

SEMINAR ON INTERNAL FINANCIAL CONTROLS

Pune Branch of WIRC of ICAI

June 25, 2016

AGENDA

Session	Topic
I	Framework & Planning for IFC
II	Review of IT General Controls
III	Review of Business Process Controls
IV	Validation of IPE and Other Important Considerations
V	Opportunities for CAs and CISAs Role & Reporting of Auditors and Management

Session I

Framework & Planning for

IFC

CA Chandan Chourasiya

B Com, FCA, DISA, CISA, CIA, CFE

Session Agenda

- Introduction and History of IFC
- Regulatory Mandate
- What is Internal Financial Controls (IFC)?
- Applicable Statement of Auditing
- How do we implement IFC (Scoping and Frameworks)?
- Key Concepts in IFC

Introduction and History

- Cadbury Committee in UK on Corporate Governance
- COSO Framework 1992
- Accounting scandals in USA
- Sarbanes Oxley Act 2002
- COSO 2013
- Other Legislations
- Indian scenario

Sarbanes Oxley Act

Named for
Senator Paul Sarbanes(D-MD)
and
Representative Michael Oxley
(R-OH)



- Sec 404 requires auditors to attest and report on the assessment on the effectiveness of the internal control structure and procedures for financial reporting.
- Sec 302 Principal Officers to certify quarterly and annual statements responsibility for establishing and maintaining Internal Controls over financial reporting

Regulatory Mandate in India

Directors Responsibility Statement
Section 134 (5)(e) of Cos Act 2013

Directors, in the case of a **listed company**, had laid down internal financial controls & that such internal financial controls are adequate and were operating effectively

Board of Director's Report
Rule 8 (5) of Companies (Accounts) Rules

The details in respect of adequacy of internal financial controls with reference to the Financial Statements.
All Entities – Listed or Unlisted

Powers and duties of auditors and auditing standards
Section 143 (3) (i) of Cos Act 2013

Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls
All Entities – Listed or Unlisted

Audit Committee & Independent Directors

Section 149 (7), Schedule IV of Cos Act 2013

- Satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible

Section 177 of Cos Act 2013 for Audit Committee

- Sub Section (4) - “Evaluation of internal financial controls and risk management systems”
- Sub Section (5) – “Call on auditors to comment in internal control systems & before their submission of Financial Statements to the Board, may also discuss any related issues with the internal & statutory auditors and the management”

Schedule IV

- 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.

IFC Definition Companies Act

IFC has been defined as the policies and procedures adopted by the company to ensure 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 accounting records, and the timely preparation of reliable financial information.

- The focus goes beyond the “Financial Reporting Controls” to cover “all the aspects” of Controls Framework including tone at the top, policies and procedures, Design of controls, operating effectiveness of controls, monitoring of controls etc.

IFC Explained

Definition of IFC provided in explanation to
Sec 134 (5) (e)

Policies and procedures adopted by the
company for ensuring the orderly and efficient
conduct of its business, including

1. Adherence to company's policy
2. Safeguarding of assets
3. Prevention and detection of
frauds and errors

Management
Operational, Financial &
Compliance Controls

1. The accuracy and completeness
of the accounting records
2. And the timely preparation of
reliable financial information

**Auditor &
Management**
Financial Controls

Applicability of IFC

Management's Responsibility

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graph TD; A[Management's Responsibility] --> B[Listed Companies  
As per Section 134(5)(e) of listed company should state adequacy of IFC (i.e. Operational, Financial & Compliance)]; A --> C[Other Companies  
Rule 8(5) (viii) of Companies (Accounts) Director's responsibility statement Rules, 2014 Board report of all companies should state Details of adequacy of IFCs with reference to the Financial statements];
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Listed Companies

As per Section 134(5)(e) of listed company should state adequacy of IFC (i.e. Operational, Financial & Compliance)

Other Companies

Rule 8(5) (viii) of Companies (Accounts) Director's responsibility statement Rules, 2014 Board report of all companies should state Details of adequacy of IFCs with reference to the Financial statements

Applicable Standard of Audit

- SA 315 - Identifying and Assessing the risk of material misstatement through understanding the entity and its environment
- SA 200 – the auditor shall comply with SAs relevant to the audit
- SA 230- Documentation
- SA 330 – overall responses to address the assessed risk of material misstatements

Framework for IFC



Categories of Controls

- **Operational Controls-**
Effectiveness and efficiency of operations conducted.
- **Financial Controls-**
Reliability of financial reporting / financial impact.
- **Compliance –**
Compliance with applicable laws and regulations.

Example- Procure to Pay

Operational

Effectiveness and efficiency of operations conducted

- Vendor Selection process
- Purchase Requisitions
- Quotation Analysis
- Purchase Ordering process

Financial

Reliability of financial reporting

- Purchase Order creation
- Creation of Vendor Masters
- Goods Receiving Process
- Bill verification and payment
- Vendor ledger accounting

Compliance

- Input credits on taxes paid
- Deduction of tax at source
- Related Party Disclosures
- MSME disclosures and compliance
- Other Disclosures as per statutory requirements

Steps in Implementation of IFC

Scoping

- Review Financial statements to identify significant accounts
- Identify relevant processes to be covered
- Finalize scoping with financial and IT General Controls

Assessment

- Assess Entity Level Controls
- Understand processes and identify risks
- Develop Risk Control Matrix (RCM)
- Identify Key Controls and
- Review and identify control gaps
- Provide recommendations to address gaps

Steps in Implementation of IFC

Documentation

- Discuss control gaps and recommendations with management and agree on changes to controls
- Update and finalize RCMs
- Develop control test procedures for key controls
- Map anti-fraud controls

Testing

- Conduct the operating effectiveness testing for key controls
- Prepare draft control test results highlighting control failures
- Discuss test results with management and finalize control failure report

Steps in Implementation of IFC

Automation & CSA

- Develop questionnaire for control self assessment to be uploaded in the CSA tool
- Identify and assign ownerships to controls
- Conduct training workshops
- Implement CSA

Key Concepts

Materiality

In planning the audit of internal financial controls over financial reporting, the auditor should use the same materiality considerations he would use in planning the audit of the company's annual financial statements. Provides basis for

- Determining the nature, timing and extent of risk assessment procedures;
- Identifying and assessing the risks of material misstatement;
- Identifying classes of transactions, account balances and disclosures that need to be considered for testing; and
- Determining the nature, timing and extent of audit procedures.

Risk Assessment

- Business Risks
- Financial Statement Misstatement risks
- Appendix IV to the Guidance Note provides (for most account captions) illustrative
 - Risk of misstatement (what possible misstatements could occur)
 - Related Control objectives and
 - Control activities
- Can be used to assess adequacy of management's Risk Control Matrices ("RCMs") and assess design

Fraud risk assessment

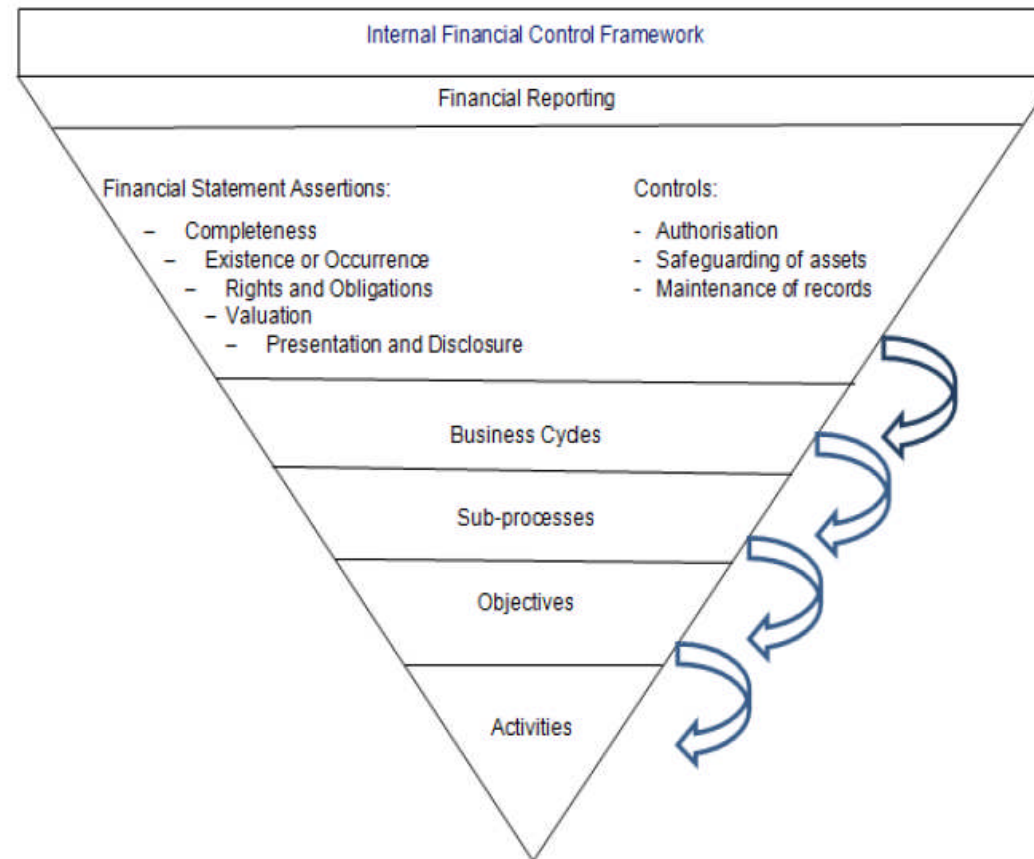
- Perform a Fraud Risk Assessment
- Evaluate whether the company's controls sufficiently address
 - Material misstatements due to fraud
 - Risk of management override of controls
- Done as part of the evaluation of entity level controls. Controls to address fraud risk would be controls
 - Over significant unusual transactions particularly late or unusual journal entries
 - Over journal entries & adjustments made during period end financial reporting
 - Over related party transactions
 - Related to significant management estimates
 - That mitigate incentives for and pressures on management to falsify or inappropriately manage financial results

Entity Level Controls

- Entity Level Controls
 - Tone at the Top
 - Key decision making
 - Code of Conduct
 - Whistleblower policy
 - Risk Management Policy
 - HR Policy
 - MIS & Reporting
 - Delegation of Authority
 - Segregation of Duties
 - Training and development policy

Top Down Approach

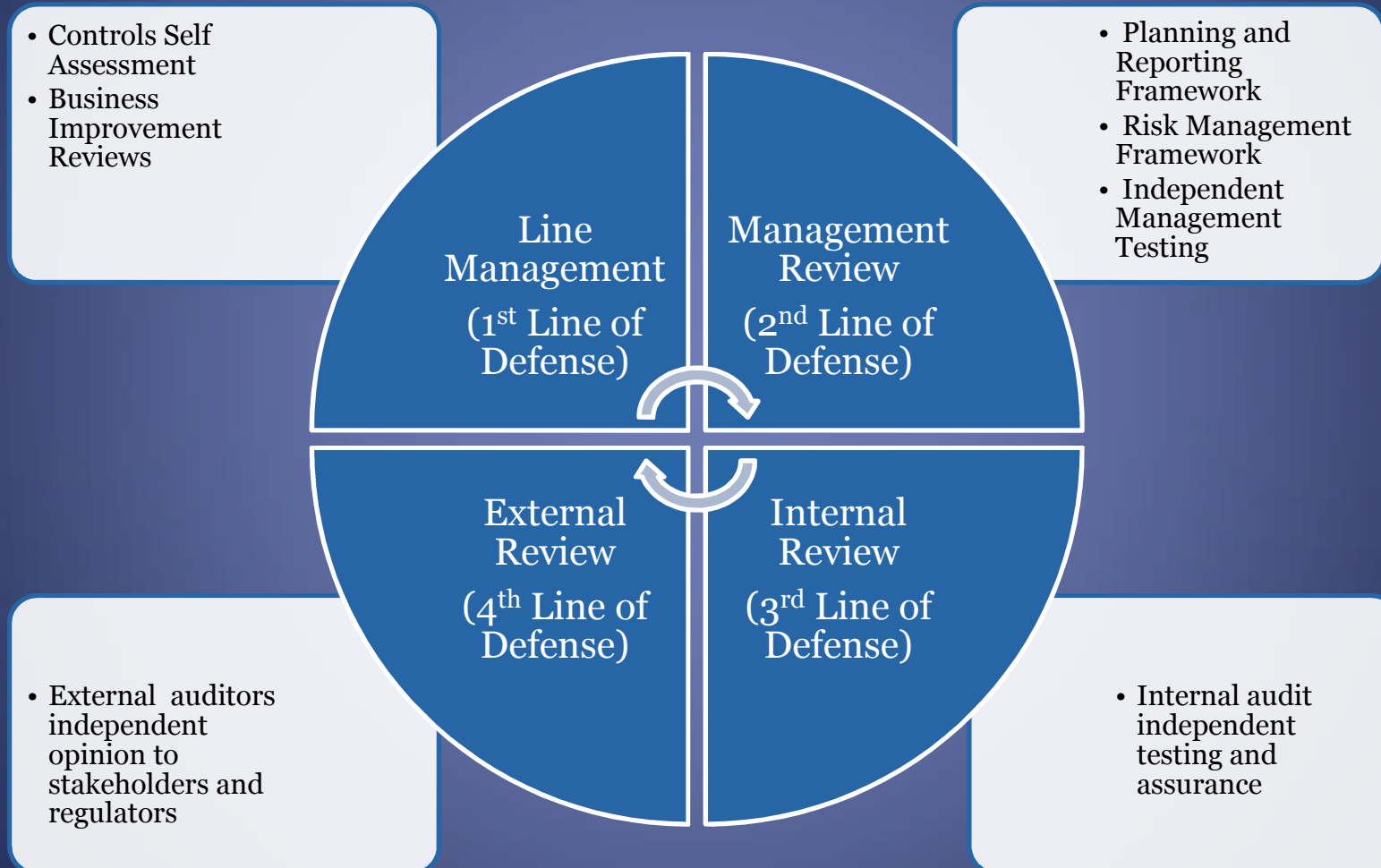
Top-Down Approach to Internal Financial Controls Over Financial Reporting



Integrated Audit

- Audit of Internal control over financial reporting should be combined with the audit of the financial statements
- Design his or her testing of controls to accomplish the objectives of both audits simultaneously
- Obtain sufficient evidence to obtain assurance for IFC and financial statement
- Obtain evidence for control risk assessment for the purpose of audit of financial statements

IFC- Lines of Defense



Thanking You

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Session II

Review of IT General Controls

CA Shirish PADEY

FCA, CPA, CISA, CEH, CSQP, DITL



- *Just When I had found all of Life's Answers*

- *They Changed All The Questions*

1.1 Reliance on IT General Controls

- Relying on Automated Controls and Automated Accounting Procedures
- Reliance on the logic of Reports and System-Dependent Manual Controls
- Reliance on Underlying Data

2.1 IT General Controls

- ITGCs may also be referred to as General Computer Controls which are defined as:

“Controls, **other than application controls**, which relate to the environment within which computer-based application systems are developed, maintained and operated, and which are therefore applicable to all applications”.

2.2 IT General Controls

- ITGCs cover 5 domains-
 - IT Governance,
 - Access to Programs and Data,
 - Change Management,
 - Program Development,
 - Computer Operations
- The objectives of general controls are to ensure the proper development and implementation of applications, the integrity of program and data files and of computer operations.
- Like application controls, general controls may be either manual or programmed.

3.1 IT Governance

- Entity Level Controls
- Policies and Procedures
- Information security and IT security policies
- Regulatory compliance and audit issues management
- Roles and responsibilities of IT team
- HR activities related controls (background checks)
- Information Security Awareness and Training

3.2 Access to Programs and Data

Generic Coverage

- Formally documented user management process
- Creation, modification and deletion of user access (Application, Operating Systems, Databases, Networks, Computing facilities)
- Approval of user access by authorized personnel
- Periodic review of user access rights
- Timely revocation of user access (resigned/absconded users)
- Physical Accesses (access to data centre, computing facilities, environmental controls)

Pointers – Access to Programs and Data

- Inability to determine Population of Changes
- Unauthorized Access or Unauthorized Modification of Access Rights
- Delayed deactivation of access
- Privileged (super-user) user access at the

Pointers – Access to Programs and Data

- End-User Access to Databases
- Logging for critical tables
- Default Accounts are not locked and/or their default passwords are not changed
- Front-End access to database

3.3 Change Management

Generic Coverage

- Formally documented change management process
- Population of Changes
- Validation of application program, configuration and infrastructure changes
- Validation of changes to Operating Systems, databases and network

Pointers - Change Management

- Inability to determine Population of Changes
- Unauthorized Changes to Applications, Operating Systems, databases and network
- Changes are not tested sufficiently prior to implementation in Production
- Absence of segregation of environments (development, test and production)
- Developer Access to Production

3.4 Program Development

Generic Coverage

- Approved Project Plan and Blueprint
- Roles and Responsibilities of team involved
- Segregation of duties between development and implementation team.
- User acceptance testing and sign off
- Post implementation/Go-Live sign off

Pointers – Program Development

- Technical Upgrade vs Functional Upgrade
- Data Migration -
 - Absence of Data Migration Strategy document
 - Only checking for Account Balances

3.5 Computer Operations

Generic Coverage

- Batch Processing and scheduling
- Interface testing
- Database backup
- Disaster Recovery and BCP
- Network security

Pointers - Computer Operations

- Failed batch jobs are not monitored and rescheduled
- Interfaces are not monitored
- Back-ups are not taken nor tested for successful restoration

4.1 ITGC - Impact on Audit

- In case ITGCs are adequate, the auditor will be able to rely on
 - Underlying data
 - Standard Reports and
 - Automated Controls
 - Automated Accounting Procedures
- A Controls-Based audit approach can be followed.

4.1 ITGC - Impact on Audit - contd..

- In case there are inadequate ITGCs, the auditor will not be able to rely on
 - Underlying data
 - Automated Controls
 - Automated Accounting Procedures
 - Logic Reports (Standard and Customized)
- Specially for MNCs, in case servers are hosted or managed from abroad, there could be different challenges.

5. Challenges for IFC Reporting

- Educating the client on why ITGC is part of IFC
- Obtaining appropriate Controls Matrices from the client on ITGCs
- Testing before March 31, 2016
- Remediation Testing also before March 31, 2016
- Inadequate guidance on Remediation Testing

6. Auditor's Roles

Category of IT System (1)	Client Reliance on IT	Probable IT Auditor's Role	Probable Core Assurance Role
Inherent IT Control Limitations	No Reliance	No Involvement	Test non IT Controls over Financial Reporting
	Reliance	No Involvement	Design Deficiency

6. Auditor's Roles

Category of IT System (1)	Client Reliance on IT	Probable IT Auditor's Role	Probable Core Assurance Role
Significant issues on ITGCs, noted on inquiry etc. and client confirms that there will be no remediation	No Reliance	No Involvement	Test non IT Controls over Financial Reporting
	Reliance	Possible Involvement to identify all Significant Control Deficiencies	Design Deficiency Deficiency in Operating Effectiveness

6. Auditor's Roles

Category of IT System (2)	Client Reliance on IT	Probable IT Auditor's Role	Probable Core Assurance Role
Significant issues on ITGCs, noted on inquiry etc. and client confirms that there will be remediation during the year	No Reliance	No Involvement	Test non IT Controls over Financial Reporting
	Reliance	Involvement – <ul style="list-style-type: none"> - To identify Significant Control Deficiencies - Remediation Testing 	Depends on IT Auditors conclusions

6. Auditor's Roles

Category of IT System (3)	Client Reliance on IT	Probable IT Auditor's Role	Probable Core Assurance Role
History of reliance on ITGCs	No Reliance	No Involvement	Test non IT Controls over Financial Reporting
	Reliance	Involvement – <ul style="list-style-type: none"> - To identify Significant Control Deficiencies - Remediation Testing 	Depends on IT Auditor's conclusions

Questions?

THANKS

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Session III

Review of Business Process Controls

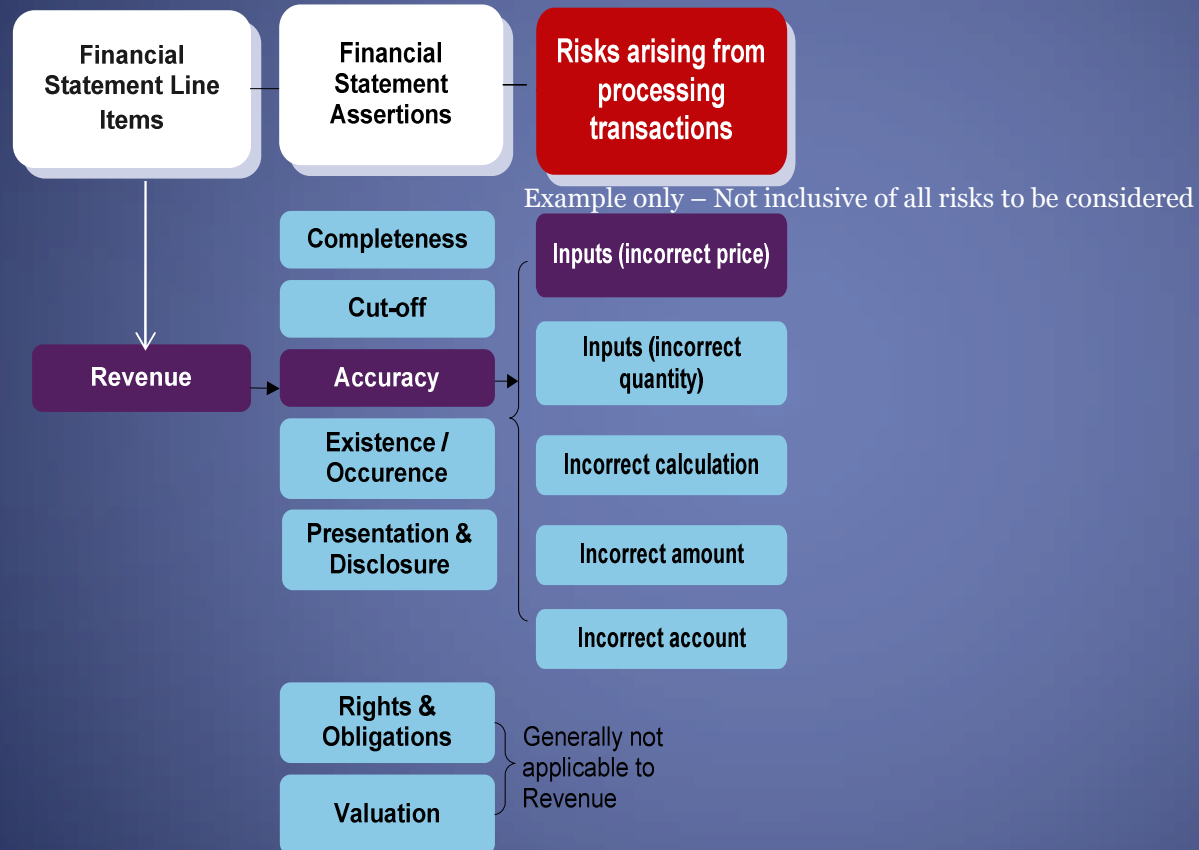
CA Jayanta Kumar Ghanty

Agenda

1. Contribution of ITGCs on the controls over Business Processes.
2. Various business cycles
3. Testing of Design of Manual and Automated Controls
4. Testing of Operating Effectiveness of Manual and Automated Controls.
5. Process flow diagram
6. Entity level controls
7. Methods of assessing SODs
8. Impact of SODs on Automated Controls

1. Contribution of ITGCs on the controls over Business Processes.

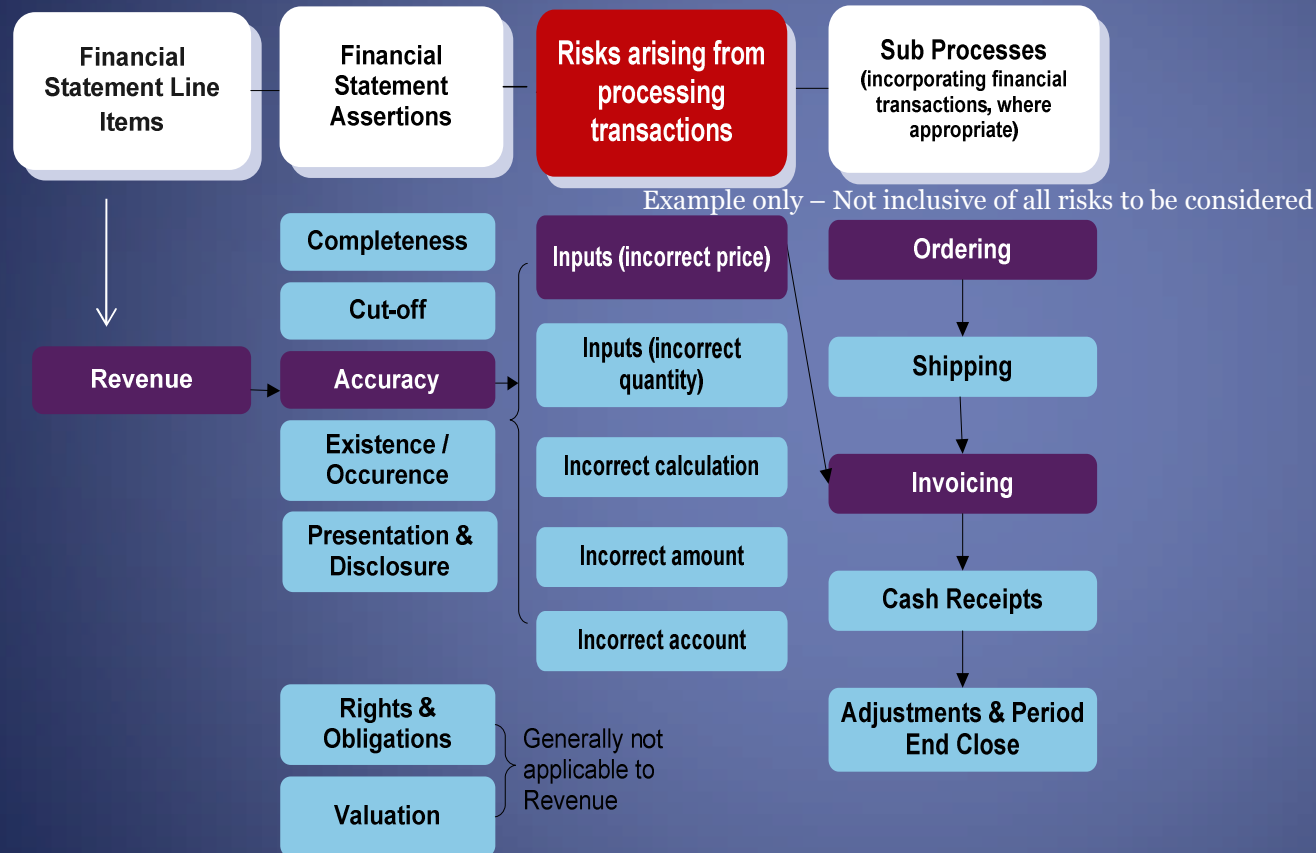
Risks arising from processing transactions



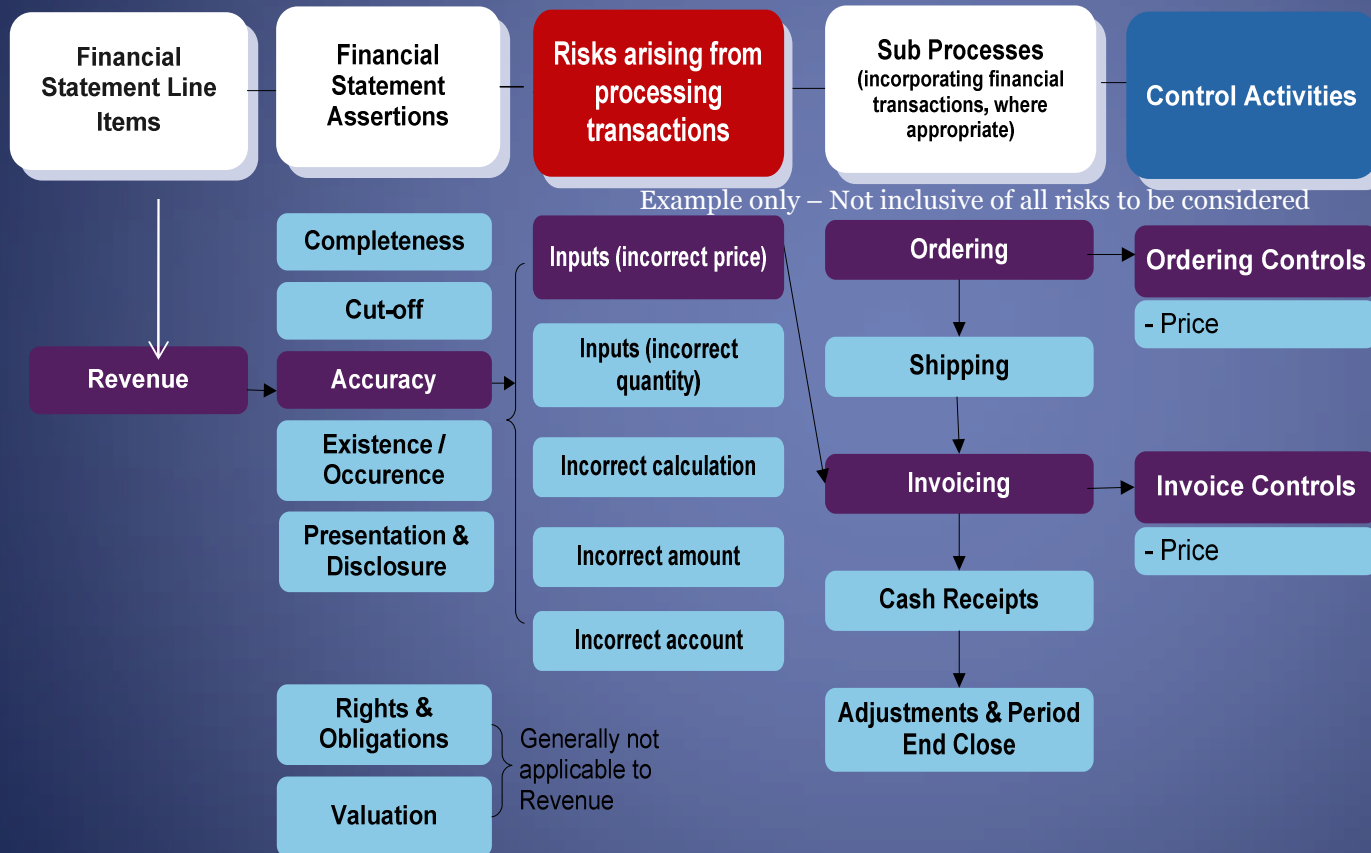
Examples of risks arising from processing transactions (not all inclusive)

- Transaction not recorded
- Transaction recorded in duplicate
- Transaction recorded in the wrong period
- Incorrect price used
- Incorrect quantity used
- Incorrect calculation applied
- Incorrect amount used
- Incorrect account used
- Did not occur / is not supported
- Sub-ledger updates to the G/L are incomplete
- Sub-ledger updates to the G/L are inaccurate

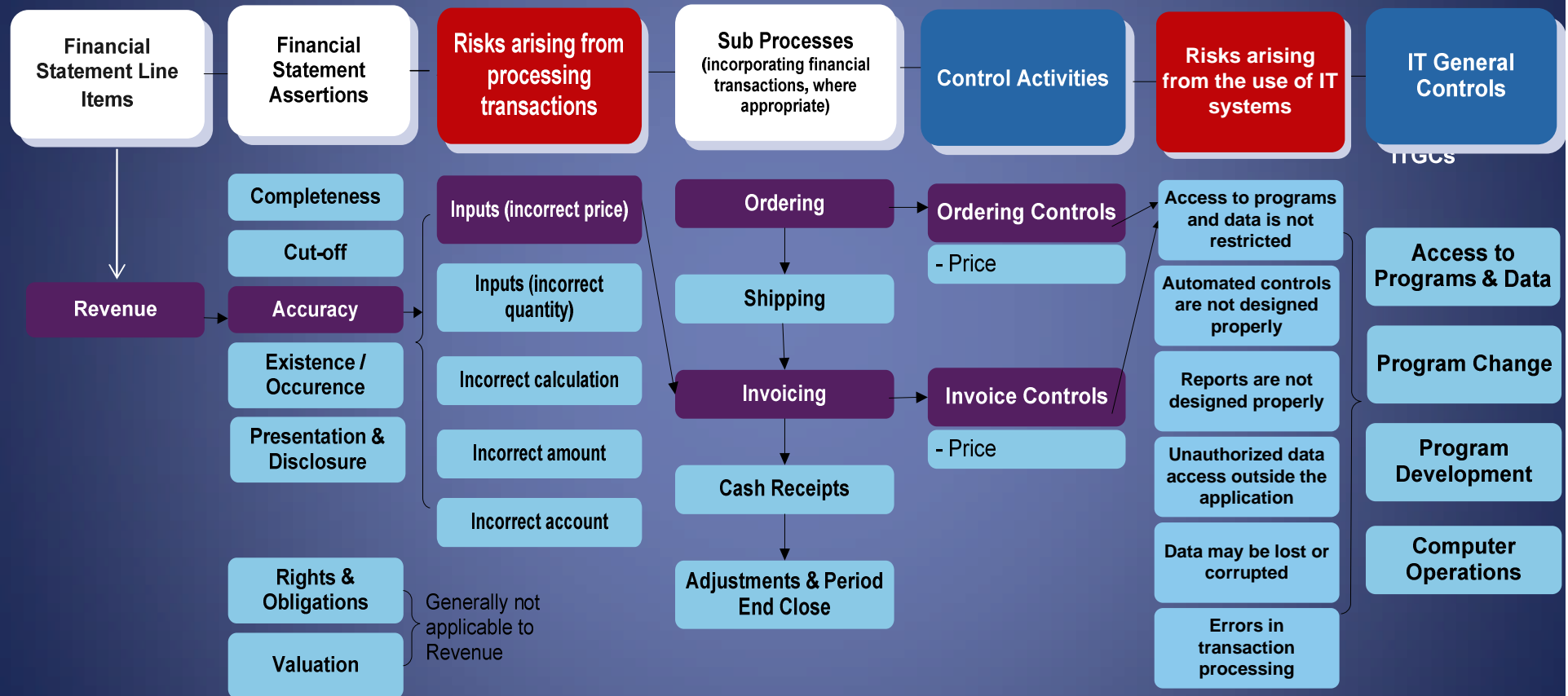
Risks arising from processing transactions are linked to sub-processes



Control activities are linked to risks arising from processing transactions through sub-processes



Link control activities with risks arising from the use of IT systems and ITGCs



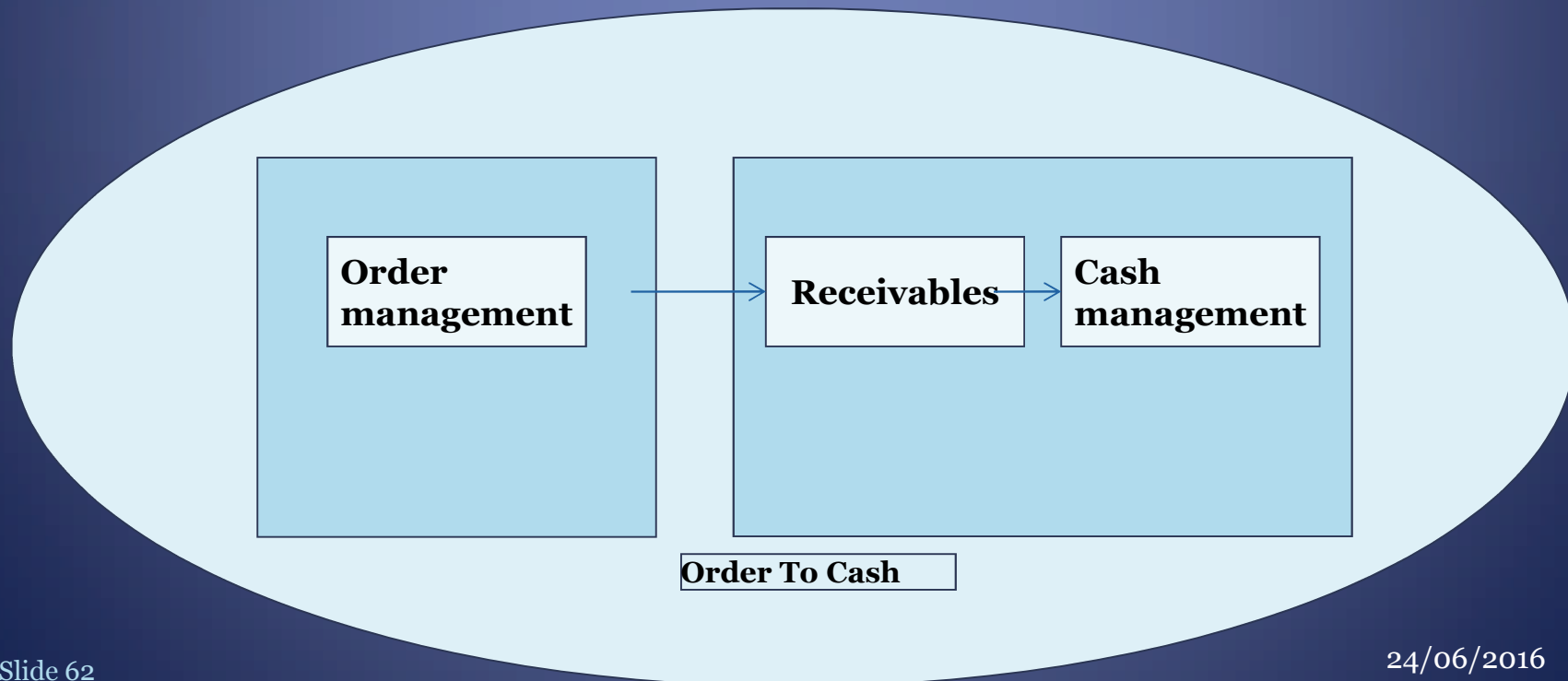
2. Various Business Processes

Key Business Processes

- Revenue & Receivables
- Purchasing & Payables
- Inventory
- Fixed Assets
- Payroll
- Treasury
- General Ledger

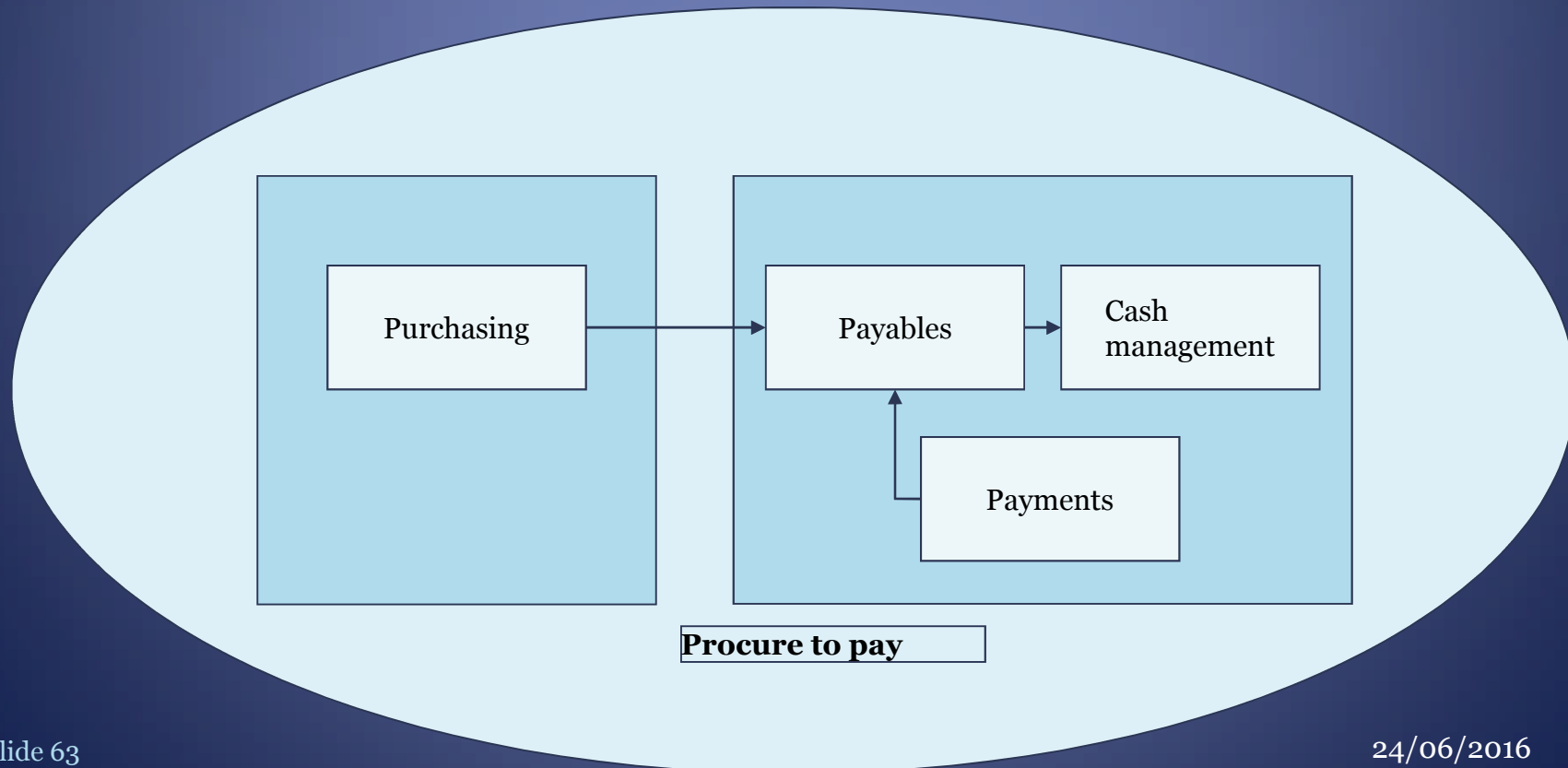
Revenue & Receivables

The Revenue & Receivables business cycle is equivalent to the “Order to Cash” process. The core applications (modules) to support this process includes Order Management, Receivables, and Cash Management.



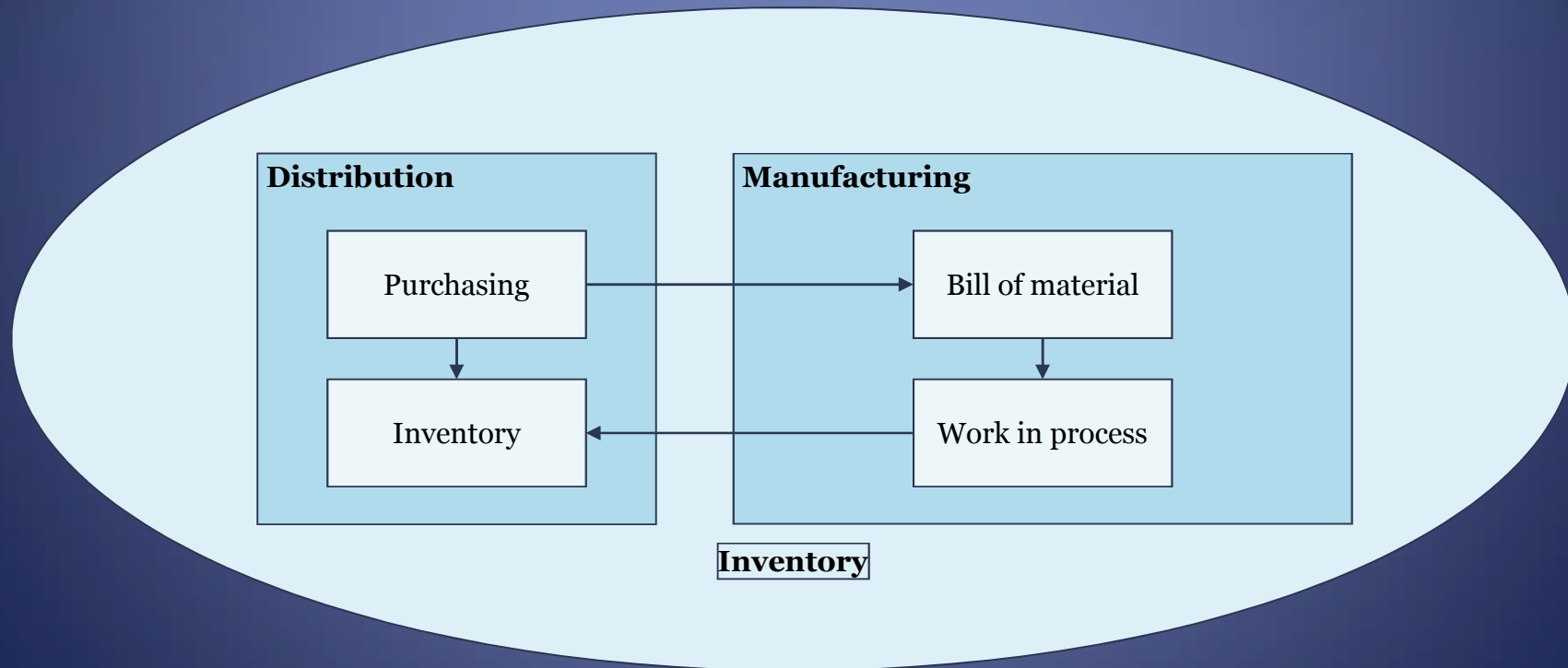
Purchasing & Payables

The Purchasing & Payables business cycle is equivalent to the 'Procure to Pay' process. The core applications (modules) to support this process includes Purchasing, Payables, Cash Management, and Payments.



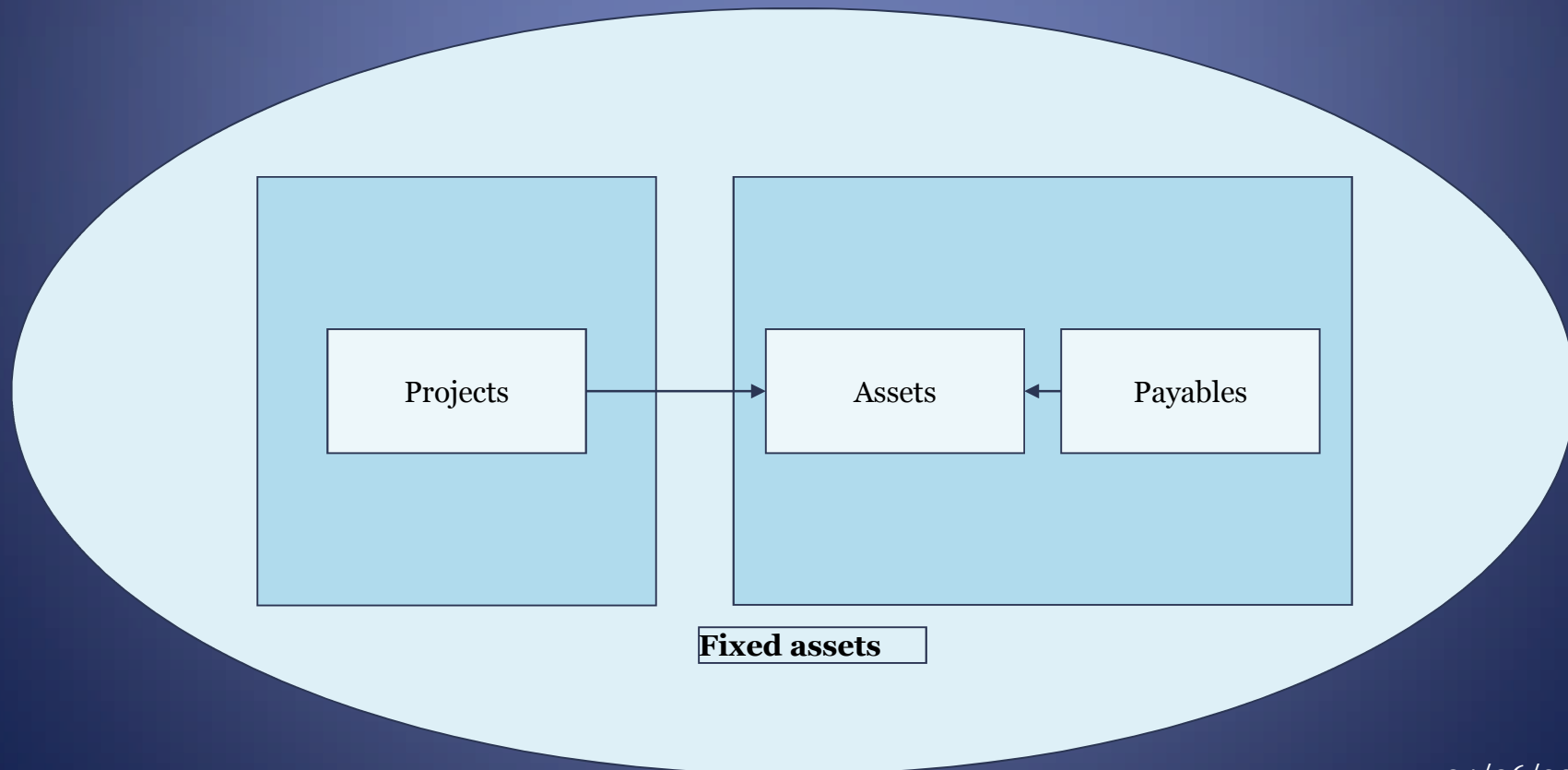
Inventory

The Inventory business cycle is equivalent to the 'Inventory' process. The core applications (modules) to support this process includes Inventory, Purchasing, Payables, Manufacturing (Bill of Material, Work in Process).



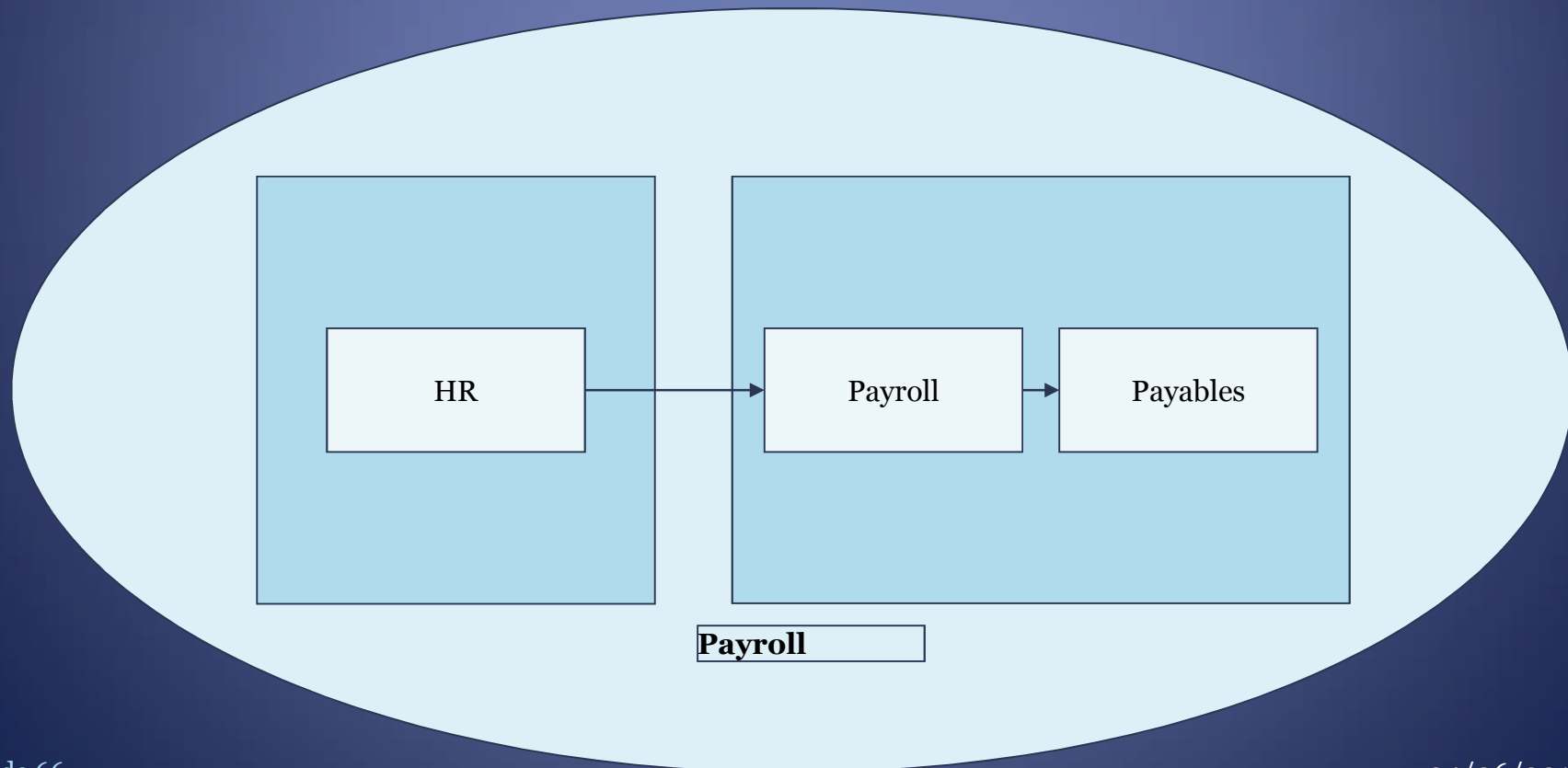
Fixed Assets

The Fixed Assets business cycle is the equivalent to the 'Fixed Assets' process. The core applications (modules) to support this process includes Projects and Payables.



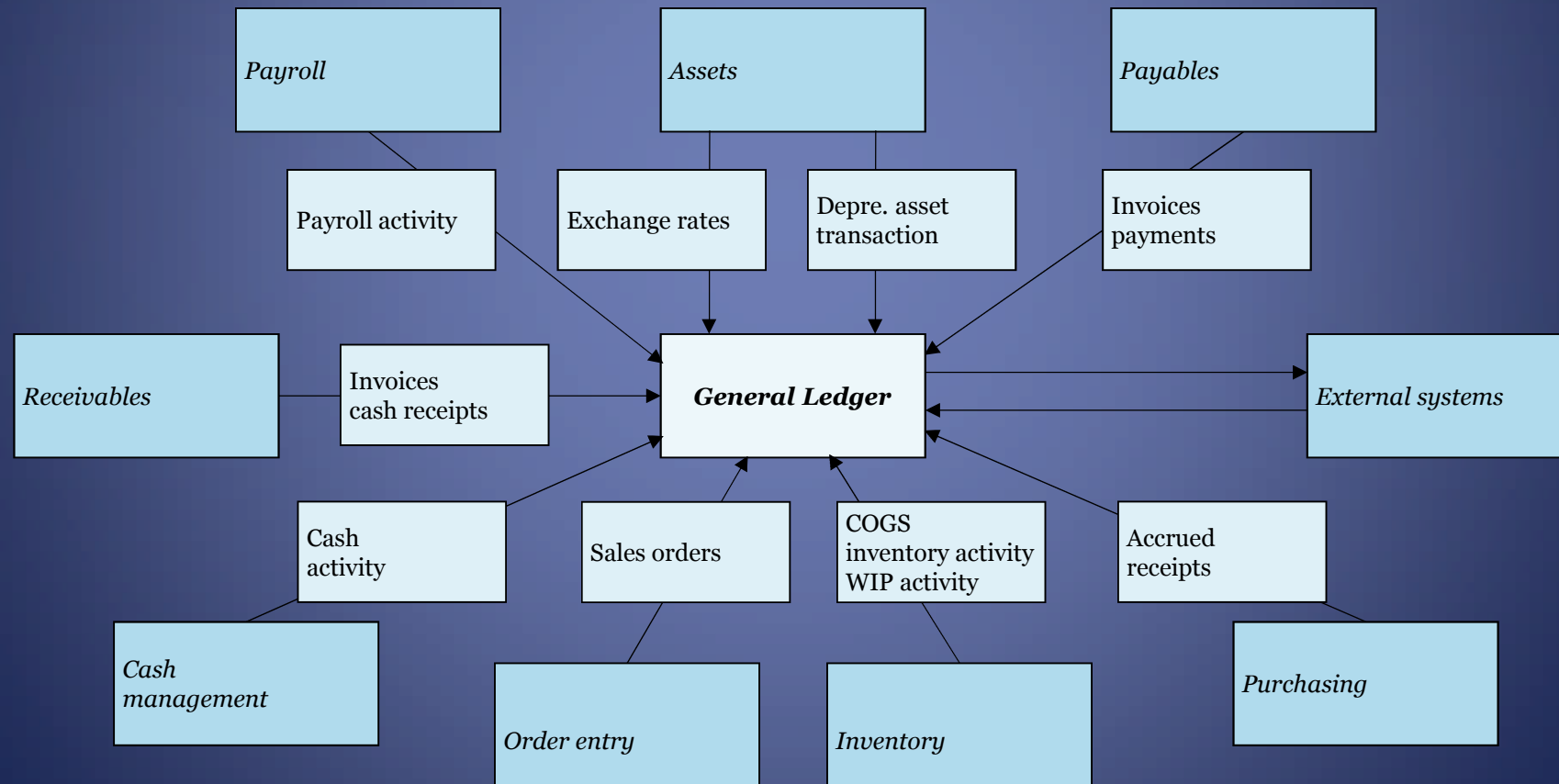
Payroll

The Payroll business cycle is the equivalent to the 'HRMS' process. The core applications (modules) to support this process includes HR and Payables.



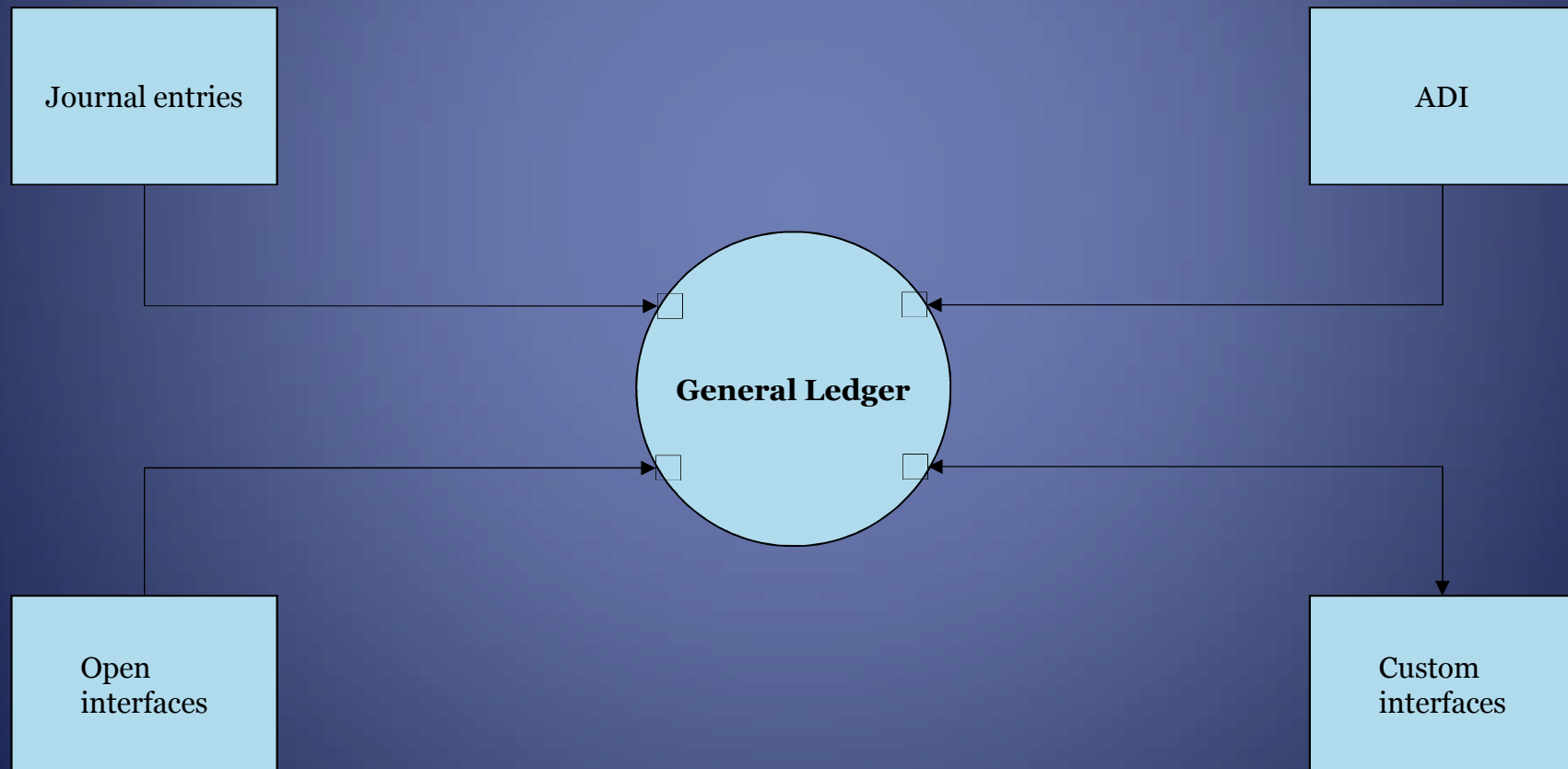
General Ledger

General Ledger is the central repository for all financial information. It integrates other modules with financial transactions.



External Interfaces

There are four primary ways that data can be entered into ERP applications from external systems.

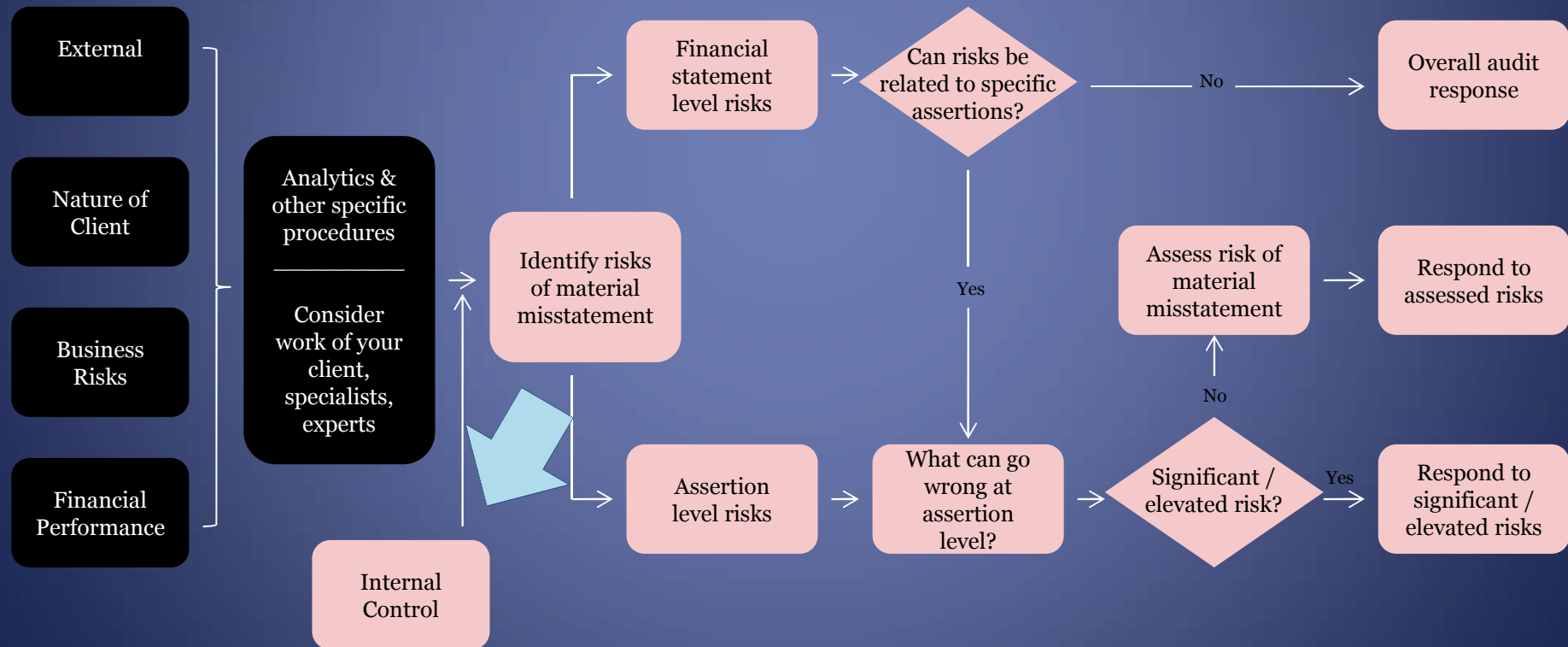


3. Testing of Design of Manual and Automated Controls

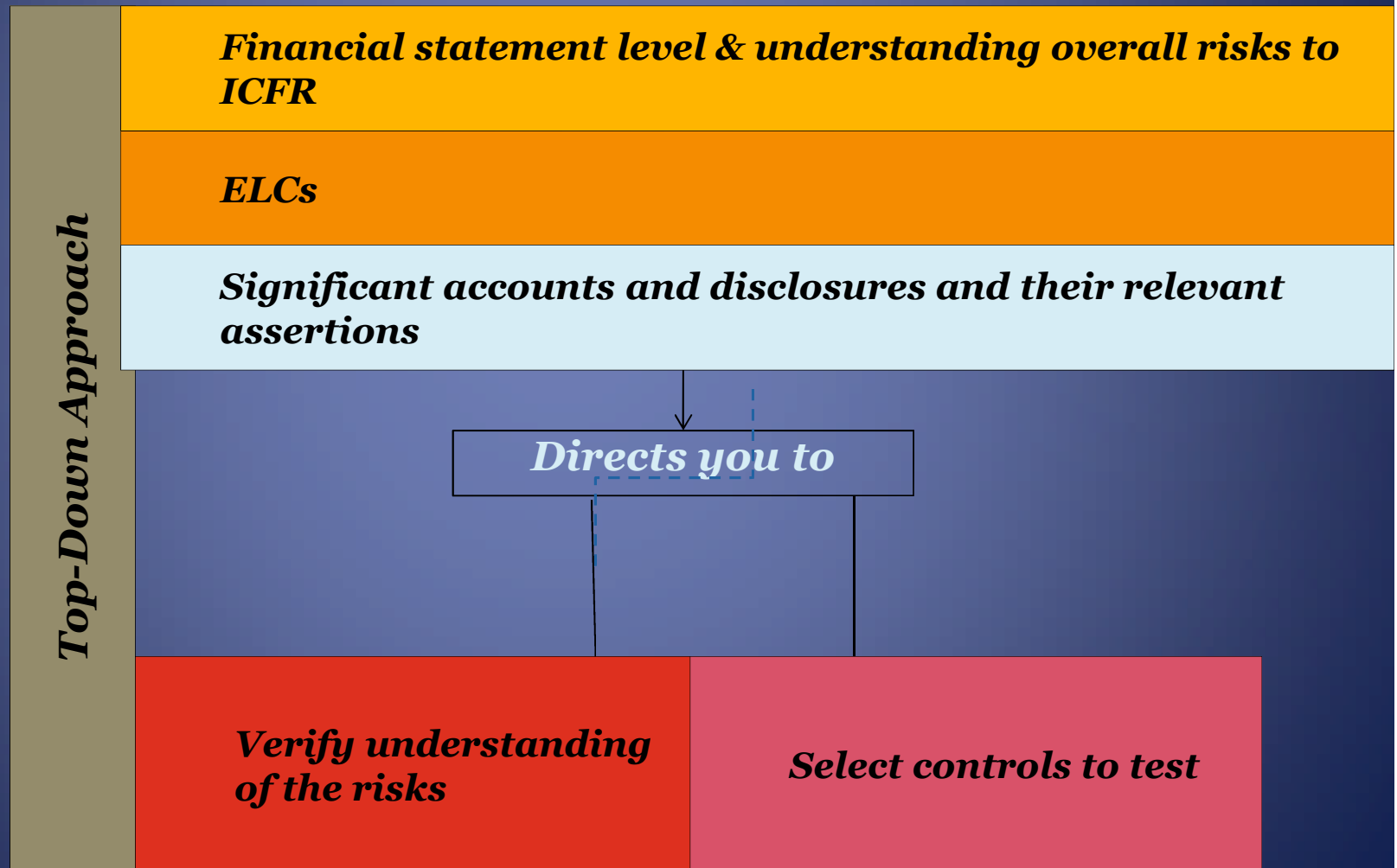
What are ICFRs (Internal controls over financial reporting)?

- ICFR refers to 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.

Understanding controls is a part of the risk assessment process



Top-down, risk-based approach



9-step controls approach

1. Understand the end-to-end process
2. Identify likely sources of potential misstatements
3. Identify points in the process where LSPMs occur
4. Identify key controls and evaluate their design and implementation
5. Identify and respond to control deficiencies
6. Determine controls reliance strategy and assess the risk
7. Plan tests of the operating effectiveness of controls
8. Test controls and consider that and other evidence about their operating effectiveness
9. Identify and respond to control deficiencies

Your steps to identifying key controls

- Risk assessment
- Understanding the business processes
- Identifying risks in the business process



Key controls are the controls that effectively addresses the risks identified in financial reporting. Can be ELCs and TLCs.

Identifying the key controls over financial reporting - tips

- The identification of key controls requires judgment, and there is no quantitative formula or prescriptive checklist for management to follow
- Key controls should be identified for all relevant financial statement assertions for
 - all significant account balances and
 - disclosures for all individually important locations and
 - significant or specific risks
- Although one control may cover a specific assertion, the standard indicates that a combination of preventive and detective controls is generally most effective.

Evaluating the design of key controls

- How strong is the control?
- Is it operating?
- Are staff competent?
- Characteristics of the population
- Sample based?
- Which assertions does it address?

The “best” controls

- Invisible
- Automated
- Preventative
- Risk-based

4. Testing of Operating Effectiveness of Manual and Automated Controls.

Developing and executing an effective controls testing plan

How we get there:

- Ensure the nature, timing and extent of controls testing reflects the assertions intended to be addressed and level of control reliance desired
- Evaluate ITGCs and consider this when determining reliance on controls and the testing strategy
- Document evaluation of the design of controls and testing of operating effectiveness

Testing controls

NATURE

TIMING

WHAT do we test?

HOW do we test?

WHEN do we test?

Control Activities

Business performance reviews

Automated controls and processes

IT-dependent manual controls

Manual controls

IT General Controls

What do we do with EXCEPTIONS?

How do we DOCUMENT?

How MANY do we test?

EXTENT

Testing Automated Controls

- Automated controls are part of the functionality of the systems so if they operate correctly once, theoretically they will always operate correctly.
- The number of items that need to be tested to evaluate the operating effectiveness of an automated control is generally limited to seeing all important aspects of the control operate once (often referred to as a "test of one").

Need for documentation of controls

A control must be documented!

- Otherwise, there can only be limited certainty that the control would operate effectively.
- Documentation also provides a basis for communicating a control to those responsible for monitoring its application.
- One should be able to clearly identify the controls.
- Documentation to be at an appropriate level of detail to provide a clear understanding.
- Documentation is current and reflects the internal controls placed in operation.

Good documentation of controls ... some tips

The following are some aspects to be considered by management while the controls are to be defined :

- ✓ Includes all Key Controls for Key Sub Processes/departments /locations
- ✓ Right mix of Manual and Automated controls
- ✓ Right mix of Preventive and Detective controls
- ✓ A standard format documenting typical routine transactions and non-routine
- ✓ A standard format of Key Controls Matrix
- ✓ Who/what performs the control activity?
- ✓ What control activity is being performed?
- ✓ When is the control activity performed?
- ✓ Why is the control activity performed – to prevent/detect what?
- ✓ Where is the control activity performed, if relevant?
- ✓ Who is the designated reviewer- is he duly authorized to review?

Evaluating testing - documenting exceptions

For every control deficiency we need to consider any compensating controls and the likelihood of potential material misstatement. Auditors need to:

- Be clear on the **audit impact**. Apply the 'so what' test. Are you sure it is not just a business risk?
- Identify **mitigating controls** or factors
- Document what **additional procedures** that could be done.

Evaluating testing exceptions

The auditor must evaluate the severity of each control deficiency that comes to his or her attention to determine whether the deficiencies, individually or in combination, are significant deficiencies or material weaknesses as of the balance sheet date.

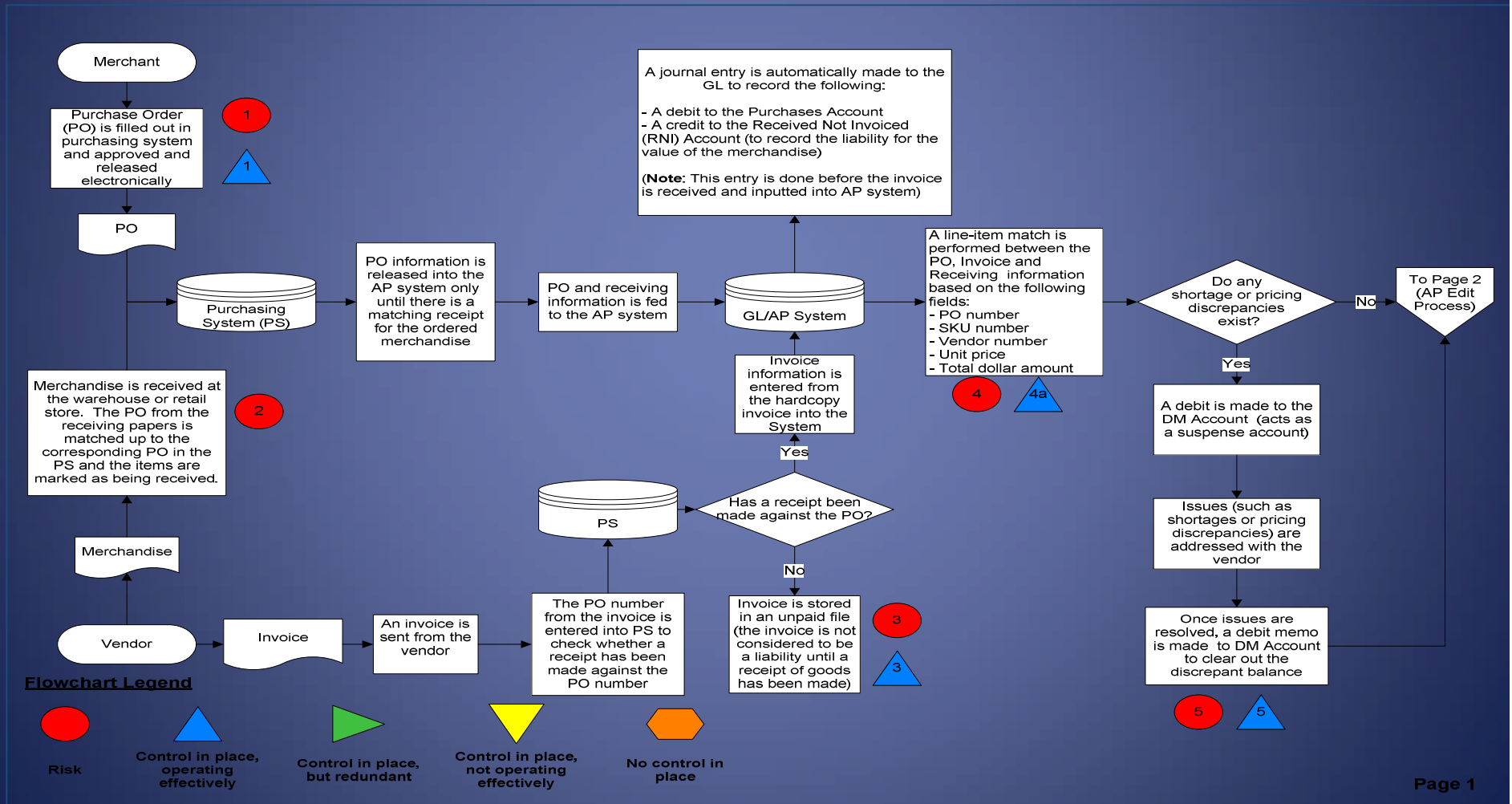
The auditor must communicate, in writing, to management and those charged with governance all material weaknesses and any deficiencies, or combinations of deficiencies that are significant deficiencies identified during the audit

In an audit of internal financial controls over financial reporting, the auditor should obtain written representations from management about management's responsibilities.

5. Process flow diagram

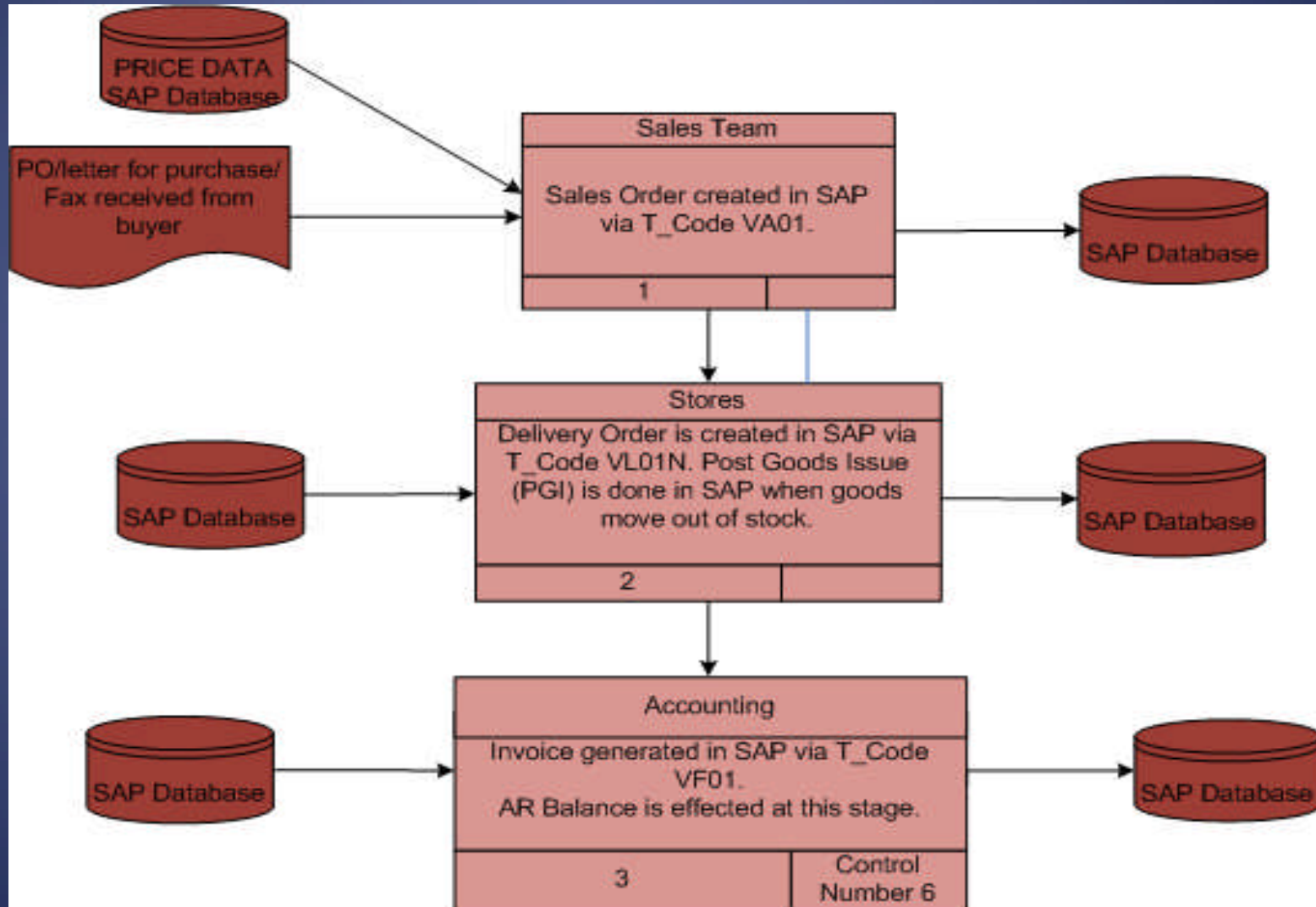
Internal controls-flowcharts

Sample flowchart of a sub-process



Process Flowchart – Revenue & Receivables Process

EXAMPLE – INVOICING



Internal controls-process narratives

Process narratives:

- Simple word documents giving detailed account of the sub- processes.
- Elements of Key Controls within the business process can be highlighted in different colors/ control no. references.

Example: Revenue narrative 3 — Sales returns

Customer Service Associates receive requests for return of product. Customer Service Associates enter information into SAP at the time of request and use the original invoice number as a unique lookup code to generate base information for the return. SAP generates the Return Merchandise Authorisation (RMA) with unique number and listing of material(s) requested to be returned, with pricing obtained from original invoice data. Upon receipt of the returned items, receiving personnel inspect the items and compare them to the RMA (R_REV_8). Receiving personnel enter goods receipts within SAP to record the quantity received for the sales return associated with the RMA (C_REV_6).

Internal controls-RCMs

Sample Risk & Controls Matrix:

Control ID	Control Title	Business Process	Sub Process	Control Description	Control Category	Control Type	FSA	Nature	Expected Results	Gate Repo
R&R-Oracle-Ctrl-103	Account mappings are configured in the system.	Revenue & Receivables	Invoicing	Default account mappings are configured for Auto Accounting within Oracle Receivables to ensure transactions are processed in appropriate	Preventative	Automated	C, A, Co	Inquiry	NA	NA
R&R-Oracle-Ctrl-103	Account mappings are configured in the system.	Revenue & Receivables	Invoicing	Default account mappings are configured for Auto Accounting within Oracle Receivables to ensure transactions are processed in appropriate	Preventative	Automated	FS Audit	Observation	NA	NA
R&R-Oracle-Ctrl-103	Account mappings are configured in the system.	Revenue & Receivables	Invoicing	Default account mappings are configured for Auto Accounting within Oracle Receivables to ensure transactions are processed in appropriate	Preventative	Automated	FS Audit	Examination	a) Based on the nature of client's business, the applicable accounting types have defined setup values.	Not Built
R&R-Oracle-Ctrl-103	Account mappings are configured in the system.	Revenue & Receivables	Invoicing	Default account mappings are configured for Auto Accounting within Oracle Receivables to ensure transactions are processed in appropriate	Preventative	Automated	FS Audit	Reperformance	NA	NA
R&R-Oracle-Ctrl-1	Accounting Rules are appropriately defined and reviewed regularly to ensure they are set up according to both	Revenue & Receivables	Sales Returns / Customer	Accounting Rules are appropriately defined and reviewed regularly to ensure they are set up according to both corporate policy and regulatory requirements	Preventative	Automated	FS Audit	Inquiry	NA	NA
R&R-Oracle-Ctrl-1	Accounting Rules are appropriately defined and reviewed regularly to ensure they are set up according to both	Revenue & Receivables	Sales Returns / Customer	Accounting Rules are appropriately defined and reviewed regularly to ensure they are set up according to both corporate policy and regulatory requirements	Preventative	Automated	FS Audit	Observation	NA	NA
R&R-Oracle-Ctrl-1	Accounting Rules are appropriately defined and reviewed regularly to ensure they are set up according to both	Revenue & Receivables	Sales Returns / Customer	Accounting Rules are appropriately defined and reviewed regularly to ensure they are set up according to both corporate policy and regulatory requirements	Preventative	Automated	FS Audit	Examination	a) For all active accounting rules: -the Period and the Number of Periods fields should correspond to each other.	1. R12 AR Accounting f
R&R-Oracle-Ctrl-1	Accounting Rules are appropriately defined and reviewed regularly to ensure they are set up according to both	Revenue & Receivables	Sales Returns / Customer	Accounting Rules are appropriately defined and reviewed regularly to ensure they are set up according to both corporate policy and regulatory requirements	Preventative	Automated	FS Audit	Reperformance	NA	NA

Lack of entity's documentation

Does it relieve auditor's responsibility to understand and evaluate controls?

Does it eliminate the need for auditor to have documentation?

Does it mean controls do not exist?

Could it be a control deficiency?



6. Entity level controls

Entity-level Controls (ELCs):

- ELCs may be categorized into three “buckets”:
- **Indirect entity-level controls:** Those ELCs that do not themselves directly address risks of material misstatement at the account/assertion level but are important to effective internal control.
- These include controls that fall within the control environment, risk assessment, monitoring, and information and communication components of internal control frameworks, including the general IT controls.
- **Direct entity-level controls that are not precise enough:** Those ELCs that directly address a risk of material misstatement but are not precise enough *on their own* to fully address a risk of material misstatement at the account/assertion level.
- **Direct entity-level controls that *are precise enough (D&P ELCs)***—Those ELCs that directly address a risk of material misstatement at the account/assertion level and are precise enough on their own to fully address the risks of material misstatements.
- For example, in an entity with more than 300 components, the balance sheet and income statement of each component are reviewed in detail at the segment level by segment controllers, while the monthly financial reporting package, is analyzed at the group level.

7. Segregation of Duties

SOD - Impact on Audit

- SOD is primarily Fraud Risk
- Impact of SODs on automated controls
- Extremely complicated definitions of accesses
- Generally Role-Based access
- Assessment of SODs through
 - Specific System Generated Reports – Standard or Customized
 - Tools such as GRC
 - Auditors proprietary tools

SOD - Impact on Audit – contd..

- Identification of “critical” SODs
- Identification of compensating controls
- Business Process Review controls may not address the risk of SOD conflicts
- Extracting data for such transactions

SOD - Impact on Audit – contd..

- SOD Analysis is “Point-in-time”
- Roles and Profiles also may have changed
- Risk of multiple ids used by the same person
- Identification of SOD per transaction requires specific SEP expertise
- In case of inadequate ITGCs, there can be no reliance on data for access rights

Segregation of duties matrix

	Accrual Writeoffs	Approve Expenses	Approve RFQ	Payables Setup	Purchasing Setup	Create PO	Create RFQ
Accrual Writeoffs	■						
Approve Expenses		■					
Approve RFQ			■				
Payables Setup				■			
Purchasing Setup					■		
Create PO		10	5		15	■	
Create RFQ			8		3		■

Questions



Thank You

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Session IV

Validation of IPE and Other Important Considerations

CA Rakesh Lakhani

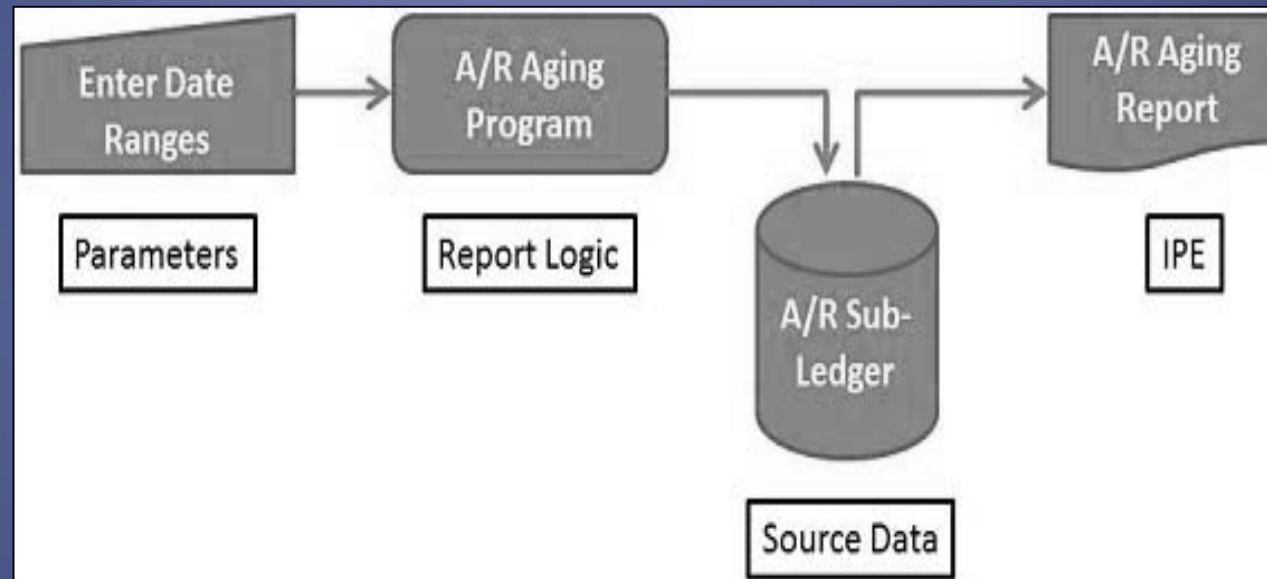
Domain 1

IPE (Report) testing

What is IPE ?

- There may be a large amount of information that is generated by an entity for use in managing the business and to analyse and prepare financial information. Such information is generally termed as Report
- In IFC , 'Report' is termed as "Information produced by the entity "(IPE)
- Typical forms of "IPE" may be:
 - system-generated,
 - manually-prepared,
 - combination of both (e.g., system accumulated data manipulated in an Excel spreadsheet)
- The reports can be extracted through
 - sessions, transaction codes from applications
 - running queries on database

Elements of IPE



IPE – Relevance to audit

The auditor is only required to test the accuracy and completeness of IPE that is relevant to the audit and used as audit evidence.

As per **IG 8.3 of IFC guidance** IPE that is relevant to the audit and used as audit evidence generally falls into one of three “buckets” as depicted in below:

IPE that the entity uses	When performing relevant controls
IPE that the auditor uses as an audit evidence	When performing tests of operative effectiveness of relevant controls
IPE that the auditor uses as an audit evidence	When performing substantive procedures

Elements of IPE

➤ Source Data :

The information from which the IPE is created. This may include data

- Data maintained within an application system or database
- Data maintained in an Excel spreadsheet

which may or may not be subject to general IT controls

➤ Report Logic :

The computer code, algorithms, or formulas for transforming, extracting or loading the relevant source data and creating the report

Elements of IPE

➤ Report parameters :

Parameters allow the user to look at only the information that is of interest to them. Parameters facilitate the

- defining the report structure
- filtering data used in a report
- connecting related reports (data or output) together

Parameters may be created by user or may be pre-set in the system

Evaluating the IPE

The auditor is required to "evaluate whether the IPE is sufficiently precise and detailed for purposes of the audit."

This involves evaluating whether the IPE is appropriate for its intended purpose

For example :

Debtors aging report may be used for internal credit management decision making , which would capture details of invoices from “due date”.

Whereas debtors aging report used for making provisions would be required to be extracted considering “invoice date”.

Testing of IPEs

Auditor needs to perform procedures to test :

- accuracy of data input parameters
- accuracy of the logic of the report
- accuracy of the data captured in the report
- completeness of data captured in the report

Testing Completeness and accuracy of IPE

The auditor may test IPE that he proposes to use to perform tests of controls by either:

- Performing "direct testing" procedures to address the accuracy and completeness of IPE

In a combined audit of internal financial controls over financial reporting and financial statements, the auditor may directly test IPE that the auditor uses to perform tests of controls only when management is not using the IPE in the performance of its controls.

Eg Debtors aging report testing

- trace selections back to source documents
- agree sub-ledger total to the GL balance of debtors

Examples of IPEs used in audit

- List of program changes made to application
- List of users created / deleted and accesses modified
- List of terminated employees
- Fixed asset register
- Listing of non moving inventory
- Debtors aging report
- Report for consumption of stock during production
- Listing of invoices that are not booked against goods receipts booked in system

Domain 2

Remediation testing

Remediation testing

- Auditors' opinion on the effectiveness of the entity's internal financial controls is required as of the balance sheet date.
- Management to remediate deficiencies that are identified relating to design or operating effectiveness of the controls within the financial period which is under consideration
- In such circumstances auditor can still express an unqualified opinion
- Sufficient time should be available to evaluate the test the controls for operating effectiveness as at balance sheet date
- Frequency of the operation of remediated control is a factor to be considered in determining sufficient time.
- Sufficient time for remediation is higher for controls operating at less frequency as against controls operated more frequently.

Remediation testing

- The amount of time a remediation control should be in existence for placing reliance on the control by the auditor is a matter of professional judgement.
- As a **good practice** at least minimum sample size prescribed by the IFC guidance can be considered as sample size for remediation testing depending on the frequency of control.
- Control remediation that occurs after year-end will not mitigate an identified deficiency for reporting purposes.
- Auditor should not express an opinion on management's disclosure about corrective actions taken by the company after the balance sheet date.

Domain 3

Roll forward testing

Roll forward testing

The roll forward period (“remaining” period) is the period from the date of the interim conclusion about the effectiveness of a control up to, and including, the balance sheet date for the report on internal financial controls.

The roll forward procedures the auditor performs are focused on changes to the business or the entity’s financial reporting that may give rise to a new risk or may affect an existing risk of material misstatement, which, in turn, would necessitate the entity’s implementing new controls or modifying the design of existing controls.

Auditor can roll-forward the conclusions of the effectiveness of those relevant controls which were tested and concluded to be effectiveness as at an interim date.

Key Activities

Key activities for performing procedures to roll forward interim conclusions of design and operating effectiveness:

- Perform procedures to determine whether there have been any significant changes to the business or the entity's financial reporting
- Test the design and operating effectiveness of new or modified relevant controls
- Obtain appropriate evidence of operating effectiveness that the controls tested at interim date continue to operate effectively for the roll forward period
- Document the roll forward procedures performed, basis for professional judgement, and conclusions for each of the relevant controls.
- Log any deficiencies for classification as to severity and further evaluation of their impact on the risk assessment and audit of the financial statements.

Domain 4

Rotation Plan for Testing

Rotation plan for testing

- Rotation plan for testing of internal controls may be relevant to efficiently perform an audit of internal financial controls.
- The auditor may be able to utilise the tests of controls performed in prior audits in the current audit.
- This plan can be considered when there are no changes in the underlying controls .
- Auditor is required to establish the continuing relevance of that evidence in current audit period by obtaining audit evidence by performing inquiry combined with observation or inspection.
- If there have not been such changes, it is recommended that the auditor tests the controls at least once in every third audit and need to test some controls each audit.

Domain 5

Use of Service Providers

Service Organisation

Entity use service organization to perform processes relevant to financial reporting e.g.

- Payroll processing
- Processing of insurance or medical claims

Service organisation may use their system to perform business processes.

An entity may also

- outsource administration of one or more of its systems
- use a service organisation to “host” its systems

Controls at service Organisation

- Processes or system which are outsourced , if are relevant to audit , then auditor may consider controls that service organisation have in place to address the related risks of material misstatement or IT risks.
- However, to the extent that the entity (client) has controls in place that are sufficiently precise to address the relevant risks and these controls do not rely on automated controls, data, or reports from the systems used by or administered by the service organisation, the auditor may determine that the service organisation controls are not relevant to the audit.
- *The auditor should not refer to the service auditor's report when expressing an opinion on internal financial controls.*

Audit Procedures

Obtaining an understanding of the controls

- at the service organisation that are relevant to the entity's internal control the
- at the user organisation over the activities of the service organisation

Obtaining evidence that the controls that are relevant to the auditor's opinion are operating effectively.

If a service auditor's report on controls placed in operation and tests of operating effectiveness is available, the auditor may evaluate whether this report provides sufficient evidence to support his or her opinion.

Evaluation of Service Auditor's Report

When a significant period of time has elapsed between the time period covered by the tests of controls in the service auditor's report and the date specified in management's assessment, additional procedures should be performed.

If the auditor concludes that additional evidence about the operating effectiveness of controls at the service organisation is required, the auditor's additional procedures might include :

- Evaluating procedures performed by management and the results of those procedures
- Contacting the service organisation, through the user organisation, to obtain specific information
- Requesting that a service auditor be engaged to perform procedures
- Visiting the service organisation and performing such procedures.

Thank You

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SESSION V

Opportunities for CAs and CISAs

Role & Reporting of Auditors and Management

CA Ashwin Gangakhedkar

Huge

Opportunity!

How to start?

Skills

- Understanding of business processes
- Understanding of IT
- Understanding of “controls”
- Good networking skills
- Good co-working skills

Mandate

- Section 143 (3)(i)

I / we carry out an audit of the internal financial controls over financial reporting of ABC Company Limited (the 'Company') as at March 31, 20X1 [balance sheet date]

in conjunction with our audit of the standalone and consolidated financial statements

- Section 143 (10)

This audit will be conducted in line with the guidance note issued by ICAI and is deemed to be prescribed by the

Central Government

Opportunities

- Trainers
- Mandatory increase in statutory auditor's scope
- Assistance for Management Self Assessment (MSA)
- Automation Experts
- Internal Audit

How to proceed?

- Identify significant account balances and disclosures e.g.5% of Net Profit
- Understand process flows – where these numbers are coming from
- Identify risks in the processes
- Check available controls – documented and not documented
- Identify applications and related ITGC
- Design assessment
- Operating Effectiveness assessment
- Findings and Discussions
- Opinion
- Report

Deliverables

- Process Narrative
- Flowcharts
- Risk Control Matrices
- Test of Adequacy
- Test of Operating effectiveness

9 Business Domains

1. Entity Level Assessment
2. Order to Cash (O2C)
3. Procure to Pay (P2P)
4. Hire to Retire (H2R)
5. Fixed Assets
6. Treasury
7. Inventory
8. Book Closure
9. ITGC

Sample size guidance

Frequency of control activity	Minimum sample size	
	Risk of failure	
	Lower	Higher
Annual	1	1
Quarterly (including period- end, i.e., +1)	1+1	1+1
Monthly	2	3
Weekly	5	8
Daily	15	25
Recurring manual control (multiple times per day)	25	40

Roles & Responsibilities (Documentation guidance)

Coverage:

- Representation from Management
- Management's responsibilities
- Auditor's responsibilities
- Audit Report
- Modified Audit Report

Representation from management *(for assessment)*

- To be given on entity's letter head
- Representation is in respect of **IFC-FR**
- For period covered under audit
- Reference to Guidance Note, Standards of Auditing and Sec.143(10) [Control criteria]
- Assessment is independent of auditor's tests / non-reliance on auditors' work for self assessment
- Design deficiencies
- Operating effectiveness deficiencies
- Information on which deficiencies are significant/have material impact
- No Frauds/ No management role in frauds
- Remediation of previous findings
- No Regulatory stick
- Unrestricted access to entity
- Audit report of subsidiaries made available
- Change/No change in **ICF** since BS Date and Representation letter date
- Remediation since BS Date and proposed remediation
- **Any other matters auditor considers appropriate**

Management's responsibilities

- Establishing and maintaining IFC based on Guidance note/ any other criteria
 - Design, Implement, Maintain adequate IFC
 - Ensure operating effectively for efficient conduct of business
 - Adherence to company policies
 - Safeguarding of assets
 - Prevention and detection of frauds and errors
 - Accuracy and completeness of accounting records
 - Timely preparation of reliable financial information under Co. Act 2013

Auditor's responsibilities

Management's responsibilities

- Establishing and maintaining IFC based on Guidance note/ any other criteria
 - Design, Implement, Maintain adequate IFC
 - Ensure operating effectively for efficient conduct of business
 - Adherence to company policies
 - Safeguarding of assets
 - Prevention and detection of frauds and errors
 - Accuracy and completeness of accounting records
 - Timely preparation of reliable financial information under Co. Act 2013

Express Opinion

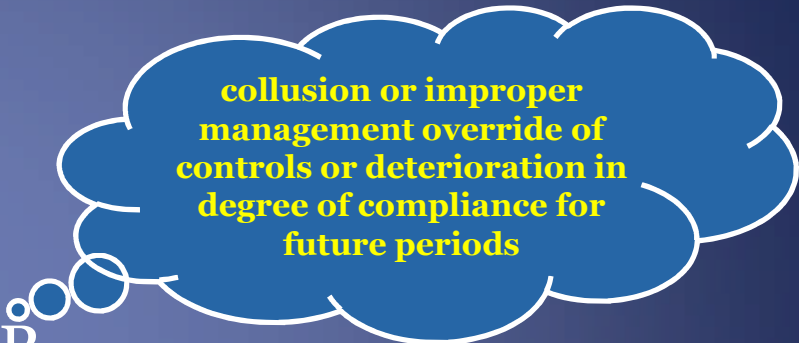
**On adequacy of ICF-
FR and its operating
effectiveness as at
BS Date**

ICF-FR

- **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. Includes policies and procedure 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 authorisations of management and directors of the company;
 - 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.

Audit Report

- Unmodified (contents)
 - Management's responsibility
 - Auditor's responsibility
 - Meaning of ICF-FR
 - Inherent Limitations of ICF-FR
 - Opinion
- Modified
 - Qualified
 - Adverse
 - Disclaimer



**collusion or improper
management override of
controls or deterioration in
degree of compliance for
future periods**

Modified

	Adequacy	Operating Effectiveness
Scenario 1	Qualified	X
Scenario 2	Adverse	X
Scenario 3	Unmodified	Qualified
Scenario 4	Unmodified	Adverse

Modified

Disclaimer

IFC not established but no impact on FS

IFC present, auditor unable to obtain audit evidence but no impact on FS

Unable to obtain audit evidence + Disclaimer on FS

Crux of the matter

Materiality is the key.

Auditor's judgement is ultimate.

Thank you

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