

INTERNAL CONTROL

By Akash Dubey

Internal Control System is the process executed by the management to ensure the safeguarding of assets, maintenance of efficiency and effectiveness.

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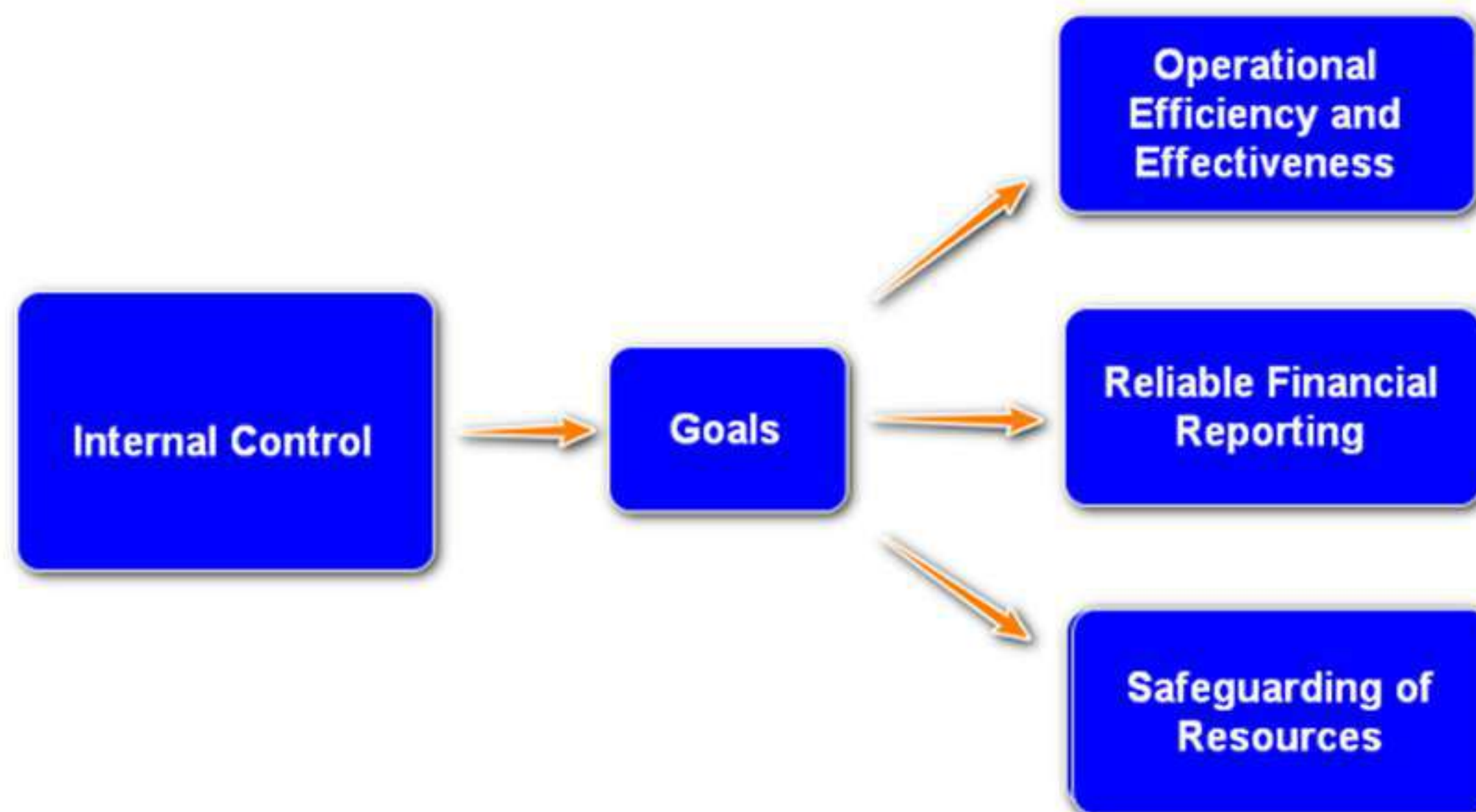
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What is Internal Control?

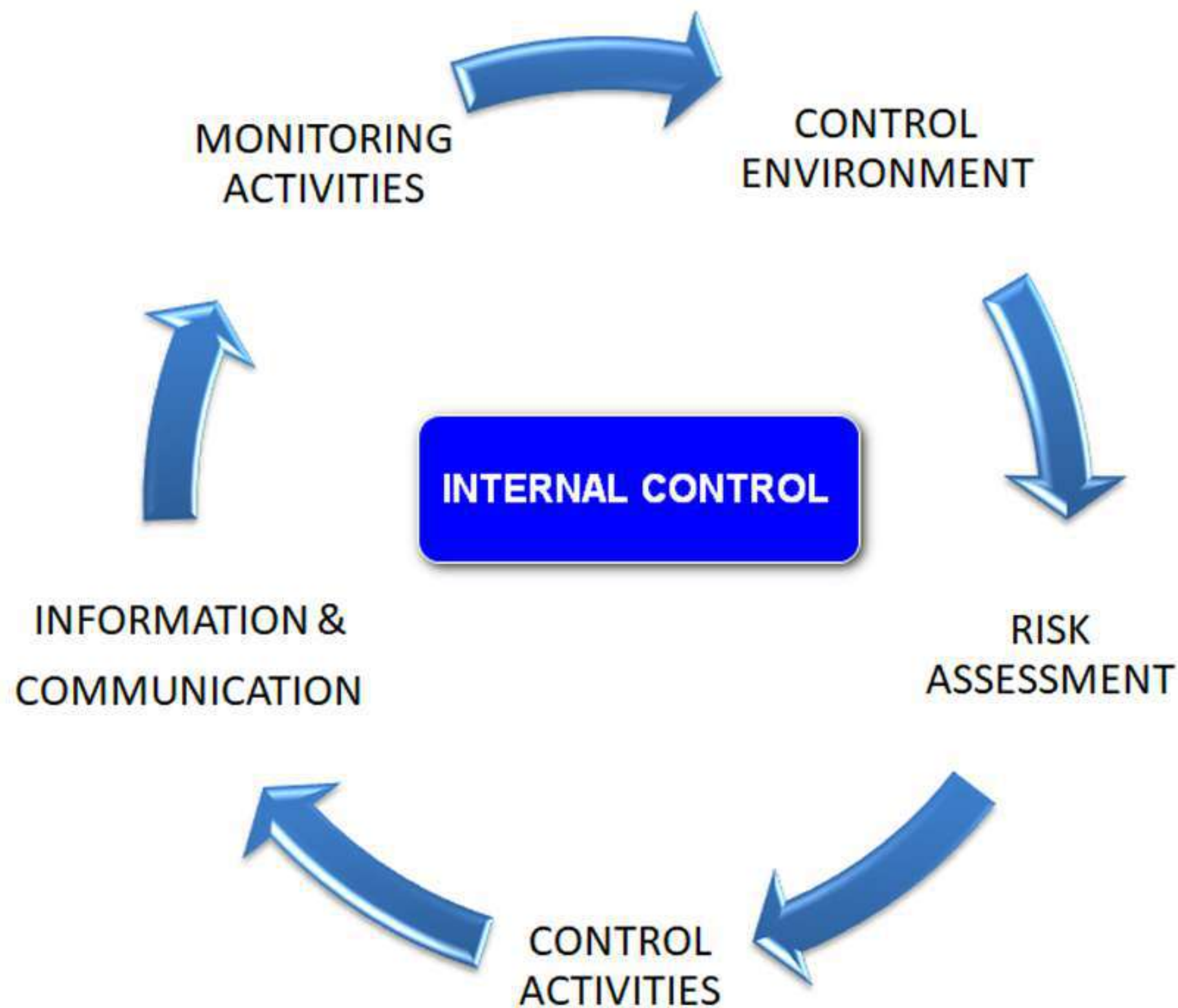
Internal Control System is the process executed by the management to ensure the safeguarding of assets, maintenance of efficiency and effectiveness in operations and trustworthiness of financial statements to prevent any fraudulent conduct or wastage of resources.



Benefits of a Good Internal Control System

- ✓ Improving accountability of operations
- ✓ It helps in the safeguarding of assets and reduces fraudulent transactions
- ✓ Improving the efficiency of operations
- ✓ Increasing financial transparency
- ✓ Meeting legal and statutory regulations
- ✓ Establishing monitoring procedures
- ✓ Protection and optimum utilization of resources

Components of Internal Control

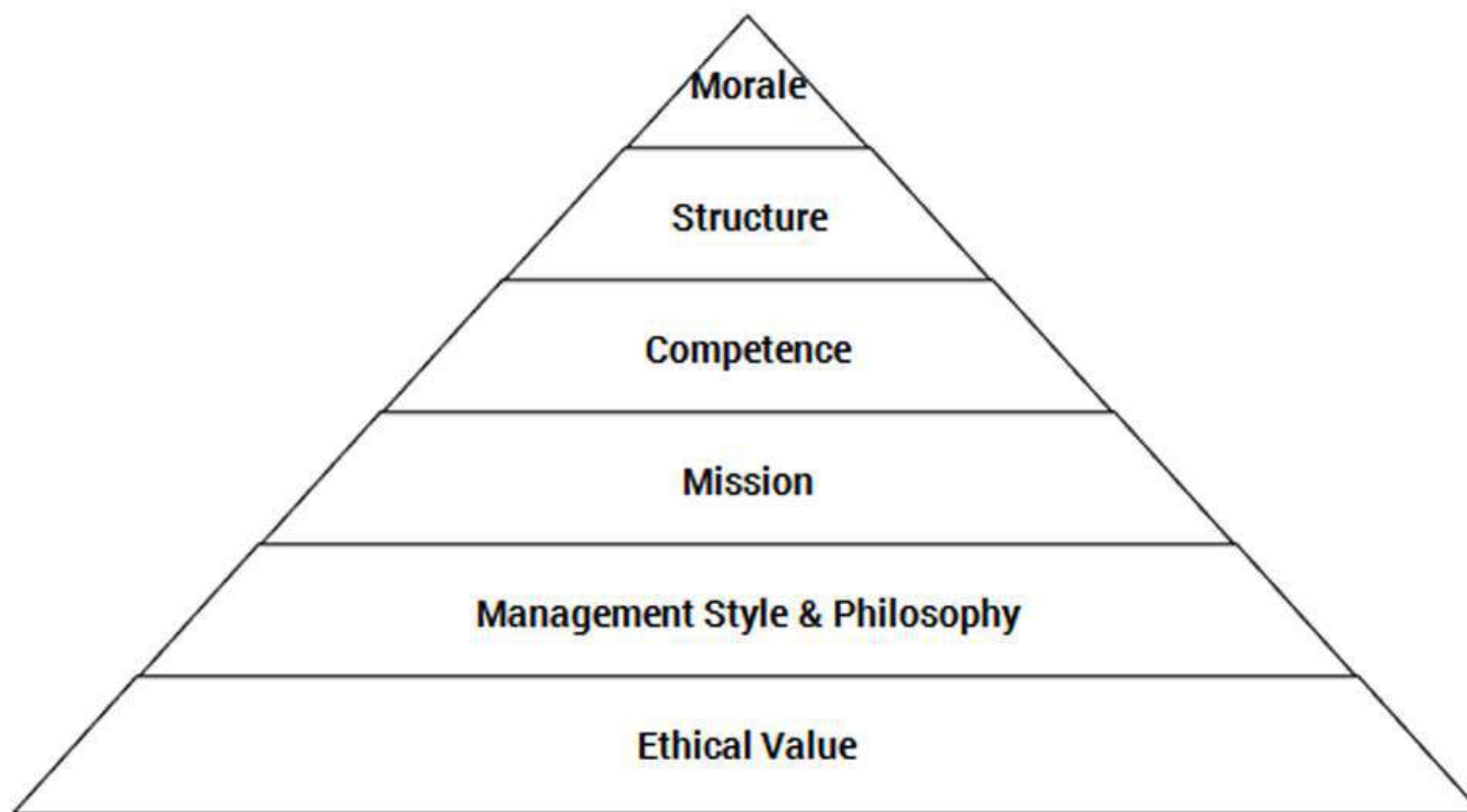


✔ **Control Environment**

Control environment is the base of all other standards of internal control system. It comprises working approach and outlook of management that guides the execution of all other activities in the system.

Functions

- ✔ Establishment of internal structure and hierarchy
- ✔ Development of an ethical and moral code of conduct
- ✔ Establishing accountability and responsibility



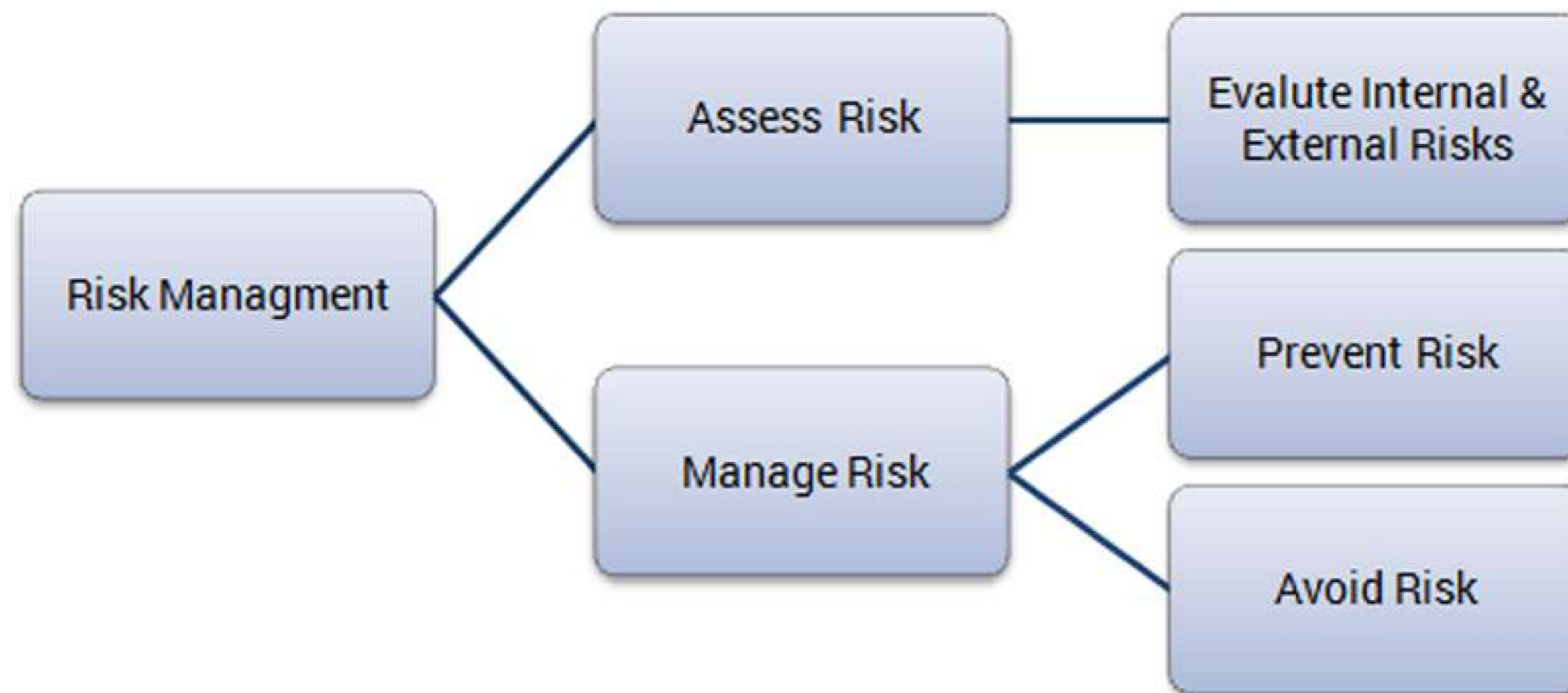
✔ Risk Assessment

Risk assessment is the process of identifying, analyzing and managing the risks that can be a threat to achievement of organizational goals.

This component not only includes assessment of risks but also management of same.

Functions

- ✔ Assessment of risks
- ✔ Based on pre-established objectives
- ✔ Risk identification and mitigation
- ✔ Risk management tools



✔ Control Activities

Control activities are a sum of rules, policies, and procedures that ensure that the directives of the management are implemented effectively.

Functions

- ✔ Development of control activity functions
- ✔ Establishment of internal technology control
- ✔ Deployment of policies and by laws

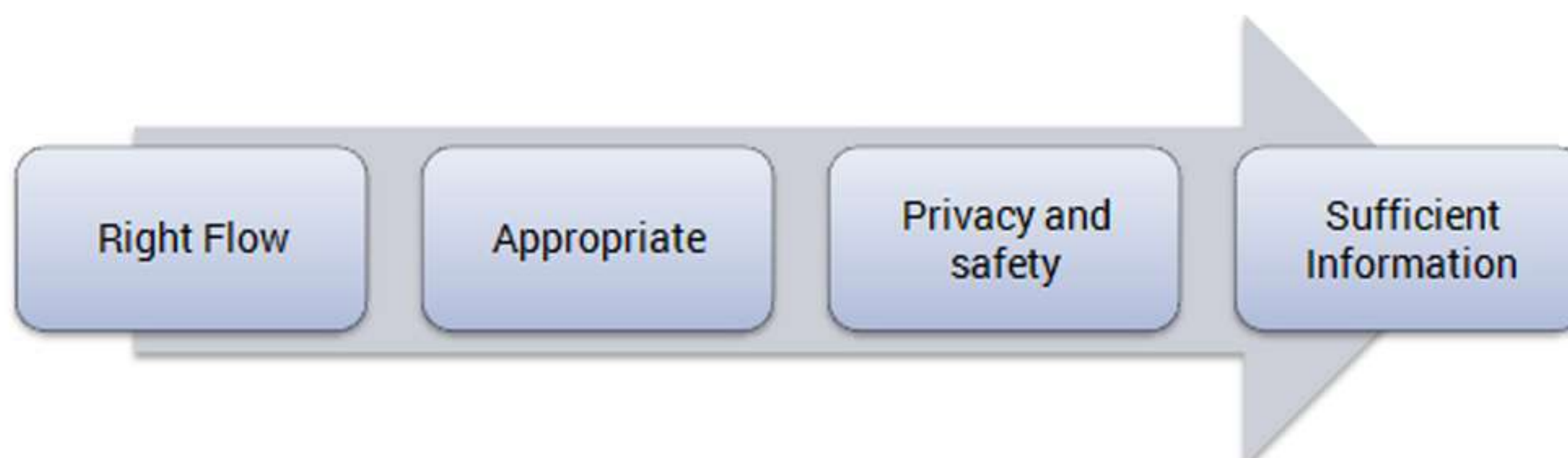


✔ Information & Communication

Effective communication and timely exchange of important information can help the management to achieve their organizational goals and reduce the risks associated with them.

Functions

- ✔ Setting up channels of internal & external communication
- ✔ Establishing communication flow
- ✔ Safety and Privacy of information

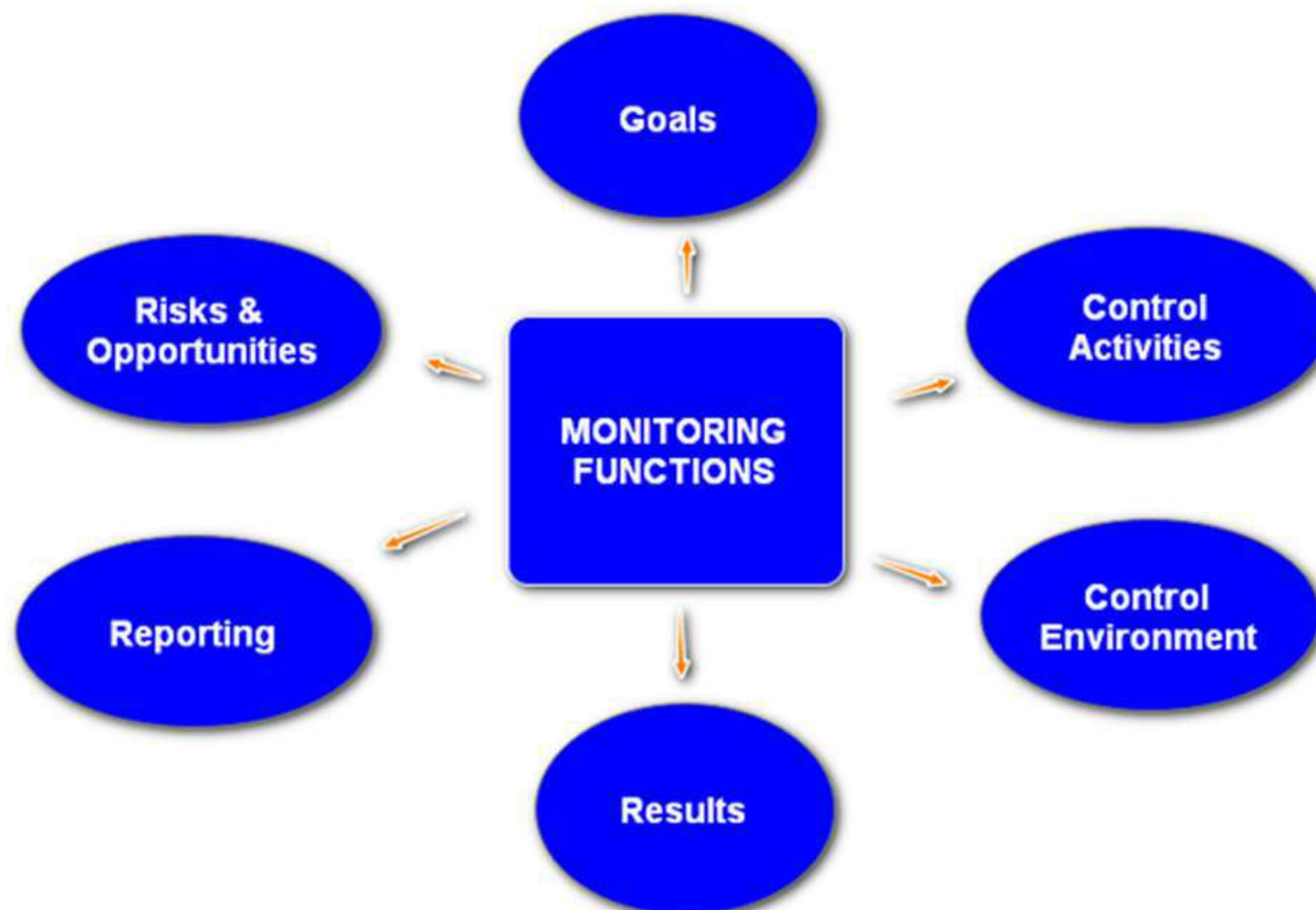


✔ **Monitoring Activities**

Monitoring is a continuous process for an organization. It verifies that whether the control system is working according to the desired standards or not.

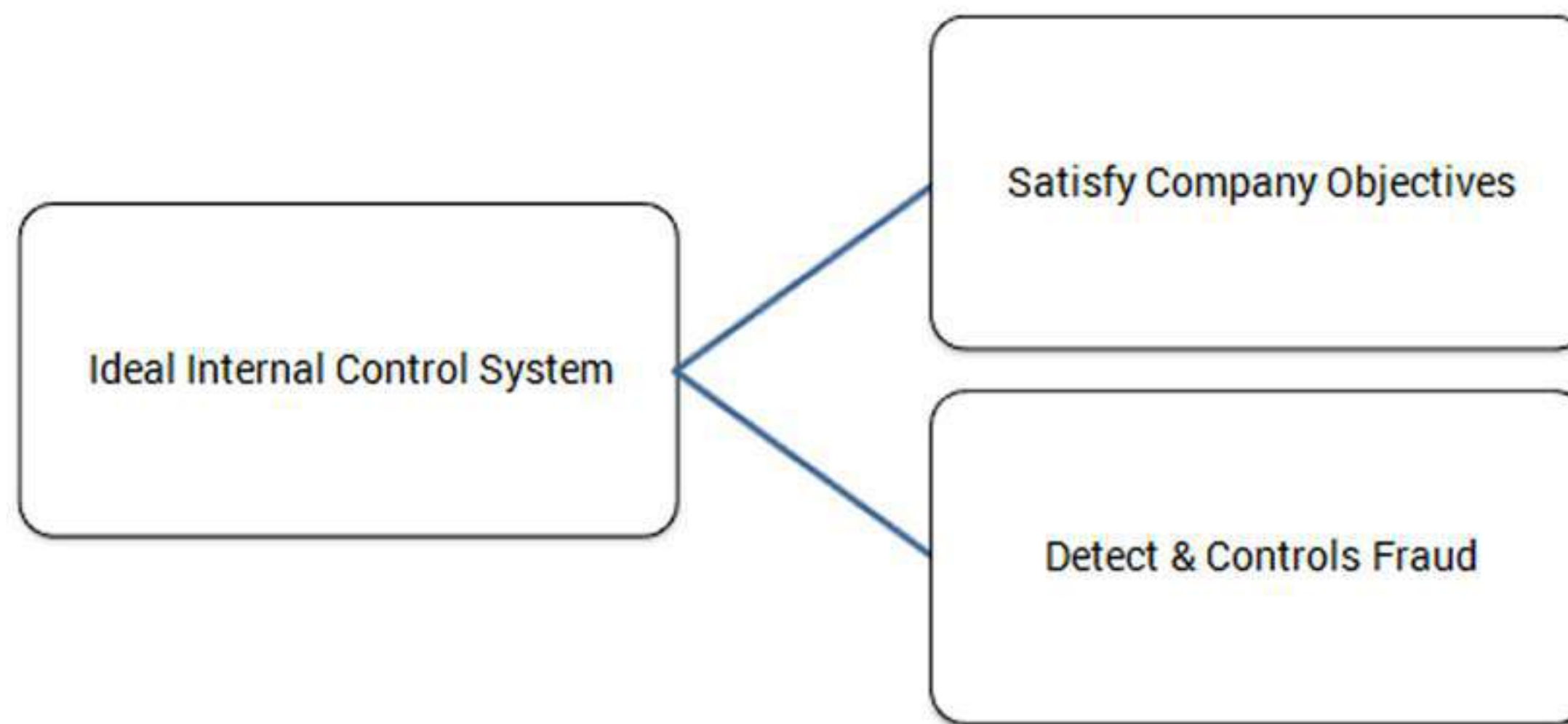
Functions

- ✔ Evaluation of organizational activities
- ✔ Communication of deficiency to top management
- ✔ Comparison of targets with actual results



✔ Design and Implementation of Internal Control

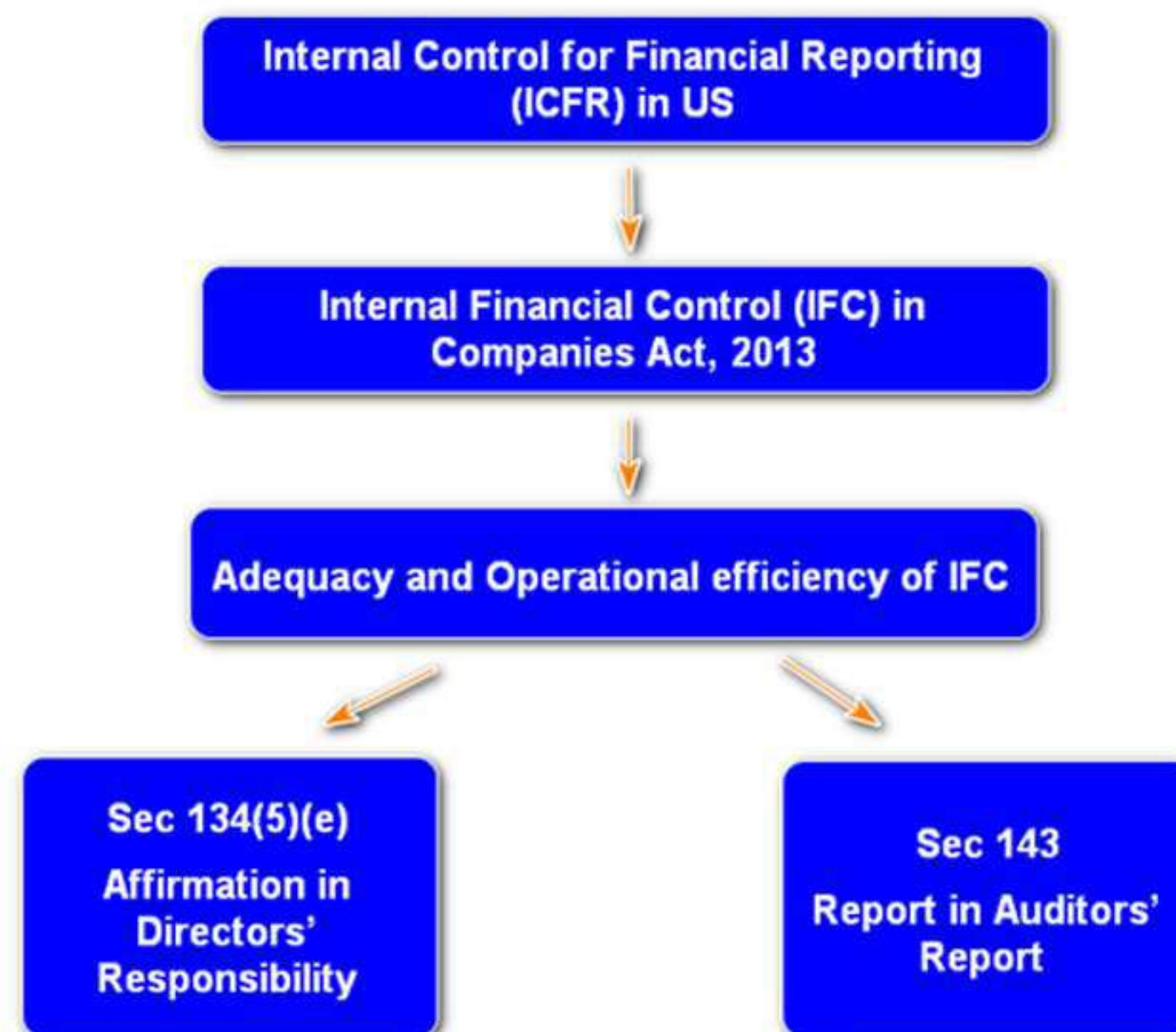
Ideal Design of Internal Control System



The Need for Internal Financial Control System



✓ Indian Context with Concern to Internal Financial Control



Advantages of a Sound Internal Financial Control System

- ✓ Increased Financial Accountability
- ✓ Improvements in the financial reporting process
- ✓ Better creditability in investors eyes as a result of financial reporting
- ✓ Promotes transparency in financial operations
- ✓ Reliability of Financial Statements.
- ✓ Improvements in Financial Control

Benefits of Internal Audit

- ✓ The Board or management defines the objective of the audit
- ✓ The internal auditor reports to the board directly to ensure the right flow of reporting
- ✓ Helps in controlling function of management
- ✓ Establishing of process-oriented working methodology
- ✓ Identifies fallacies and errors and suggest rectification measures
- ✓ Regular internal audit prevents a big fraud from taking place
- ✓ Increases accountability in the organization

What is Internal Control over Financial reporting [ICOFR]?

ICOFR means having systematic control over the procedures related to financial reporting.

Internal Control Over Financial Reporting [ICOFR] - Merits



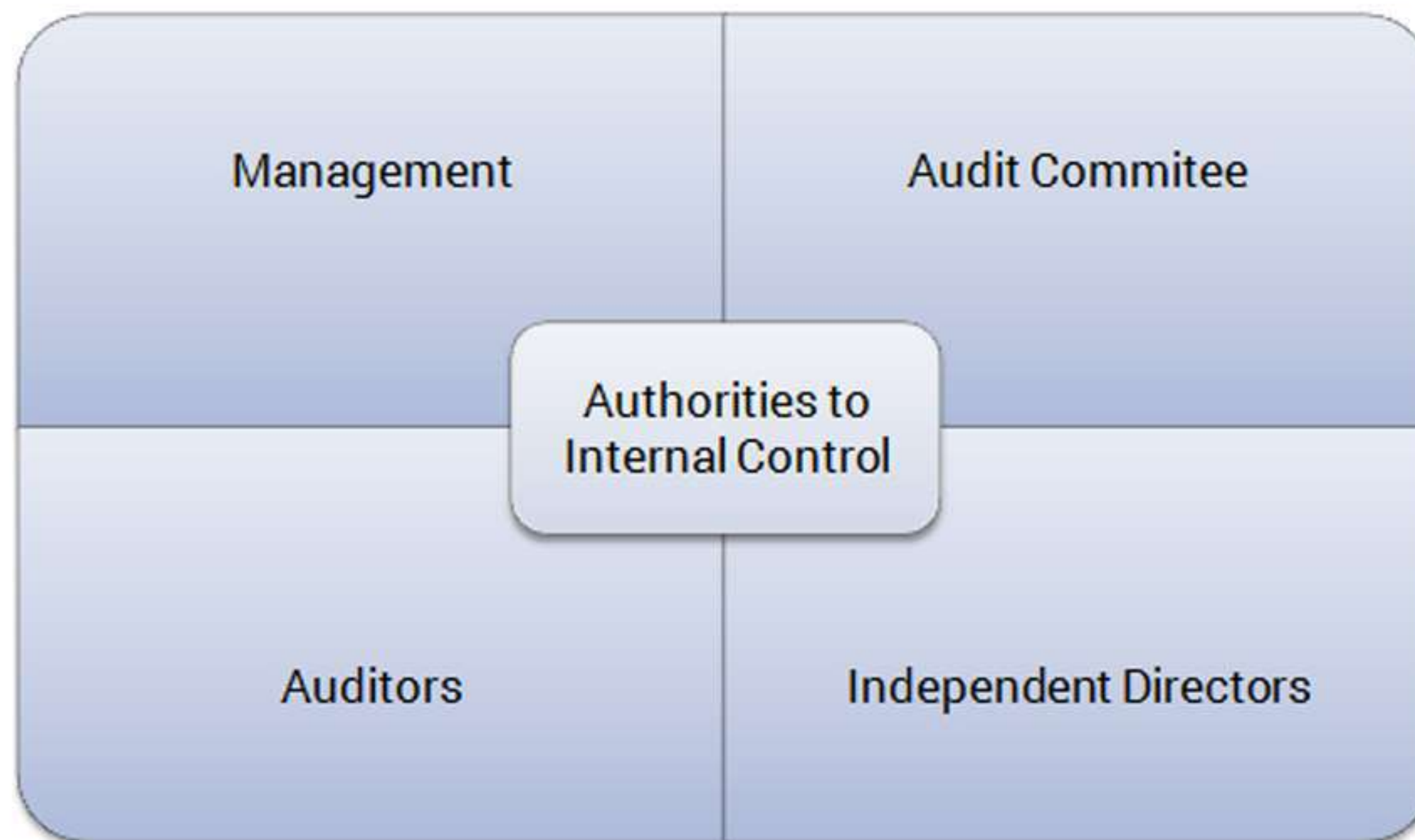
Reporting by Auditor

- ✔ The Financial records are accessed by the auditor to check for any fallacy or error in the books.
- ✔ The auditor makes suggestions to the management and takes report whether the corrections are being implemented or not.
- ✔ In the case of non-implementation, the auditor must report the factual situation.
- ✔ The auditor should report about the controlling capacity of the organization
- ✔ The auditor's opinion does not constitute a legal status about the organization concerning the capacity of financial controlling.

Limitations of Internal

- ✔ Frauds can occur even during a robust internal control system.
- ✔ The internal control system does base on cost-benefit analysis.
- ✔ The pace of business expansion and diversification can outpace the development process of the internal control system.
- ✔ Management can tend to overlook the standard controlling process in times of crisis.

Role of Various Authorities in Internal Financial Control System



1) Management

✓ For LISTED companies

a) Section 134(5)(e) of the Companies Act, 2013-

- Adequate resources for internal control system and efficiency in control operations

b) Clause 49 IX(C) of Equity Listing Agreement-

- Certification of effective internal control system over financial reporting

✓ ALL companies-

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

- Sufficiency of internal controls over financial reporting

2) Auditor

Section 143(3) (i)

-Reports on the organizational capacity of internal financial controls over financial reporting and its effectiveness

Exception:

- ✓ One Person Company or a small company
- ✓ Turnover is less than INR 500 million, or borrowings are less than INR 250 million.

3) Independent Directors

Sec 149(8) read with Schedule IV-

- Get assurance on financial statements and financial control system
- Ensure efficiency and effectiveness of the risk management system

4) Audit Committee

Section 177(4) (vii) –

- Evaluation of management systems internal financial control system
- Evaluation of auditor's opinion about the financial control system
- Analysis of control systems and financial records

Opportunities for Companies

- ✓ Evaluate risks, opportunities, and the scope of business activities.
- ✓ Reduce the risk of frauds
- ✓ Opportunity to manage future financial risks and crisis
- ✓ Sustainable growth of the business
- ✓ Optimum utilization of resources



Thank You!

For more information on Internal Control or any other query contact Mr. Akash.

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Akash Dubey is a Law Graduate and works as an Advisor at Enterslice. He is proficient in Legal and Financial Advisory. His expertise in the skills of Legal and Financial Research is an aid to his strengths as an Advisor.