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Helping you decipher Internal Financial Controls

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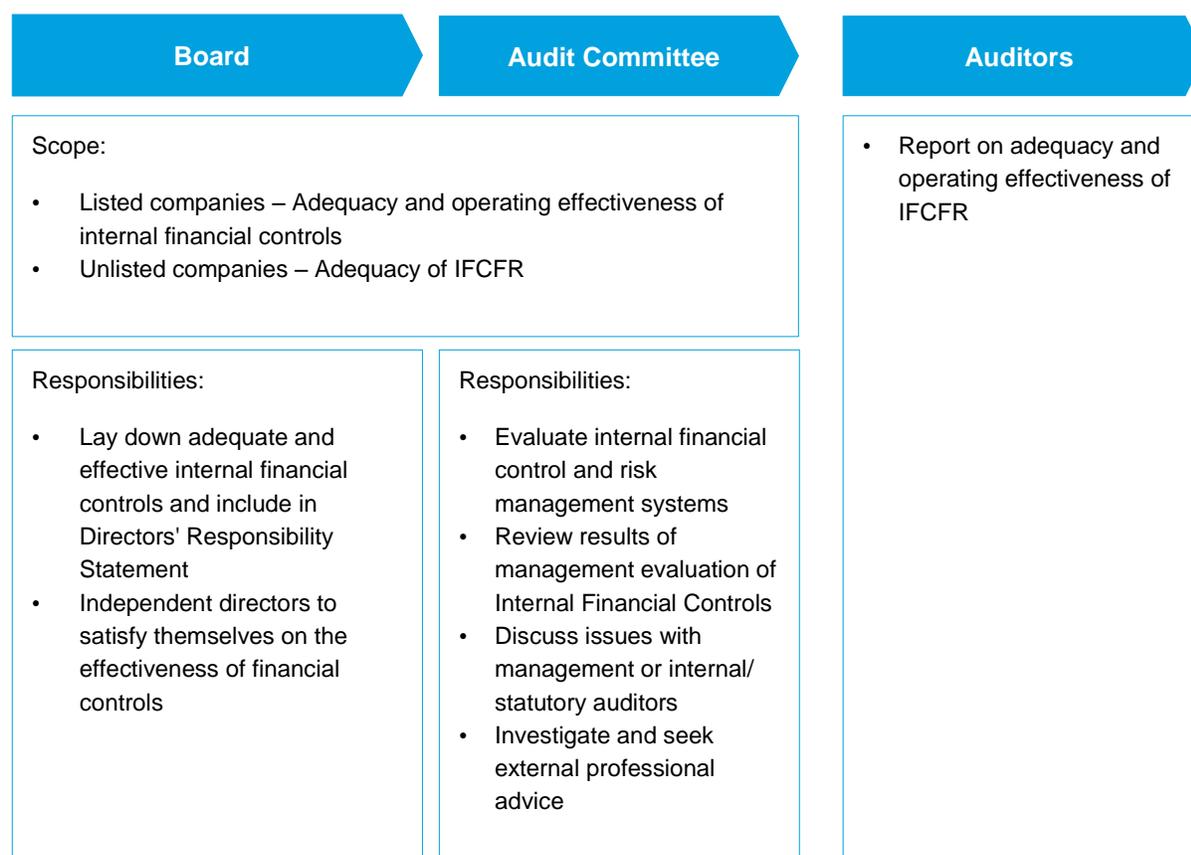


Prepare for the Changes

The Companies Act, 2013 (the “2013 Act”) has imposed specific responsibilities on the Board of Directors (“Board”) towards the company’s internal financial controls and, inter alia, requires the Board to state that they have laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively. These changes are effective from the financial years beginning on or after 1 April, 2014. Currently, many companies are assessing the impact these new requirements will have on the operations and processes of the company, including the financial reporting process. Internal financial controls include policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including regulatory compliance and prevention and detection of frauds and errors, thereby covering not only the controls over reliable reporting of financial statements (more commonly known as Internal Financial Controls over Financial Reporting (“IFCFR”), but also include all other controls pervasive across the business.

Statutory auditors are required to report on the adequacy and operating effectiveness of the company’s IFCFR. The reporting by the auditors is voluntary for the year ending 31 March 2015 and mandatory for financial years beginning on or after 1 April, 2015.

The scope and responsibilities of the Board, Audit Committee, and Auditors are summarised below:



Based on experiences globally where IFCFR has been mandated, it is not unreasonable to expect that significant efforts will be required to establish robust internal financial control systems to meet the new reporting requirements. Companies in consultation with the Board and Audit Committees must act expeditiously on this requirement and complete the process of bringing in the necessary changes by 31 March, 2015 so that the Board can report on the adequacy and the operating effectiveness of such internal financial controls.

Role of Boards and Audit Committees

Consequent to the formal responsibility introduced under the 2013 Act, the role of the Board and the Audit Committee in the oversight of internal control has become increasingly critical.

The Board is expected to play an important role in establishing the control environment, including clarity of expectations regarding integrity and ethics and adherence to codes of conduct and creating clear accountability for performance of internal control responsibilities. The Board's assessment of the risk of management override of internal control and establishing open lines of communication between management and the Board, as well as providing separate lines of communication (e.g., whistle-blower hotlines) is important. The need for Boards to perform this self-evaluation and ensure maintenance of appropriate skills and expertise is a critical success factor in meeting the new requirement of the 2013 Act.

Audit Committees play a critical role in overseeing internal control. Although their primary focus may be on IFCFR, now, more than ever, Audit Committees are taking the lead in overseeing controls pertaining to compliance and operational matters. Expectations of the Audit Committee's role have expanded due to enhanced company and external auditor reporting requirements, along with an increased focus on compliance by regulators.

Questions for Board and Audit Committees to consider:

- Has a framework for internal financial controls been identified for the company (e.g. COSO 2013)?
- Does the framework include operations and regulatory compliance as well?
- Has the internal controls been mapped to the framework defined?
- Based on the defined framework are there any gaps in current processes, control activities, or documentation, and if so, how are these being addressed?
- Is the company educating leadership & executive management, and control owners regarding the content in the framework?
- What policies are in place and who is responsible for communicating internal control considerations to external parties (e.g., third-party service providers)?
- Does the company use information technology and data analytics to help continuously monitor internal control systems?

Advantages of a robust internal financial control system:

By placing more accountability and responsibility on the Board and Audit Committee with respect to internal financial controls, the 2013 Act is attempting to align the corporate governance and financial reporting standards with global best practices. With adequate and effective internal financial controls, some of the benefits that the companies would experience include:

- Senior Management Accountability
- Improved controls over financial reporting process
- Improved investor confidence in entity's operations and financial reporting process
- Promotes culture of openness and transparency within the entity
- Trickle down of accountability to operational management
- Improvements in Board, Audit Committee and senior management engagement in financial reporting and financial controls
- More accurate, reliable financial statements
- Making audits more comprehensive

Internal financial controls also become important as they help derive values in the form of:

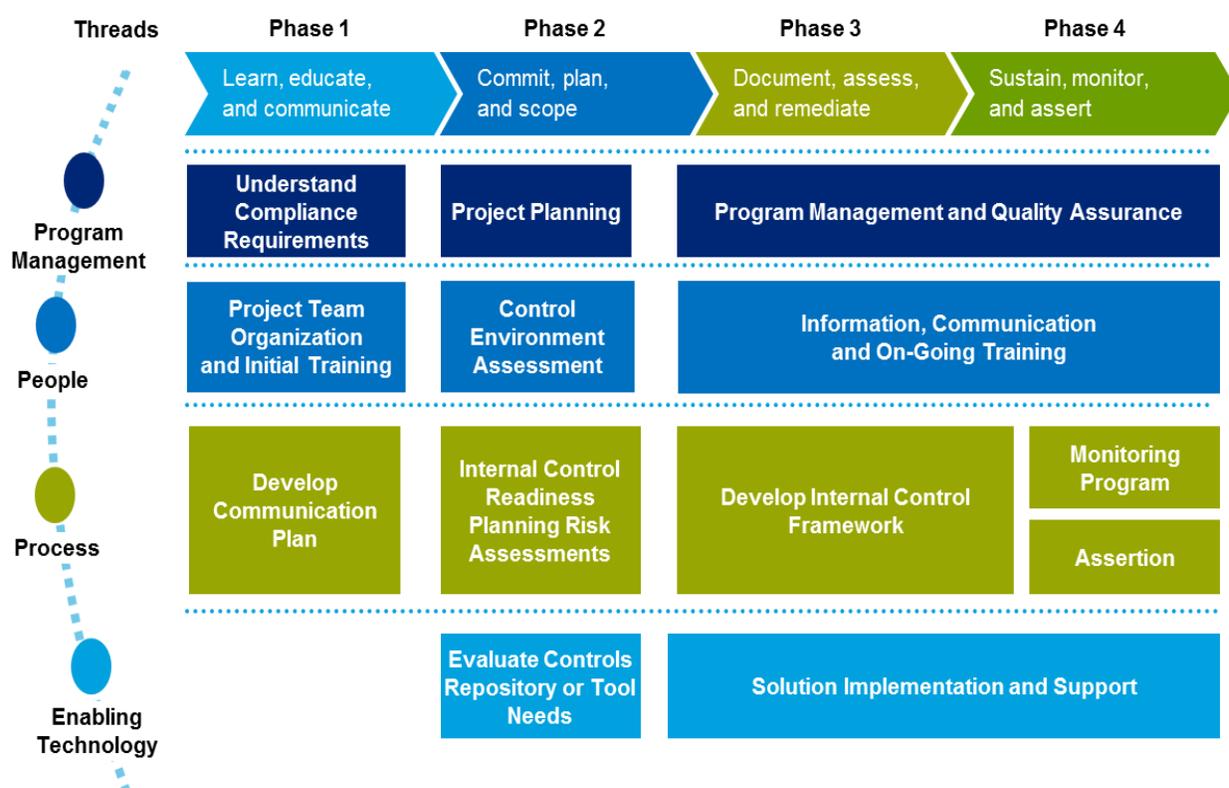
- Fresh independent look at key business processes
- Identification of potential operating process opportunities
- Updated formal, centralized, and managed internal financial controls documentation for the company
- Enhanced support to CEO/CFO certifications
- Enhanced control environment, thereby mitigating risk
- Better understanding of inherent and residual control risks in internal controls

Opportunities for Companies

To truly unlock the value that can be achieved by adopting the internal financial controls, management should take a step back and evaluate how it is addressing the risks to its organization in light of the company's size, complexity, global reach, and risk profile. In companies' implementation of the internal financial controls, there is a difference between doing the minimum and doing the right thing to effectively address the requirements. Companies that choose to do the right thing will unlock the value, reduce fraud risk, avoid financial reporting surprises, and support sustained business performance over the long term.

Implementation Methodology

Internal financial controls implementation methodology would typically include four phases and approach threads which are relevant for companies planning to implement an internal control framework addressing annual assertions of the design and effectiveness of IFCFR.



The process described above requires careful consideration by companies, in order to create an internal financial controls program that is efficiently scoped and meeting the requirements under the 2013 Act. Such an approach and

the related documentation will be critical in advising Board, as companies undertake an assessment required in connection with 2015 financial statements, and in subsequent 2016 certifications required by auditors

Why Deloitte?

The process of complying with the annual assertion under the 2013 Act requires effective planning, knowledgeable resources, and excellent coordination and communication. The requirements for a successful implementation includes understanding the complexities of the business, perform against tightly controlled timelines, and stay alert for opportunities to improve effectiveness and /or efficiencies.

Deloitte's internal controls specialists have provided internal financial controls and Internal Controls over Financial Reporting (ICFR) related services for leading companies. Our internal control specialists have experience as auditors of Sarbanes Oxley compliance programs — we understand what auditors expectations are for such programs. We also have considerable experience as controls testing providers and are well versed in internal financial control related requirements, tools and technologies.

- We have deep industry and internal financial controls Testing expertise
- We have the accelerating tools you need
- We can assist as you grow

Deloitte offers companies assistance in the following areas:

Area	Our Offerings
Education and Training	<ul style="list-style-type: none"> • Educate Audit Committee and C-Suite on internal financial controls and factors to consider in determining the control framework to be adopted
Readiness/Gap Assessment	<ul style="list-style-type: none"> • Assess current state processes, control activities and available internal control documentation, mapping with the internal control framework elements • Provide advice and recommendations on potential gaps, including potential efficiencies and enhancements to business and IT processes.
Implement Controls or Process Improvements	<ul style="list-style-type: none"> • Assist in implementing new processes and controls or enhancing existing processes and controls in areas such as: <ul style="list-style-type: none"> – Risk assessment, including fraud risk assessment – Information quality, including Information Produced by Entity (IPE) – Monitoring and oversight of third party service providers – Precision of management review type controls – Use of analytics in the context of control activities and monitoring.
Integrate Control Framework into Other Functions	<ul style="list-style-type: none"> • Evaluate the effectiveness of other functions (e.g., Internal Audit, Regulatory) in meeting the control framework requirements • Assist the function in integrating the control framework into existing processes, methods and documentation • Advise management on potential opportunities to leverage control framework in other operational or compliance functions

For any queries or information, please contact – infcindia@deloitte.com

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