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Internal Financial Control over Financial Reporting (ICFR) Implementation approach

3rd November'2015

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Background



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Up to F.Y. 2014-15

- So far, companies were to satisfy their Statutory Auditors about the adequacy of Internal Controls related to purchase of inventory and fixed assets and sale of goods and services for Auditor's reporting under CARO.
- However, in case of listed company, Clause 49 of the Equity Listing Agreement requires that CEO and CFO of listed companies to certify to the board of directors that they accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting.

From F.Y. 2015-16 onwards

- The Companies Act, 2013 has stated specific responsibilities on the board of companies towards the company's internal controls and, *inter alia*, requires the board to state that they have laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.
- Statutory auditor of company will be giving a separate report on the adequacy and effectiveness of Internal Financial Control over Financial Reporting with effective from Financial Year 2015-16.
- Compliance of Clause 49 of the Listing agreement will continue to be complied by the listed companies.



Snapshot of relevant provisions

Section/Rule	Related to	Description (relevant text only)
Rule 8(5)(viii) of Companies Accounts Rules, 2014	Board Report	Board's report to include the details in respect of adequacy of internal financial controls with reference to the financial statements.
Section 143 of Companies Act, 2013	Statutory Audit	Report on whether the company has adequate internal financial controls system and operating effectiveness of such controls
Section 134 of Companies Act, 2013	Director Responsibility statement	Director's responsibility statement to state that directors <ul style="list-style-type: none"> - had laid down internal financial controls to be followed by the Company - and that such internal financial controls were adequate and operating effectively
Section 177 of Companies Act, 2013	Audit committee	<ul style="list-style-type: none"> - Evaluation of internal financial controls and risk management systems - Call for / discuss the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement 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
Schedule IV of the Companies Act, 2013	Independent Directors	Satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible



Who needs to comply?

Applicability → Requirements of the Statutes / Acts	Listed companies	Unlisted Public Limited companies*	Other companies
Board Report [Rule 8 of the Companies (Accounts) Rules, 2014]	✓	✓	✓
Statutory Auditor Report (Sec. 143)	✓	✓	✓
Director's Responsibility Statement (Section 134)	✓		
Audit Committee (Sec. 177)	✓	✓	
Independent Directors (Schedule IV)	✓	✓	

* Specified class of companies:

- public companies with a paid up capital of Rs.10 Crores or more;
- public companies having turnover of Rs.100 Crores or more;
- public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs.50 Crores or more

The above thresholds as existing on the date of last audited Financial Statements shall be taken into account



Key components of Internal Controls

Designing an Internal Control Framework should be aligned to the five components of the control framework as suggested by the *Institute of Chartered Accountants of India*.



- Control Environment**
Code of Conduct / Ethics, Whistle Blower Mechanism, Identification of Authority & Responsibilities, HR Policies & Practices
- Risk Assessment**
Elements of material misstatements, Fraud Risk Management, Action plan to mitigate identified risk
- Control Activities**
Application Controls, IT General Controls, Physical Controls – Safeguarding of Assets, Segregation of Duties, Policies & Procedures
- Information System & Communication**
Reliable and accurate financial data, Timely preparation of financial data, Period end financial closing process, Accounting Manuals / Policy
- Monitoring**
Performance Reviews, Internal Audit, Compliance of Laws and Regulations, External Audit



IFC vs. ICFR?

Basis of difference	IFC	ICFR
Full form	Internal Financial Control (IFC)	Internal Financial Control over Financial Reporting (ICFR)
Scope	It's scope is very vast (refer the definition in the next slide)	It's scope is restricted to financial reporting only
Definition source	It's defined in the Companies Act, 2013 under Section 134	It's defined in the Guidance Note issued by ICAI in Sep'2015
Applicability	Mandatory for listed companies	Mandatory for unlisted companies
Auditor's report	Will not comment on IFC	Will comment on the adequacy and effectiveness of ICFR

Definition of IFC



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As per Section 134 of the Companies Act, 2013, the term “Internal Financial Control” means the ***policies and procedures*** adopted by the company for:

- Orderly and efficiently conduct of it’s business, including adherence to company policies,
- Safeguarding of it’s assets
- Prevention and detection of frauds and errors,
- Accuracy and completeness of accounting records, and
- Timely preparation of reliable financial information

Definition of ICFR



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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

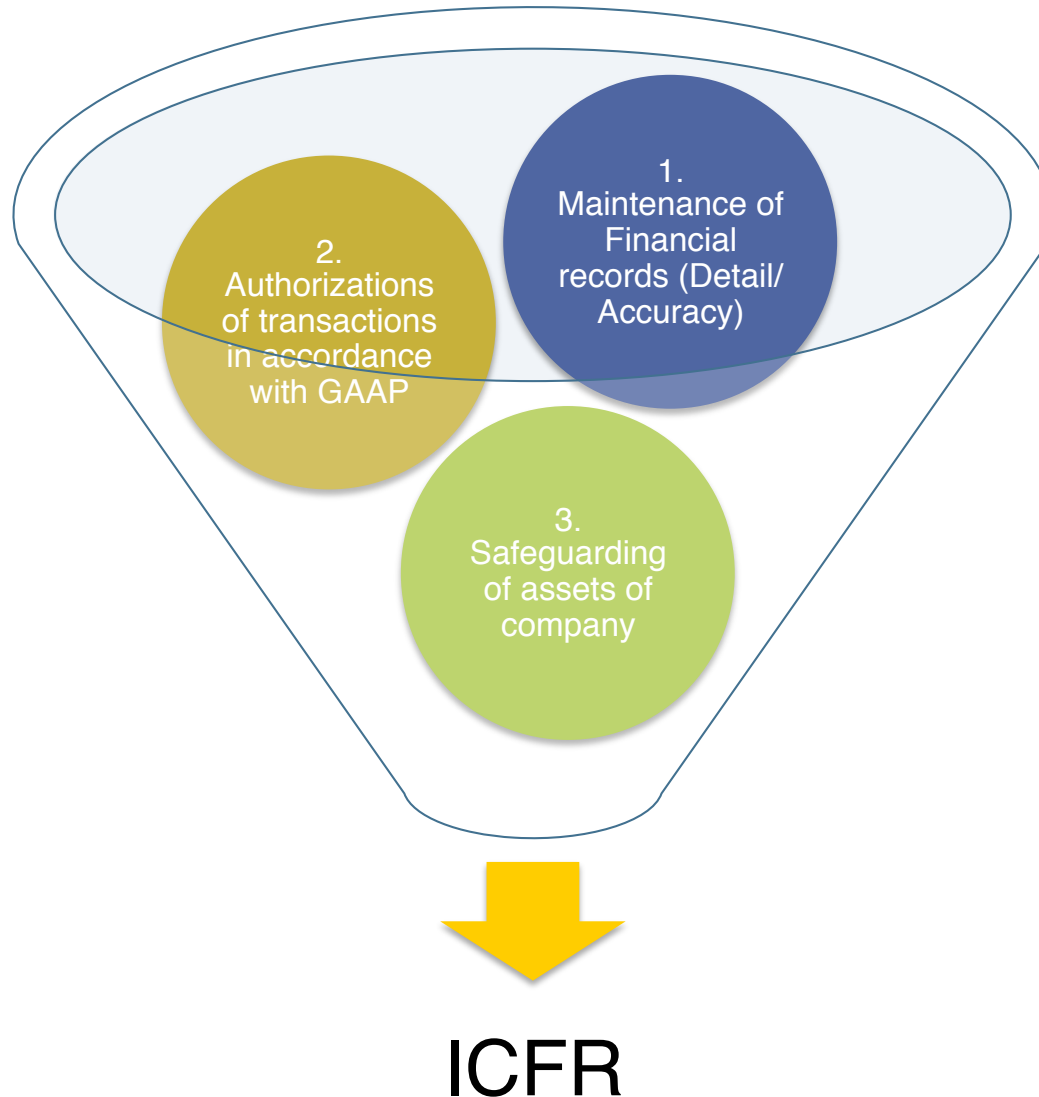
policies and procedures that:

- 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

Components of ICFR



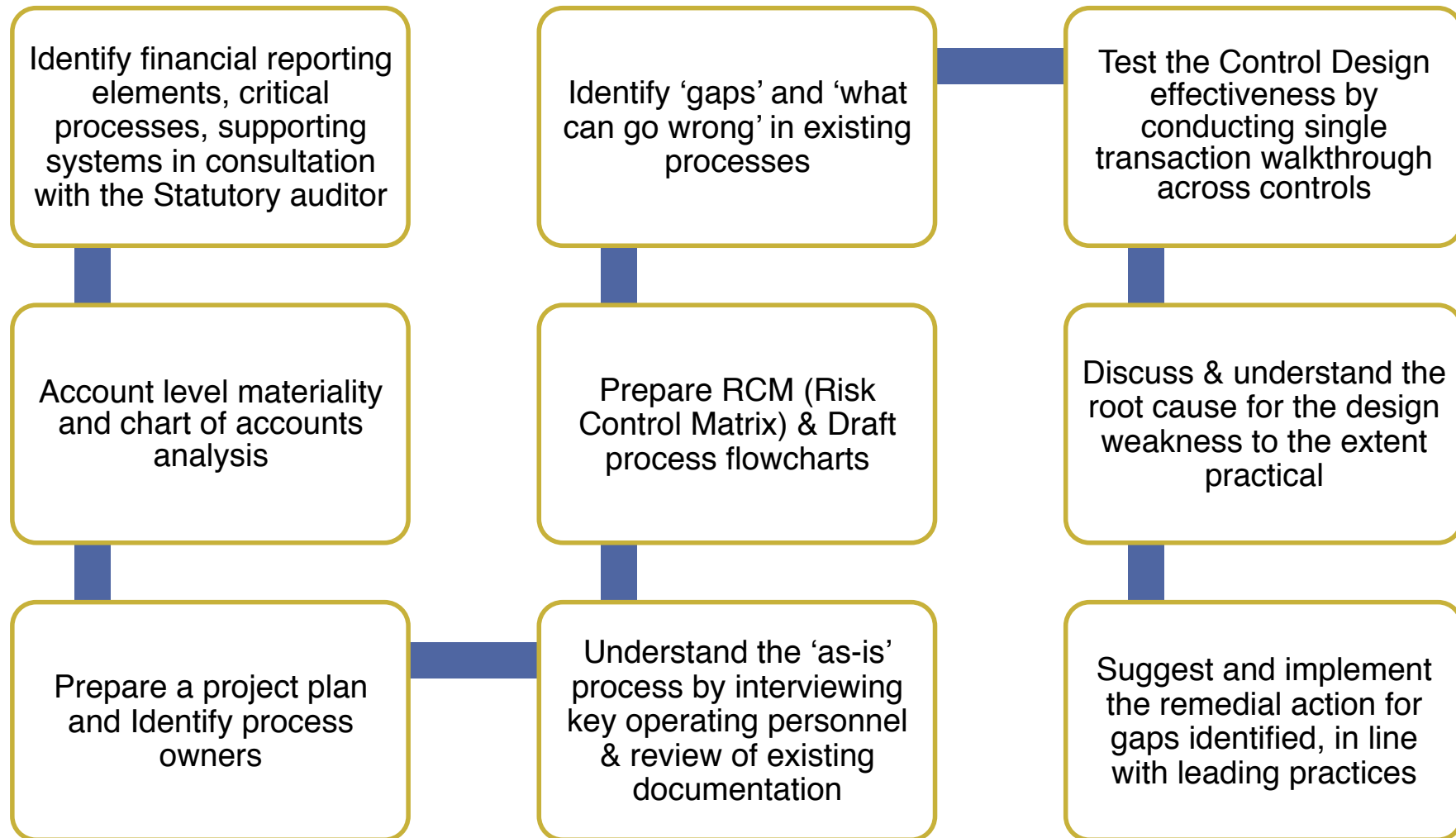
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Guidance note issued by ICAI in September'2015 has borrowed the definition of Internal Financial Control over Financial Reporting **(ICFR)** from Auditing Standard (AS) 5, *An Audit of Internal Control Over Financial Reporting that Is Integrated with An Audit of Financial Statements* issued by the Public Company Accounting Oversight Board (PCAOB), USA.



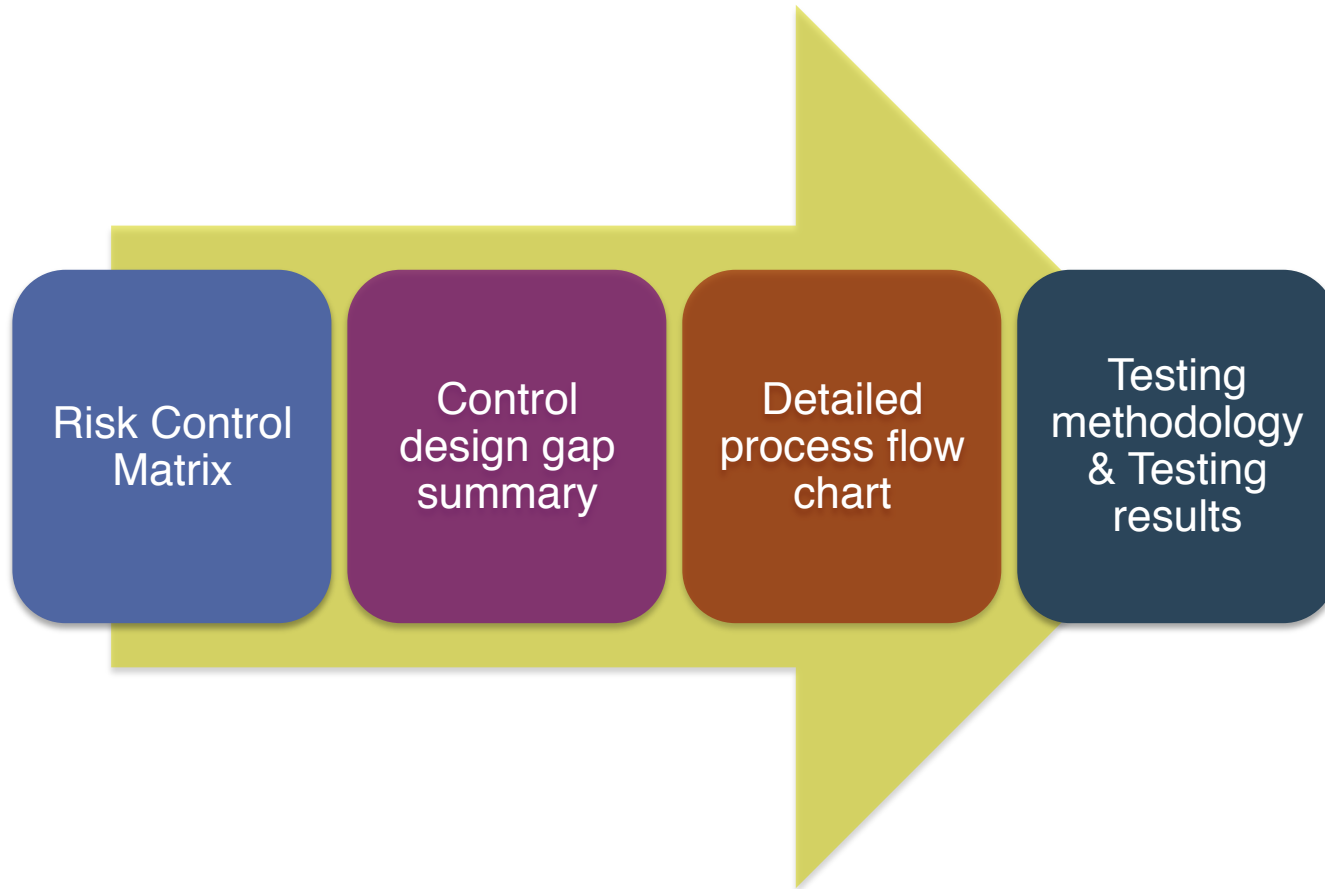
Execution approach by companies



Documentation by companies for ICFR



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About us



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Served more than **60**
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Impressive client
retention period : >
7 years

Client's turnover :
INR **50** cr to Rs.
1,500 cr

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to SLA's



We would be happy
to hear from **YOU!**



Blue Consulting Pvt. Ltd.

Chandan Goyal

Chief Executive Officer

Mobile : +91 98104 10421

Ph : +91 120 4821 753

chandan.goyal@blueconsulting.co.in

A-18, 1st Floor, Sector-6

Noida -201301.

www.blueconsulting.co.in