# Internal Financial Controls (IFC) as per Indian Companies Act, 2013

OVERVIEW AND KEY REQUIREMENTS

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# Introduction to IFC

**Definition of IFC:** A brief overview of Internal Financial Controls (IFC) and their importance in business.

The Companies Act of 2013 defines Internal Financial Controls (IFCs) as policies and procedures that a company uses to ensure that its business is conducted in an orderly and efficient manner. IFCs also include measures to safeguard the company's assets, prevent and detect errors and frauds, and ensure the accuracy and completeness of accounting records.

**Objective:** To ensure accuracy, reliability, and transparency in financial reporting.

**Relevance:** Requirement under Section 134(5)(e) of the Companies Act, 2013.

According to Section 134(5)(e) of the Companies Act, 2013, the Directors Responsibility Statement must state that the directors have established internal financial controls and that they are adequate and operating effectively.

# Key Objectives of IFC

Strengthening Financial Controls: To evaluate the effectiveness of internal controls over financial reporting.

Compliance: Ensure alignment with Indian regulatory standards and laws.

Risk Management: Identify and address risks in financial and operational processes.

Enhanced Governance: Support decision-making and accountability by enhancing the reliability of the financial statement.

# Roles and Responsibilities

- **Board of Directors:** Responsible for establishing and maintaining IFC.
- **Audit Committee:** Oversight of IFC adequacy and effectiveness.
- **Management:** Ensures implementation and monitoring of IFC.
- **External Auditor:** Reviews and reports on IFC effectiveness in audit reports.

The auditor's objective in an audit of internal financial controls over financial reporting is to express an opinion on the effectiveness of the company's internal financial controls.

# Key Benefits of Internal Financial Control

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| **Enhanced Financial Accuracy and Integrity** | • IFC's ensure that the financial data is accurate, reliable and free from error<br>• Consistency in accounting processes with applicable standards & regulations. |
| **Operational Efficiency** | • Well implemented controls streamline processes reducing duplication & inefficiencies<br>• Help to identify area of wastages or unnecessary expense. |
| **Stakeholder Confidence** | • Robust controls provide assurance to stakeholder, including investors, auditors,& regulators that the organisation is well managed.<br>• Enhanced trust leads to better market reputation and investment opportunities. |
| **Business Continuity** | • IFCs ensure financial stability and preparedness for unforeseen circumstances.<br>• Contributes to the organisation's long term sustainability. |

# Applicability

Internal Financial Controls are applicable to listed companies, as well as some unlisted public companies:

IFC is applicable to all listed companies.

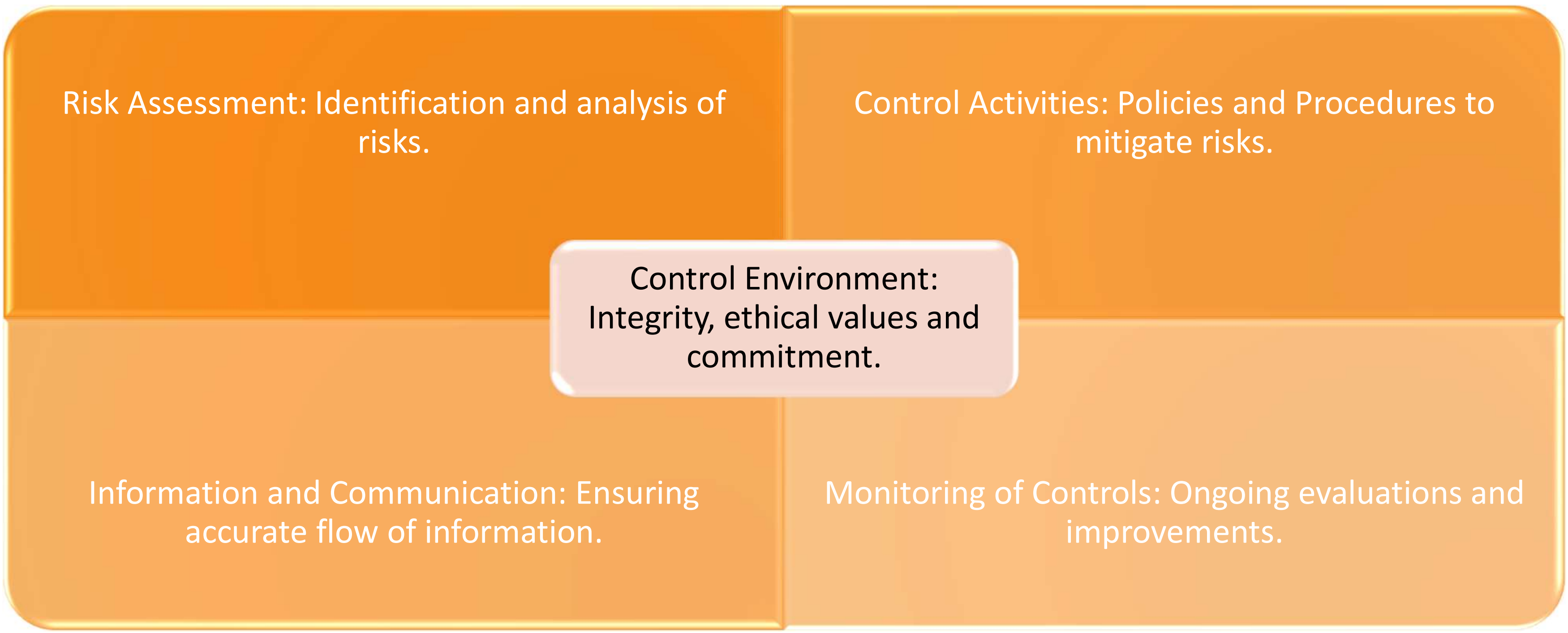
IFC applies to unlisted public companies with a paid-up capital of at least Rs 25 crore at the end of the previous financial year.

IFC do not apply to private companies that are one-person companies (OPCs) or small companies, or that meet the following criteria:

i. Have a turnover of less than Rs 50 crore as per the latest audited financial statement

ii. Have aggregate borrowings from banks, financial institutions, or any body corporate of less than Rs 25 crore during the financial year

# Components of IFC Framework



# IFC Audit Process

**1.Planning and Define the Scope**

Develop a preliminary audit plan covering matters such as general scope and timing of engagement and audit plan based on understanding of the company and its environment

**2.Risk Assessment**

Obtain an understanding of the company including its internal control by using techniques like walkthrough to understand gap, analytical procedures to identify material misstatement.

**3.Control Testing**

Develop an overall testing plan like area to be covered, number of staff involved, timing and extent of testing, perform testing of design and effectiveness of the controls in place.

**4.Reporting**

The auditor should identify the misstatement and control deficiencies individually and in the aggregate to form an opinion

# Common Challenges in IFC Audits

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| **Complexity in Processes:** | • Difficulty in identifying and documenting all controls.<br>• Identifying gaps in the control |
| **Changing Regulatory Landscape:** | • Keeping up with regulatory updates. |
| **Resource Constraints:** | • Lack of expertise and resources.<br>• Technical expert in certain controls. |
| **Coordination between Departments:** | • Ensuring alignment and cooperation<br>• Difference of opinion among the management. |

# Case Study:Internal Financial Controls for Procurement Process

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| **A. Vendor Selection and Approval** | •Maintain a **vendor master list**, updated regularly.<br>•**Due Diligence:** Conduct background checks and financial stability assessments for new vendors.<br>•Formal **approval process** for vendor onboarding. |
| **B. Purchase Requisition and Order** | •**Authorized Requisitions:** All purchase requests must be approved by designated authorities.<br>•**Purchase Orders (PO):**<br>  •PO generation should only happen post requisition approval.<br>  •Automated systems to match POs with approved requisitions. |
| **C. Goods Receipt and Verification** | •**Three-Way Matching:** Compare the following before payment processing:<br>  •Purchase Order<br>  •Goods Receipt Note (GRN)<br>  •Vendor Invoice<br>•Inspection of received goods against the specifications in the PO. |
| **D. Payment Process** | •Payments processed only after approval of invoices matched with GRN and PO.<br>•Segregation of duties:<br>  •Person authorizing payment should not process it.<br>•Regular vendor reconciliation to detect and resolve discrepancies. |

# Thank you!

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