

# **Relevance of ICoFR and Building Templates**

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# Reporting on ICoFR by Auditors

- The auditor's report shall also state whether the **company** has adequate **internal financial controls with reference to financial statements** in place and the operating effectiveness of such controls – Section 143(3)(i)
- **Exemptions to Private Companies:** Section 143(3)(i) shall not apply to a private company:
  - 1) One Person Company;
  - 2) Small Company;
  - 3) Such Private Company which fulfils both the following conditions:
    - turnover < Rs. 50 fifty crores as per latest audited financial statement; **and**
    - aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year < Rs. 25 crore ~ MCA Notification GSR No. 583(E), dated 13-6-2017

# Reporting on IFC/ ICoFR by Directors

- The Directors' Responsibility Statement shall state that the directors, **in the case of a listed company**, had laid down **internal financial controls** to be followed by the company and that such internal financial controls are adequate and were operating effectively – Section 134(5)(e)
- Every **listed company and every other public company having a paid up share capital  $\geq$  Rs. 25 crore** calculated at the end of the preceding financial year shall contain the details in respect of adequacy of **internal financial controls with reference to the Financial Statements** – Rule 8(5)(viii) of Companies (Accounts) Rules, 2014.

# Bird's eye view of Legal & regulatory requirements

## **Section 134(5)(c) ~ IFC**

In case of a listed company, the Directors' Responsibility Stating that Directors have, laid down IFC and that such controls are adequate and operating effectively

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## **Section 143(3)(i) ~ ICoFR**

The auditor's report shall also state whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls

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## **Section 177(4)(vii) and (5) ~ IFC**

Audit Committee to evaluate IFC & Risk Management Systems. Audit Committee may call for comments from Auditors about internal control systems, before submission to the Board and may also discuss any Section 177 related issues with Statutory/ Internal auditors or Management

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## **Schedule IV(II)(4) ~ ICoFR**

The Independent Directors must satisfy themselves on the integrity of financial information and ensure that the financial controls and risk management systems are robust and defensible

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# Ready Reckoner

Provisions	Requirement	Listed	PSC $\geq$ Rs. 10 cr.	T.O. $\geq$ Rs. 100 cr.	Loans, Debentures and Deposits $>$ Rs. 50 cr.	Others
			Public Unlisted Companies			
Director's Responsibility Statement	IFC	Yes	N.A.	N.A.	N.A.	N.A.
Audit Report	ICoFR	Yes	Yes	Yes	Yes	Yes (Subject to MCA Notn.)
Audit Committee	IFC	Yes	Yes	Yes	Yes	N.A.
Independent Directors	ICoFR	Yes	Yes	Yes	Yes	N.A.
Director's Report	ICoFR	Yes	Yes (but PSC $\geq$ Rs. 25 cr.)	N.A.	N.A.	N.A.

# ICoFR vs IFC

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ICoFR ~ GN by ICAI	IFC ~ Explan. to Section 134(5)(e)
<p>This means a process designed to provide <b>reasonable assurance</b> regarding the <b>reliability of financial reporting and the preparation of financial statements for external purposes</b> in accordance with <b>generally accepted accounting principles</b>. A company's ICoFR includes those <b>policies and procedures</b> that:</p> <ul style="list-style-type: none"><li>• Pertain to the <b>maintenance of records</b> that, in reasonable detail, <b>accurately and fairly reflect the transactions</b> and dispositions of the assets of the company;</li><li>• Provide reasonable assurance that <b>transactions are recorded</b> as necessary to permit <b>preparation of financial statements</b> in accordance with generally accepted accounting principles and that receipts and expenditures of the company are being made only in accordance with <b>authorizations of management</b> and directors of the company; and</li><li>• Provide reasonable assurance regarding prevention or timely detection of <b>unauthorized acquisition, use, or disposition of the company's assets</b> that could have a <b>material effect on the financial statements</b></li></ul>	<p>This means:</p> <ul style="list-style-type: none"><li>• the <b>policies and procedures</b> adopted by the company</li><li>• <b>for ensuring the orderly and efficient conduct of its business,</b></li></ul> <p>including</p> <ul style="list-style-type: none"><li>• adherence to company's policies,</li><li>• the <b>safeguarding of its assets,</b></li><li>• <b>the prevention and detection of frauds and errors,</b></li><li>• the <b>accuracy and completeness of the accounting records,</b> and</li><li>• the <b>timely preparation of reliable financial information</b></li></ul>

# Internal Controls

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- Para 4(c) of SA 315 states as follows:
  - a) **“Internal Control”**
    - 1) is a process designed, implemented and maintained
    - 2) by those charged with governance, management and other personnel
    - 3) to provide reasonable assurance
    - 4) 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.
  - b) The term **"controls"** refers to any aspects of one or more of the components of internal control

# Internal Controls vs. ICoFR and IFC

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Definition Components	ICAI	Companies Act
1. Reliability of financial reporting	X	
1A. Accuracy and completeness of accounting records and timely preparation of reliable financial information		X
2. Effectiveness and efficiency of operations	X	
2A . Orderly and efficient conduct of business including adherence to company's policies		X
3. Safeguarding of assets	X	X
4. Compliance with applicable laws and regulations	X	
5. Prevention and detection of frauds and errors		X



# Macros !!

- Internal Financial Control =
  - Internal Control over Financial Reporting
  - + Operational Controls
  - + Fraud Prevention

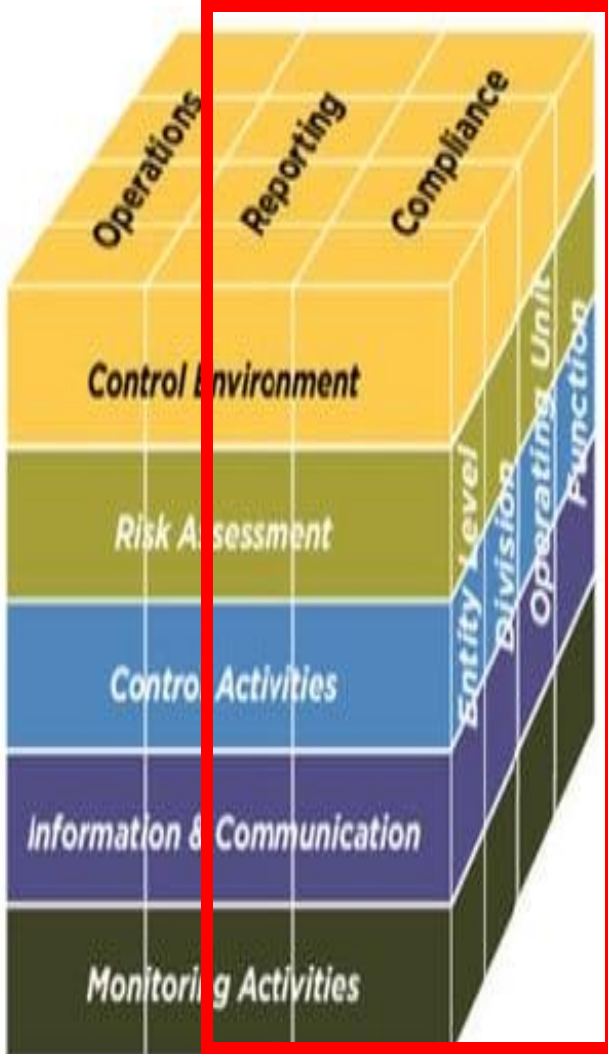
# Risks and Controls ~ Framework and Principles

- **“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
- The term **“Controls”** refers to any aspects of one or more of the components of internal control [i.e., aspects as to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations]
- **Note: Risk is the “what could go wrong” within a process. The inverse of risk is commonly referred to as the “control objective”**

# C.R.I.M.E.

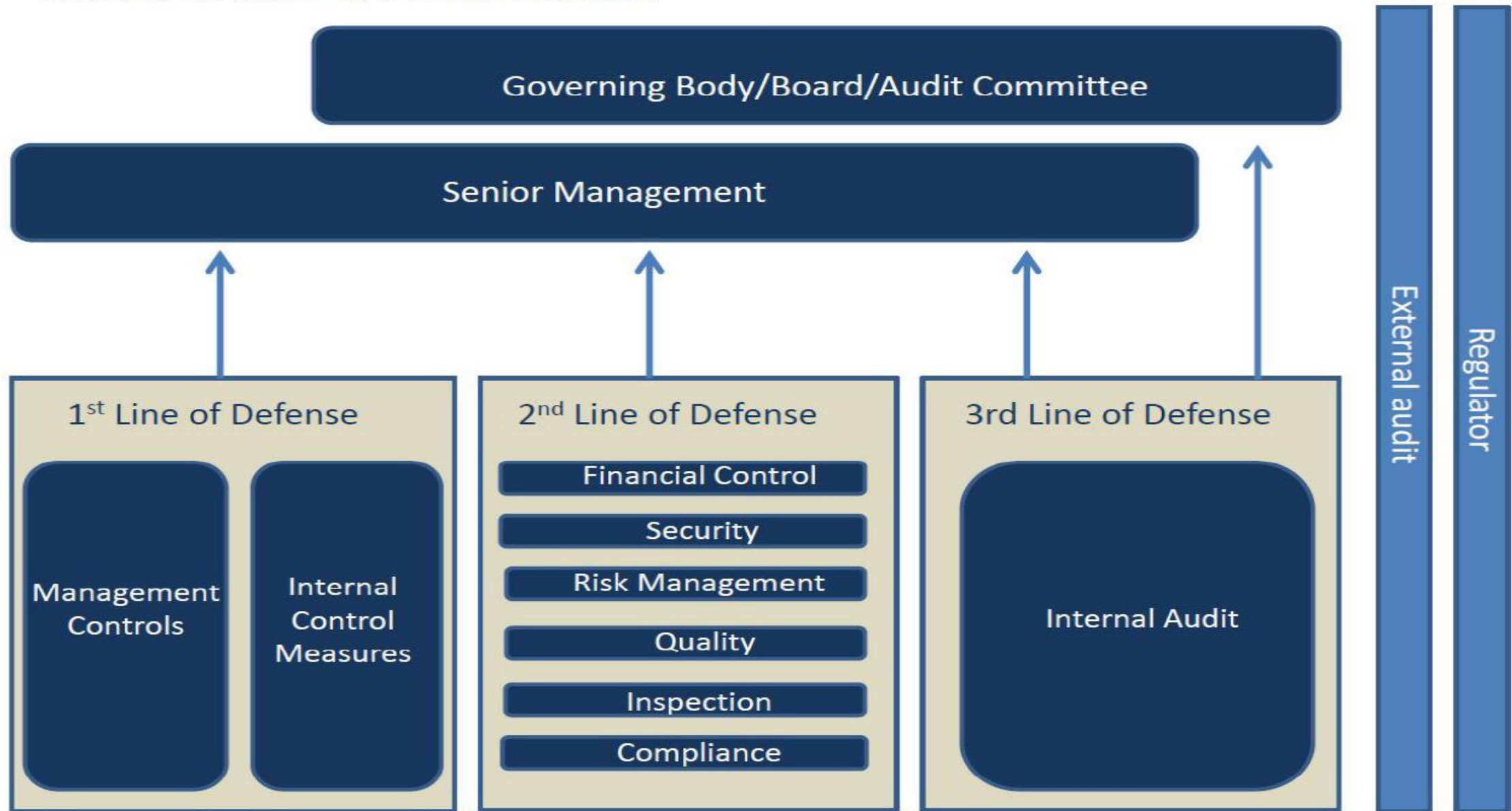
IFC

ICoFR



IC Components	Principles
<p><b>Control environment</b> ~ How has management put into place policies and procedures that guide the organization</p>	<ol style="list-style-type: none"> <li>1. Demonstrates commitment to integrity and values</li> <li>2. Demonstrates independence and exercises oversight responsibility</li> <li>3. Establishes structure, authority and responsibility</li> <li>4. Demonstrates commitment to attracting, developing and retaining competent staff</li> <li>5. Enforces accountability</li> </ol>
<p><b>Risk assessment</b> ~ How does organization assess risk in order to identify the things that threaten the achievement of their objectives</p>	<ol style="list-style-type: none"> <li>6. Specifies suitable, specific objectives</li> <li>7. Identifies and analyzes risks</li> <li>8. Assesses fraud risk</li> <li>9. Identifies and analyzes significant changes</li> </ol>
<p><b>Information and communication</b> ~ How does management communicate to their internal and external users what is expected of them</p>	<ol style="list-style-type: none"> <li>10. Uses relevant, high-quality information</li> <li>11. Communicates internally to support controls</li> <li>12. Communicates externally</li> </ol>
<p><b>Monitoring</b> ~ How does management oversee the functioning of the entire organization</p>	<ol style="list-style-type: none"> <li>13. Conducts ongoing and/or separate evaluations</li> <li>14. Evaluates and communicates deficiencies</li> </ol>
<p><b>Existing Control activities</b> ~ What are the controls that you currently have in place</p>	<ol style="list-style-type: none"> <li>15. Selects and develops control activities that help mitigate risks</li> <li>16. Selects and develops ITGC</li> <li>17. Bases controls on thorough policies and procedures</li> </ol>

## The Three Lines of Defense Model





# **Template Building**

# Using Framework for Internal Control Evaluations

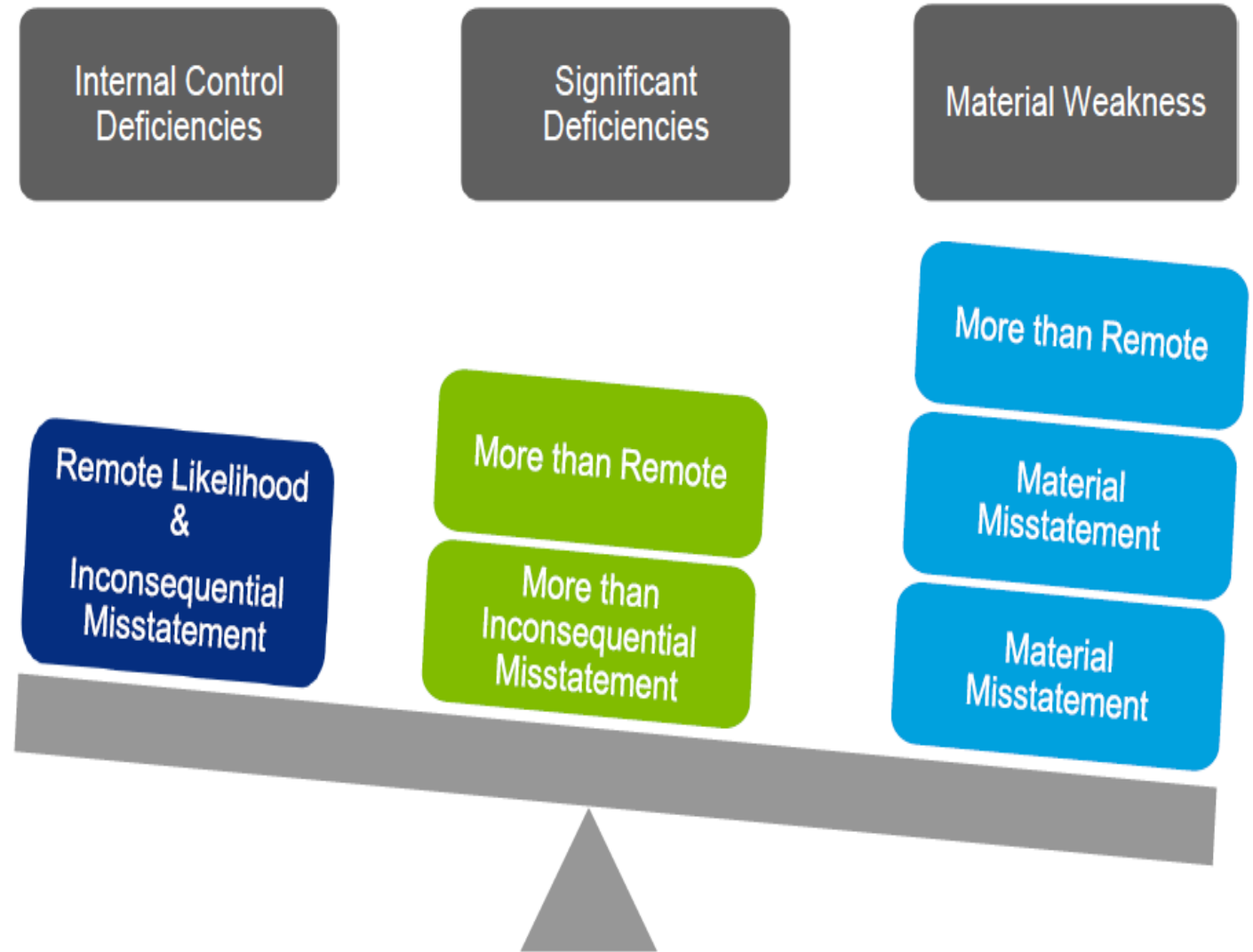
**Define Objectives**



# Control Deficiencies

Deficiency in internal control  
exists when

# Suggested approach for classifying deficiencies





# Reporting of Deficiencies

Nature of Deficiency	Management	Audit Committee	Directors' Report / Auditor's Report
Control Deficiency	✓	✗	✗
Significant Deficiency	✓	✓	✗
Material Weakness	✓	✓	✓

# Sample Template (say for Depreciation)


Assertions:

Assertions	Risk	Business Objective	Control Description	Control #	Risk Level	Frequency	Effective Date	S or M	P or D or C	Who Performs	Potential Fraud Risk	Control Category
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**Related Accounts: Fixed Assets (Tangible and Intangible)**

Recording of Other Expenses

O, A, CL	Improvements made to fixed assets (e.g., remodels, additions) are incorrectly expensed	Improvements made to fixed assets (e.g., remodels, additions) are capitalised correctly	Whether any improvement is capitalised or expensed is decided at two levels.....	RIL – C14	Medium	As and when required	1-4-2018	S/ M	P	Concerned Project + Compilation Division	No	Recording, Control Activity and Authorisation
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# **Case Study**

# Case Study 1

Total No. of Employees	100
No. of senior employees	10
No. of junior employees	90
Wages per senior employee	Rs. 7,000
Wages per junior employee	Rs. 5,000
Wages paid to senior employees	Rs. 70,000 [Rs. 7,000 (x) 10]
Wages paid to junior employees	Rs. 4,50,000 [Rs. 5,000 (x) 90]
Total Wages in P & L	Rs. 5,20,000
<b>Question:</b> Evaluate the deficiency, type of risk and degree of risk in each of the following cases:	
1. The Company has no policy of taking attendance of employees	
2. The Company has policy of taking regular attendance of employees but is not mandatory for senior employees	



# Case Study 2: Evaluating Design and Operating Effectiveness of a sample control

Control Objective	Fixed assets are recorded accurately
Review status	Senior Accountant generates the Fixed Asset Register Report on a monthly basis from ERP and reconciles the asset figures with the General ledger. Senior Finance Manager reviews the reconciliation done.
SOD (Yes/ No)	No
Type of Control	Manual
Frequency	Monthly
Population	12
Who performs this activity	Mr. X, Senior Accountant

Procedures performed when an individual is absent	No such procedure
Reports and other information used, as well as, how such information is used	Fixed Asset Register Report
What is the individual looking for to determine if there is an error and what kinds of errors have been identified	Verifying whether there are any non-reconciling items in the Fixed Asset register – General Ledger reconciliation. Non-reconciling items such as depreciation amount differences caused to system technical error.
Procedures performed when an error is identified and how the error was resolved	Errors such as depreciation differences caused due to some system technical error are resolved by manually changing rate of depreciation in asset workbench etc. after obtaining approval from Senior Finance Manager and Business Controller.



Procedures performed with respect to unusual and non-routine transactions	Proposed Activity: Any unusual transaction needs to be highlighted to the management
Whether the individual has ever been asked to override the process of controls or if other people have performed activities or made entries, and if so, to describe the situation, why it occurred, and what happened	No
What (if any) changes have occurred to control activities during the period, including changes in personnel who perform them?	No such changes have occurred

Procedures Performed to Evaluate Design and Determine Implementation of Control/  
Reference to Work Performed

**Primary Testing:**

Confirmed through inquiry with Mr. X, Senior Accountant, on 8th December, 2022 that Monthly reconciliation is being done for figures from Fixed Asset Register to General Ledger. This reconciliation is prepared by Mr. X. But there is no review of this reconciliation being done.

**Secondary Testing:**

There is no documentary evidence of review of the reconciliation statement. We obtained the sample reconciliation for the month of November 2022 and found that the figures haven't been reconciled. We were told that the reasons for non-reconciling items were audit entries to be passed. But the reasons for non-reconciling items have not been documented in the reconciliation statement.

Conclusion on Design of Controls	Ineffective
Conclusion on implementation of Controls	Ineffective
Description of the deficiency identified in control design/ implementation	Absence of review of FAR vs. GL reconciliation
Sample Size	2
Procedures Performed to Evaluate Test of Operating Effectiveness of Control	There is no documentary evidence of review of the reconciliation statement. We obtained the sample reconciliation for the month of July 2022 and Sept. 2022 and found that the figures haven't been reconciled. We were told that the reasons for non-reconciling items were audit entries to be passed. But the reasons for non-reconciling items have not been documented in the reconciliation statement
Results of test of Operating Effectiveness	Ineffective
Description of Deficiency	Absence of review of FAR vs. GL reconciliation

**IFRS | Corporate Laws | Due Diligence | Forensic Audits | BRSR**

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*Thank you*

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**Kamal Garg & Associates**