All about internal financial control (IFC)

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What is Internal Financial Control (IFC)? (Sec 134)

As per Section 134 of the Companies Act 2013, the term ‘Internal Financial Controls’ means 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.

Objective of IFC:

Primary objective of IFC to identify opportunities for improvement, and to draw up recommendations and good practices that can use as a benchmark to develop or strengthen their internal control systems and enhance the reliability of their financial statements.

- Efficiency and effectiveness in Operations
- Prevention and detection of fraud and error
- Safeguarding of assets
- Accuracy and completeness of Accounting records
Internal Control = Internal Control over financial reporting + Operational control Reporting + Fraud prevention Reporting

**What is Internal Controls over financial Reporting (ICFR)**

As per Guidance Note issued by ICAI on Guidance Note on Audit of Internal Financial Controls Over Financial Reporting (September, 2015), “Internal Financial Controls Over Financial Reporting (ICFR) 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 financial control over financial reporting includes those policies and procedures:

- Pertain to the maintenance of the records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company:

- Provides reasonable assurance that transactions are recorded as necessary to permit preparation of financial statement 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 director of the company.

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company’s assets that could have a material effects of the financial statement.

- Internal Control Over financial Reporting = Maintenance of financial records (details & Accuracy) + Authorization of Transactions + Safeguarding of assets of the Company

**WHERE IT IS LAIED DOWN**

**Section 134**
In the case of a listed company, the Directors’ Responsibility states that directors, have laid down IFC to be followed by the company and that such controls are adequate and operating effectively.

**Section 143**
The auditor’s report should also state whether the company has adequate IFC system in place and the operating effectiveness of such controls

**Sec 177**
Audit committee may call for comments of auditors about internal control systems 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.

**Sch 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.

Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 –

The director’s report should contain details in respect of adequacy of internal financial controls with reference to the financial reporting.

Responsibilities of Various Stakeholders

A. Company Management

Create & test the framework of internal controls
- IFC (including operational & Compliance)
- Controls documentation

B. Auditor

- Focus on Internal Control to the extent these relates to the financial Reporting (ICFR)
- Responsibility limited to evaluation of “Financial Reporting Controls”

C. Audit Committee /Independent Director

- Would like to see a robust framework that is aligned to acceptable standards
- Review & question the basis of your controls design and ongoing assessment

D. Board of Directors

- Would rely on the assessments and view of the audit committee
- They may ask for additional information

Value Addition by IFC

a. Helps in business process re-designing to plug revenue leakages & cost containment opportunities
b. Helps in rationalizing the number of controls across organization – moving to smart and automated controls
c. Helps in standardizing policies and procedures for multi-location/ multi-business Companies
d. Fosters a control conscious work culture for people behind controls
e. Provides assurance to the CEO/ CFO as well as improves business performance
f. In some instances, also serves as a base for blue print of optimal procedures while thinking about ERP

Audit Part
Section 143 (1) Sec 143 (1)- Every auditor of a company shall amongst other matters inquire * into the following matters, namely:—

a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the co;

c) where the company not being an investment company or banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the co;

d) whether loans and advances made by the company have been shown as deposits;

(e) whether personal expenses have been charged to revenue account; (f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading:

Note: Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statements with that of its subsidiaries.

* to be reported only if answer is in negative

Audit Report Format

Audit Reporting in India for companies is governed by statute:

- Companies Act lays down various provisions for reporting by Statutory Auditors
- Sec 227 of Companies Act, 1956
- Sec 143 of Companies Act, 2013

The statute however, only lays down the various points to be included in an audit report.

The actual format in which reporting is to be done is governed by the applicable Standards on Auditing (SAs) issued by ICAI ( or NFRA as and when notified)

Section 143 (2)

- Auditor to report to the members on the accounts examined
- every financial statements at general meeting
In accordance with provisions of Act

Accounting standards

Auditing standards and

Other matters required to be included under the Act and rules made there under

Order made under sub-section (11)

to the best of his information and knowledge, the accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed

Section 143 (3)

a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

e) whether, in his opinion, the financial statements comply with the accounting standards;

f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;

h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls; (applicable from FY 2015-16 onwards) [IFC defined in 134(5)]

j) such other matters as may be prescribed*. Rule 11

Other matters to be included in auditors report u/s 143(3)(j): Rule 11

- Whether Company has disclosed impact, if any, of pending litigations on its financial position in its FS.

- Whether Company has provided for material foreseeable losses, if any, on long term contracts including derivative contracts.

- Whether there has been any delay in transferring amounts to Investor Education and Protection Fund (IEPF).

Sec 143(4) - Where any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons there for.

Note: Requirement of highlighting adverse observations/comments in audit report in thick type or italics omitted.

- Sec 143(5) to 143(7) – Reporting to C&AG for government companies.

- Sec 143(8) – Branch Auditors – Reporting to main auditor – same responsibility as per sec 143(1) to 143(4), 143(12)

- Sec 143(9) / (10) – Auditor to comply with Auditing Standards (to be notified by NFRA). Till so notified, Standards on Auditing specified by ICAI shall be deemed to be auditing standards.

- Sec 143(11) – Statement to be included in report on matters specified (similar to CARO, 2003)

Sec 143(12) - Reporting of frauds

- If an auditor of a company, in the course of the performance of his duties as auditor,

- has reason to believe that an offence involving fraud is being or has been committed against the company

- by officers or employees of the company,

- he shall immediately report the matter to the CG within the time prescribed. Sec 143(13) - No duty of auditor w.r.t. fraud reporting to be deemed as having been contravened, if it is done in good faith.

Sec 143(14) – Provisions u/s 143(12) shall mutatis mutandis apply to

- Cost Accountant in practice

- Company Secretary in practice Sec 143(15) - If the auditor does not report the fraud committed or being committed, he shall be punishable with fine which shall not be less than Rs. 1 lakhs but may extend to Rs. 25 lakhs.
INDEPENDENT AUDITOR’S REPORT SA 700, 705 & 706 AND ILLUSTRATIVE FORMATS BY ICAI

Clean Report – SA 700

• Auditor's opinion on - General purpose financial statements
• FS prepared in accordance with a general purpose framework
• No modifications/qualifications – clean report
• New illustrative formats – issued by ICAI

New illustrative formats – issued by ICAI

(DRAFT) INDEPENDENT AUDITOR’S REPORT

To the Members of ABC Limited

Report on the Financial Statements

We have audited the accompanying standalone financial statements of ABC Limited (“the Company”), which comprise the Balance Sheet as at March 31, 2016, the Statement of Profit and Loss, the Cash Flow Statement for the year then ended, and a summary of the significant accounting policies and other explanatory information.

Management’s Responsibility for the Financial Statements

The Company's Board of Directors are responsible for the matters stated in Section 134 (5) of the Companies Act, 2013 (“the Act”) with respect to the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding of the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit.

We have taken into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of the Act and the Rules made thereunder.
We conducted our audit in accordance with the Standards on Auditing specified under Section 143(10) of the Act. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and the disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal financial control relevant to the Company’s preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of the accounting estimates made by the Company’s Directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the financial statements.

**Opinion**

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at 31st March, 2016, and its profit/loss and its cash flows for the year ended on that date.

**Report on Other Legal and Regulatory Requirements**

As required by the Companies (Auditor’s Report) Order, 2016 (“the Order) issued by the Central Government in terms of Section 143 (11) of the Act, we give in the “Annexure A” a statement on the matters specified in paragraphs 3 and 4 of the Order.

As required by section 143 (3) of the Act, we report that:
a) We have sought and obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit.

b) In our opinion proper books of account as required by law have been kept by the Company so far as appears from our examination of those books.

c) [The reports on the accounts of the branch offices of the Company audited under Section 143(8) of the Act by branch auditors have been sent to us and have been properly dealt with by us in preparing this report.]

d) The Balance Sheet, Statement of Profit and Loss, and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from the branches not visited by us].

e) In our opinion, the aforesaid standalone financial statements comply with the Accounting Standards referred of section 133 of the Companies Act, 2013, read with Rule 7 of the Companies (Accounts) Rules, 2014.

f) On the basis of written representations received from the directors as on March 31, 2016, and taken on record by the Board of Directors, none of the directors are disqualified as on March 31, 2016, from being appointed as a director in terms of section 164 (2) of the Act.

g) **with respect to the adequacy of the internal financial controls over financial reporting of the Company and the operating effectiveness of such controls, refer to our separate report in “Annexure B”;**

h) With respect to the other matters to be included in the Auditor's Report in accordance with Rule11 of the Companies (Audit and Auditors) Rules, 2014, in our opinion and to the best of our information and according to the explanations given to us:

i. The Company does not have any pending litigations which would impact its financial position.

ii. The company did not have any long term contracts including derivative contracts for which there were any material foreseeable losses.

iii. There were no amounts which were required to be transferred to the Investor Education and Protection Fund by the Company.

For _______________
Chartered Accountants

**Recommended Read**

- Impact of IND AS 116 on financial statements for the financial year ended March 31, 2019
- Analysis of Financial Reporting (CA Final - Old / New) Paper May'19
Dear Sumat, Can you pls share this in pdf form for us to download? the site does not allow print option.

Thank you sir for sharing this data.

So far there is no concrete guidance on the model of reporting either from ICAI or our professional colleagues. For example some experienced person can take illustrations in Sales, Purchases, Bank operations, cash operations, Asset accounting, Liability Accounting, Taxation matters and give model audit reports of qualified nature, clean nature etc to guide colleagues who are not experienced-K.Krishna Murty

thanks for the most important article in current relevance

It would have been better if model report for "Internal Financial Controls Over Financial Reports"is also given under various circumstances with practical situations

thanks for such valuable article..

Brilliant article. relevant provisions have been explained in a very simple manner.
I appreciate your efforts Sir. Thanks for giving such information in depth and compiling all the areas related to it at one place.

PRERANA SHENOY

nice write up

VIPUL CHAUHAN

v ... ... , with CBCc ..

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