term "Internal Controls Over Financial Reporting" has been reproduced from the Auditing Standard (AS) 5, An Audit of Internal Control Over Financial Reporting that Is Integrated with An Audit of Financial Statements issued by the Public Company Accounting Oversight Board (PCAOB), USA

In the Indian context, "Internal Control Components" of SA 315, "Identifying and Assessing the Risks of Material misstatement through understanding the Entity and its Environment" provides the necessary criteria for internal financial controls over financial reporting for companies

As per the ICAI Guidance Note on ICFR – "a benchmark internal control system, based on suitable criteria, is essential to enable the management and auditors to assess and state adequacy of and compliance with the system of internal control"



COSO Internal Control Framework

COSO Definition: Internal control is a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

ICFR + Fraud + Operational Controls = IFC

SA 315 was first issued by ICAI in February 2008:

Standard on Auditing (SA) 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment" defines **Internal Control** as follows:

The **process** designed, implemented and maintained by those charged with governance, management and other personnel to provide **reasonable assurance** about the achievement of an **entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations**. *The term "controls" refers to any aspects of one or more of the components of internal control.*" (ICAI Guidance Note on ICFR)

Appendix I to **SA 315** explains the five components of any internal control as they relate to a financial statement audit. The five components are:

1. Control environment
2. Entity's risk assessment process
3. Control activities
4. Information system and communication
5. Monitoring of controls

Note: These are same as those given in the **COSO Framework** for Internal Controls. With reference to these:

SA 315 requires the auditor to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement and help the auditor to reduce the risks of material misstatement to an acceptably low level

Risks relevant to reliable financial reporting include external and internal events, transactions or circumstances that may occur and adversely affect an entity's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements.

Taking a Simplistic & Uncomplicated Approach:



Suppose you have to sit on this Chair and I ask you – What is the risk you perceive if you have to sit on this chair?



Suppose I replace the chair with this Sofa and you have to sit on the Sofa – What is the risk you perceive if you have to sit on this Sofa? (Aren't you already thinking something bigger now, as compared to the Chair example above?)

Taking a Simplistic & Uncomplicated Approach:



Now do you see the Risk, Reward, Challenge, Opportunity and Controls in one Single Frame?

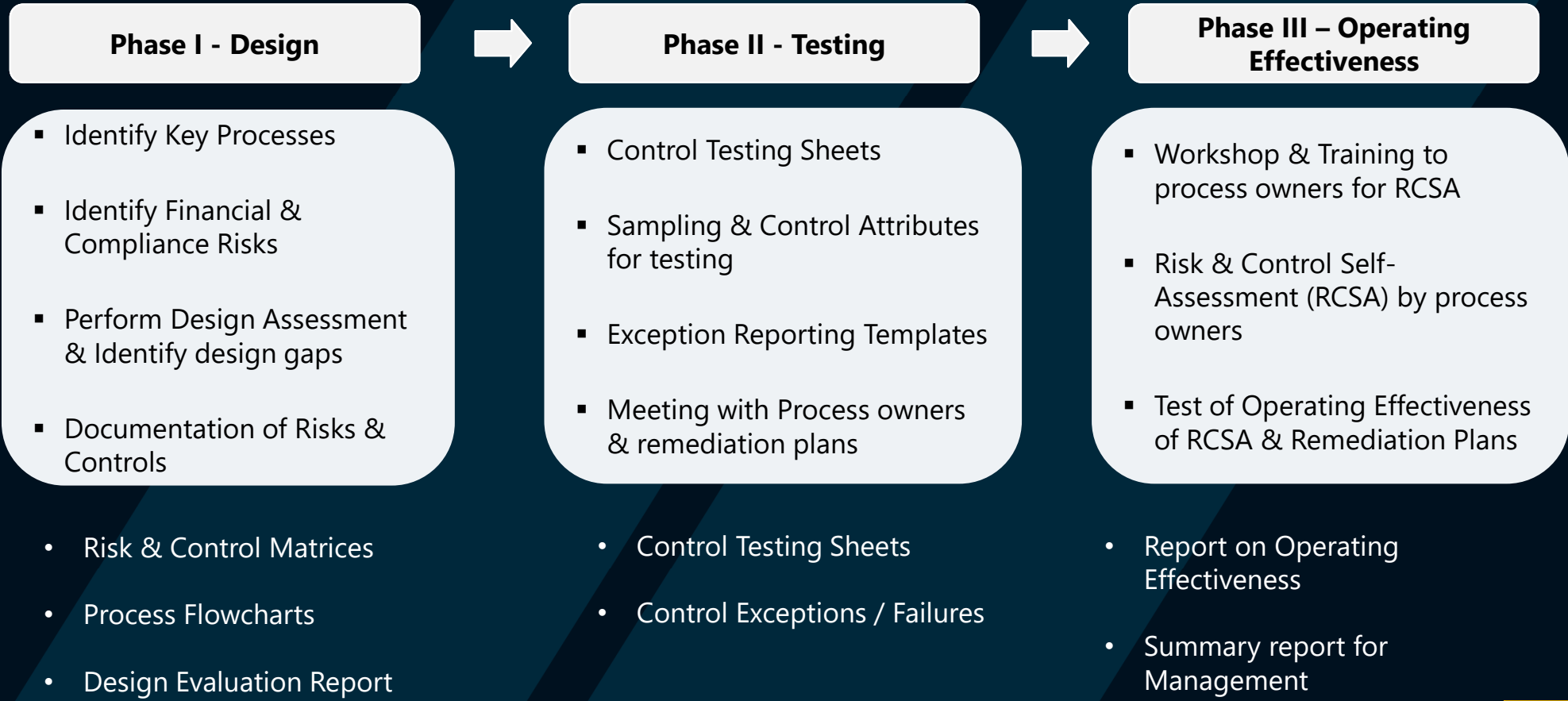
Can you reduce the Risk to Zero?



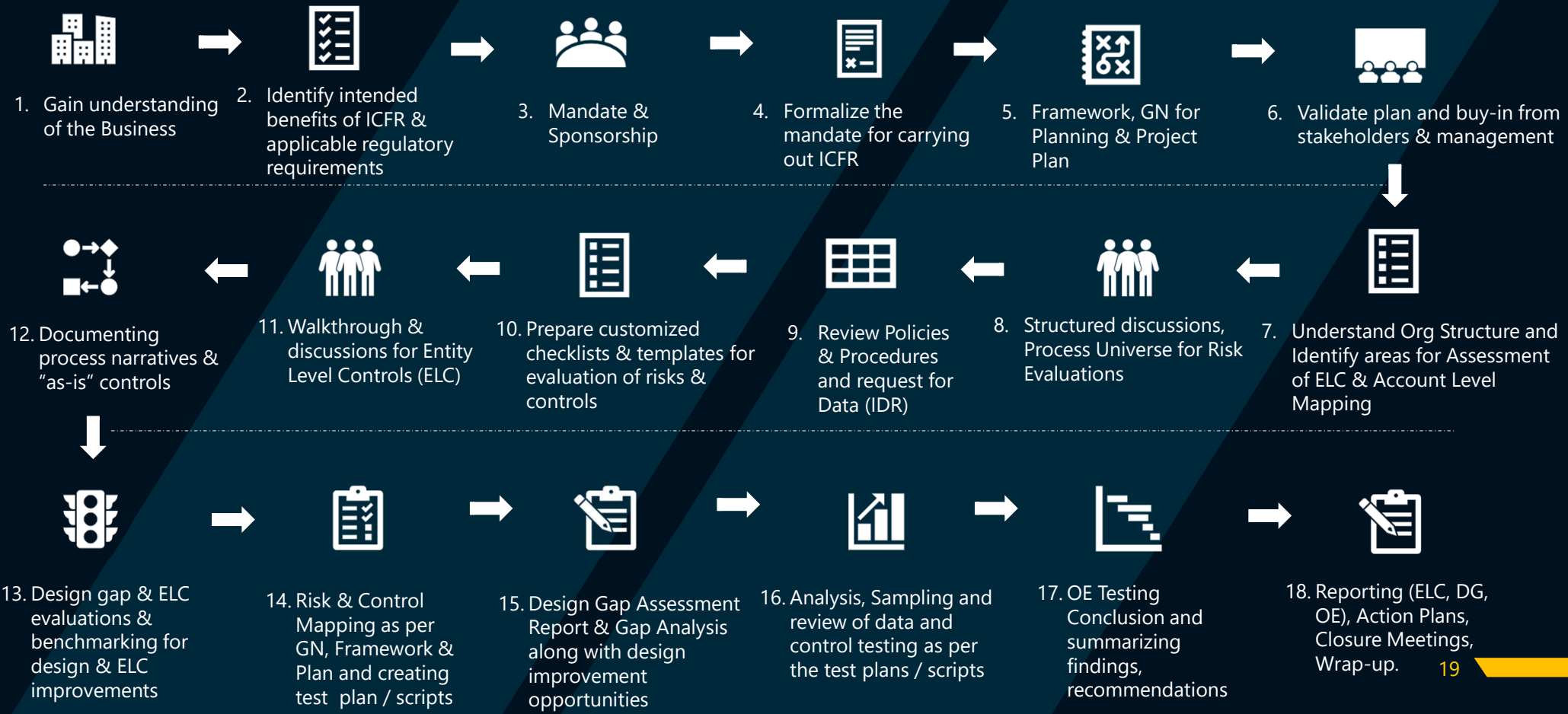
Key Considerations for IFC / ICFR Projects:

- Understand the difference between IFC and ICFR / ICOFR
- Evaluate the legal entity & operating structures and assess the applicability accordingly
- Understand the applicable provisions / compliances, framework, guidance notes etc.
- Evaluate the specific Governance, Risk and Compliance requirements for IFC and ICFR / ICOFR
- Determine the objectives of the documentation / evaluation and extent of coverage
- Evaluate Management responsibilities & Auditor's responsibilities & reporting requirements for IFC / ICOFR / ICFR
- Review the existing policies, procedures & systems in place – to avoid duplication of efforts and cut down on redundant documents
- Plan to Integrate IFC / ICFR / ICOFR and Internal Audits – so far as the policies, procedures & internal controls are concerned
- Work out a customized plan for assessment of IFC / ICFR / ICOFR and testing of controls to ensure compliance to the applicable provisions and for discharging Management & Auditors responsibilities for IFC / ICFR / ICOFR
- Agree on the approach & methodology with the Statutory Auditors / External Auditors and leverage the Internal Audit testing procedures
- Use standard templates to address multiple requirements viz. ICAI Guidance note on ICFR, Internal Audit Program / work steps, Management Assessment of Internal Financial Controls and External Auditors' assessment of Internal Financial Controls
- Optimize the cost of compliance – for Internal Audit and IFC / ICFR / ICOFR

Have a Project Plan that works for your Organization / Client:



Key Steps / Activities & assigning Roles & Responsibilities:



Illustrative Template for Building Project Plan for IFC / ICFR:



<https://www.linkedin.com/posts/activity-6536333056624689152-rM5S>

Looking at ICFR beyond Compliance:

- Helps in standardizing policies and procedures for multi-location / multi-business Companies
- Fosters a control conscious work culture for people behind controls – evaluating function wise & individual KPIs
- Provides assurance to the CEO / CFO as well as improves business performance
- In some instances, also serves as a base for blueprint of optimal procedures while thinking about ERP or new system implementation
- Evaluating business process redesign and looking at revenue leakages and cost containment opportunities
- Rationalizing the number of controls across the organization – moving to smart and automated controls



Illustrative Risk & Control Evaluation Template for IFC / ICFR:



Microsoft Excel
Worksheet

Why Proposals need to be different:

It is clear that internal audit functions have been inconsistently impacted by COVID-19. As per a recent survey conducted by the IIA, below are the most impactful activities:

1. Updating the risk assessments
2. Carrying out audit projects
3. Creating awareness of key controls
4. Performing research and benchmarking
5. Performing essential first and second-line tasks and processes

Another recent poll revealed the following:

1. Discontinued or reduced scope for some internal audit engagements
2. Cancelled some audit engagements
3. Redirected audit staff to non-audit work
4. Increased scope for some audit engagements

Most Impactful Risks:

1. Revenue
2. Human Resources
3. Supply Chain
4. Another Pandemic

Generic Table of Contents for a Proposal:

- A brief Introduction (Yourself & Your Team / Firm)
- Addressing the Opportunity / Understanding the Needs
- Perceived Problems & Proposed Solutions
- Approach for Solution
- Key Success Factors
- Project Plan, Deliverables & Timelines
- Execution Approach & Methodology
- Team Structure, Roles & Responsibilities
- Proposed Commercials
- Summarize the Proposition
- Contact Details
- Credentials (If Required)

Defining the Key Success Factors:

- Factors**
- 1 Having the **right resources** & infrastructure to support
 - 2 Understanding of the **solution requirements** & expectation setting, clarity in communication
 - 3 Defining the **roles** & responsibilities of the team members & fixing **accountability**



- Factors**
- 4 **Team work**, collaboration and **no conflict of interests**
 - 5 Adherence to project **plan**, **execution** timelines & team **focus** on quality
 - 6 **Transparency** with team, client & stakeholders

Illustrative Template for Proposals:



<https://www.linkedin.com/posts/activity-6606224547593195520-Zlky>

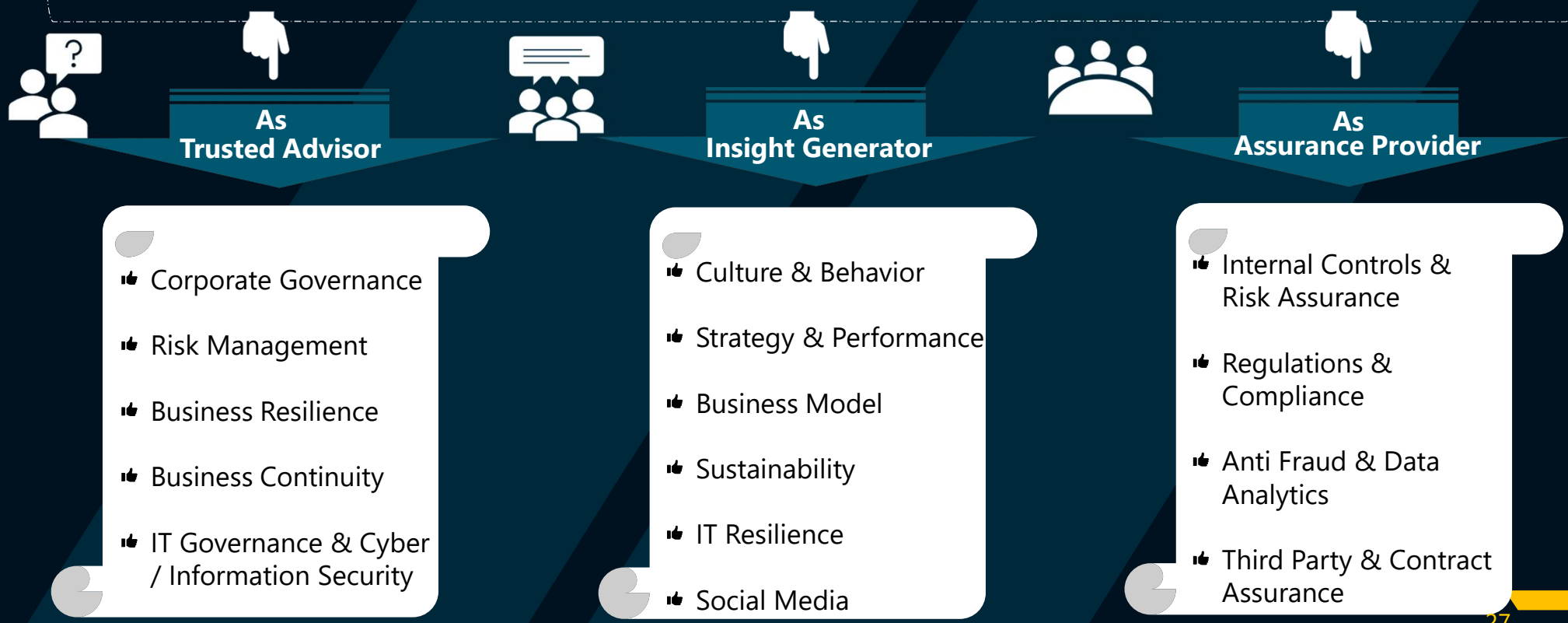
Concept note on ICFR



<https://www.linkedin.com/feed/update/urn:li:activity:6600442792684675072>

Looking at a Broader role for Internal Auditors:

Value Addition and Value Protection through Internal Audits: Below are key areas in the business where Internal Auditors can typically engage with the clients:



Note: The above list is not all inclusive – there can be many more avenues

Useful Links:

#	Learning Objective	Online Resources
1	To simplify the concept	coso.org
2	Extending our Thinking	global.theiia.org
3	Becoming more Resourceful	kb.icai.org
4	Structure your ICFR templates to meet multiple objectives	kb.icai.org global.theiia.org
5	Sharing some useful tips for better understanding of the topic	global.theiia.org/knowledge/research
6	Looking at ICFR beyond compliance	global.theiia.org
7	Wider Solution Offering with the domain of Internal Audit	global.theiia.org

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