

IND-AS AND INTERNAL FINANCIAL CONTROLS (IFC) FOR FINANCIAL REPORTING



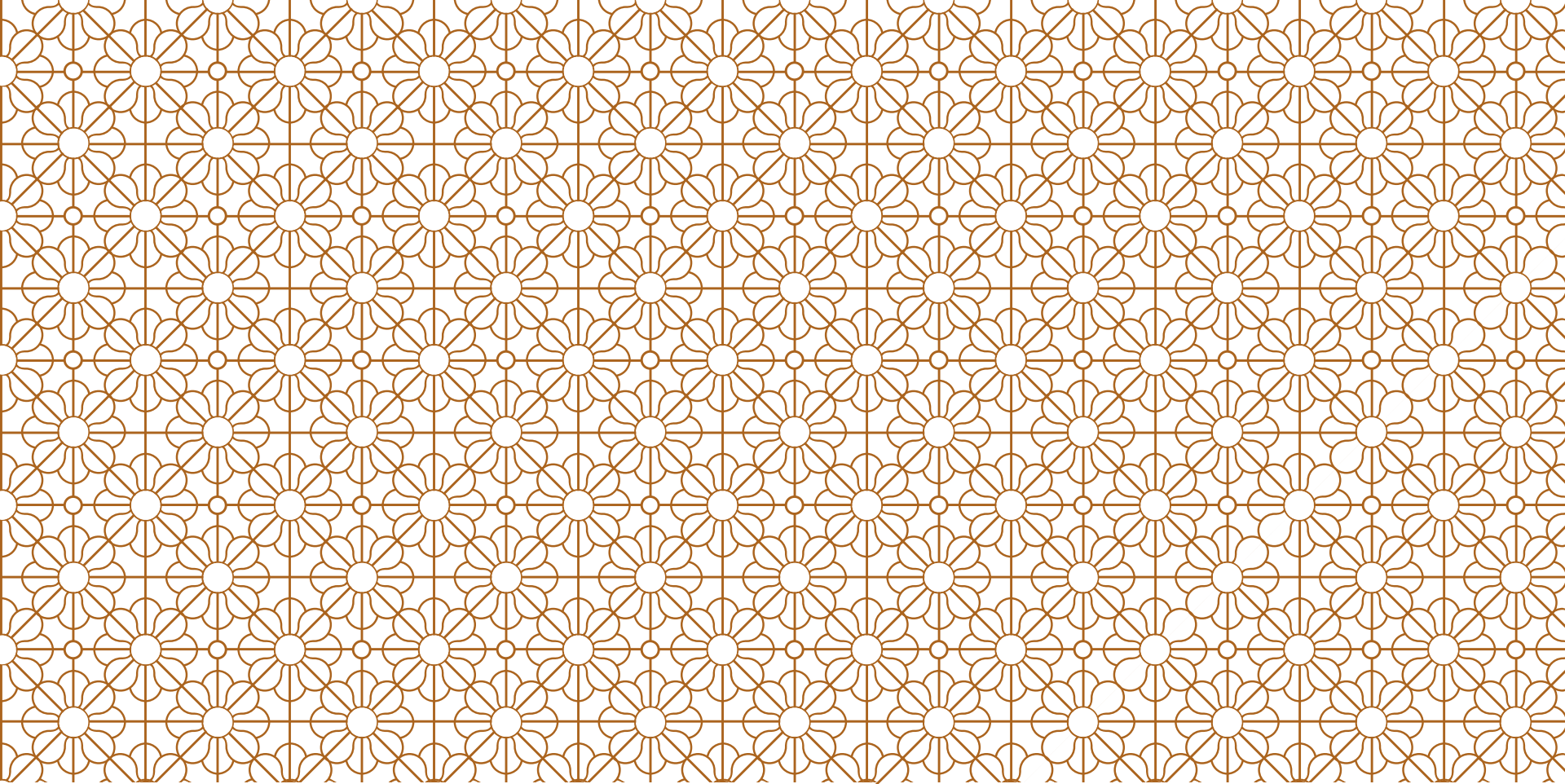
INDEX

PART I - HISTORY OF INTERNAL FINANCIAL CONTROLS (IFC)

Sr. No.	Particulars	Slide No.
1	History of Internal Financial Controls (IFC)	4-5
2	Indian Scenario	6
3	Regulatory Mandate in India	7
4	Audit Committee & Independent Directors	8

PART II – IMPACT OF IND-AS ON IFC

5	IT System Changes	10
6	Ind AS – 108 - Operating Segments	11-12
7	Ind AS – 37 - Provisions, Contingent Liabilities & Contingent assets	13
8	Ind AS – 16 - Property, Plant & Equipment	14-16
9	Ind AS – 16 - Revenue Recognition	17



HISTORY OF INTERNAL FINANCIAL CONTROLS (IFC)

SHARP & TANNAN ASSOCIATES
CHARTERED ACCOUNTANTS
www.sharp-tannan.com

HISTORY OF INTERNAL FINANCIAL CONTROLS

Cadbury Committee in UK on Corporate Governance, 1991:

Committee released a report in Dec 1992 for Financial Reporting Council of London Stock Exchange.

Major Recommendations:

- Single person should not be vested with the decision making power i.e the role of chairman and chief executive should be clearly separate.
- A majority of Directors must be independent non-executive directors i.e. not having financial interests in the co. and should act independently while giving their judgement on issue of strategy, performance, allocation of resources and designing code of conduct.

COSO Framework 1992:

- The Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued Internal Control – Integrated Framework to help businesses and other entities assess and enhance their internal control systems
- It defined Internal Control consisted of 5 interrelated components: Control Environment, Risk Assessment, Control Activities, Information and Communication, Monitoring.

Accounting scandals in USA: Waste Management Scandal (1998), Enron Scandal (2001), WorldCom Scandal (2002), Tyco Scandal (2002).

HISTORY OF INTERNAL FINANCIAL CONTROLS

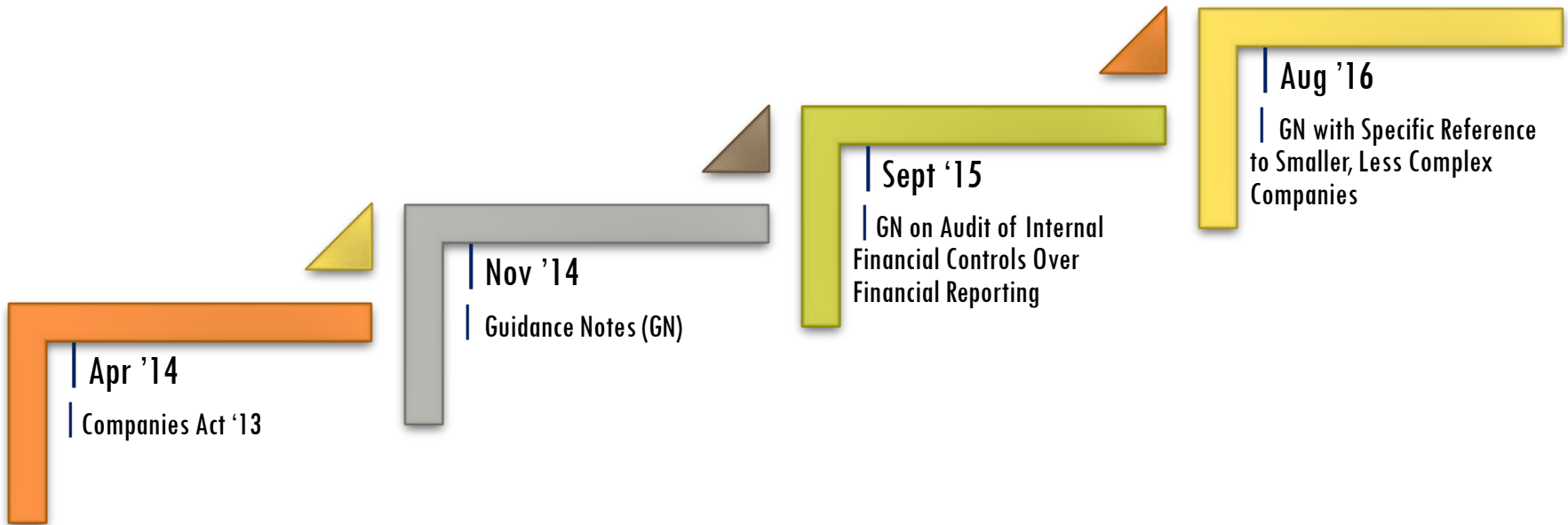
| Sarbanes Oxley Act 2002:

- Sec 404 requires auditors to attest and report on the assessment on the effectiveness of the internal control structure and procedures for financial reporting.
- Sec 302 Principal Officers to certify quarterly and annual statements responsibility for establishing and maintaining Internal Controls over financial reporting.

| COSO 2013:

- COSO released an updated edition of Internal Control - Integrated Framework in 2013 (the “2013 COSO Framework”) to address changes in business and operating environments since the original framework’s release in 1992.

INDIAN SCENARIO



REGULATORY MANDATE IN INDIA

Directors Responsibility Statement

Section 134 (5)(e) of Companies Act, 2013

- Directors — In case of a listed company, had laid down internal financial controls & that such internal financial controls are adequate and were operating effectively.

Board's Report

Rule 8 (5) of Companies (Accounts) Rules, 2014

- The details in respect of adequacy of internal financial controls with reference to the Financial Statements.
- All Entities — Listed or Unlisted

Powers & Duties of Auditors and Auditing Standards

Section 143 (3) (i) of Companies Act, 2013

- Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.
- All Entities — Listed or Unlisted

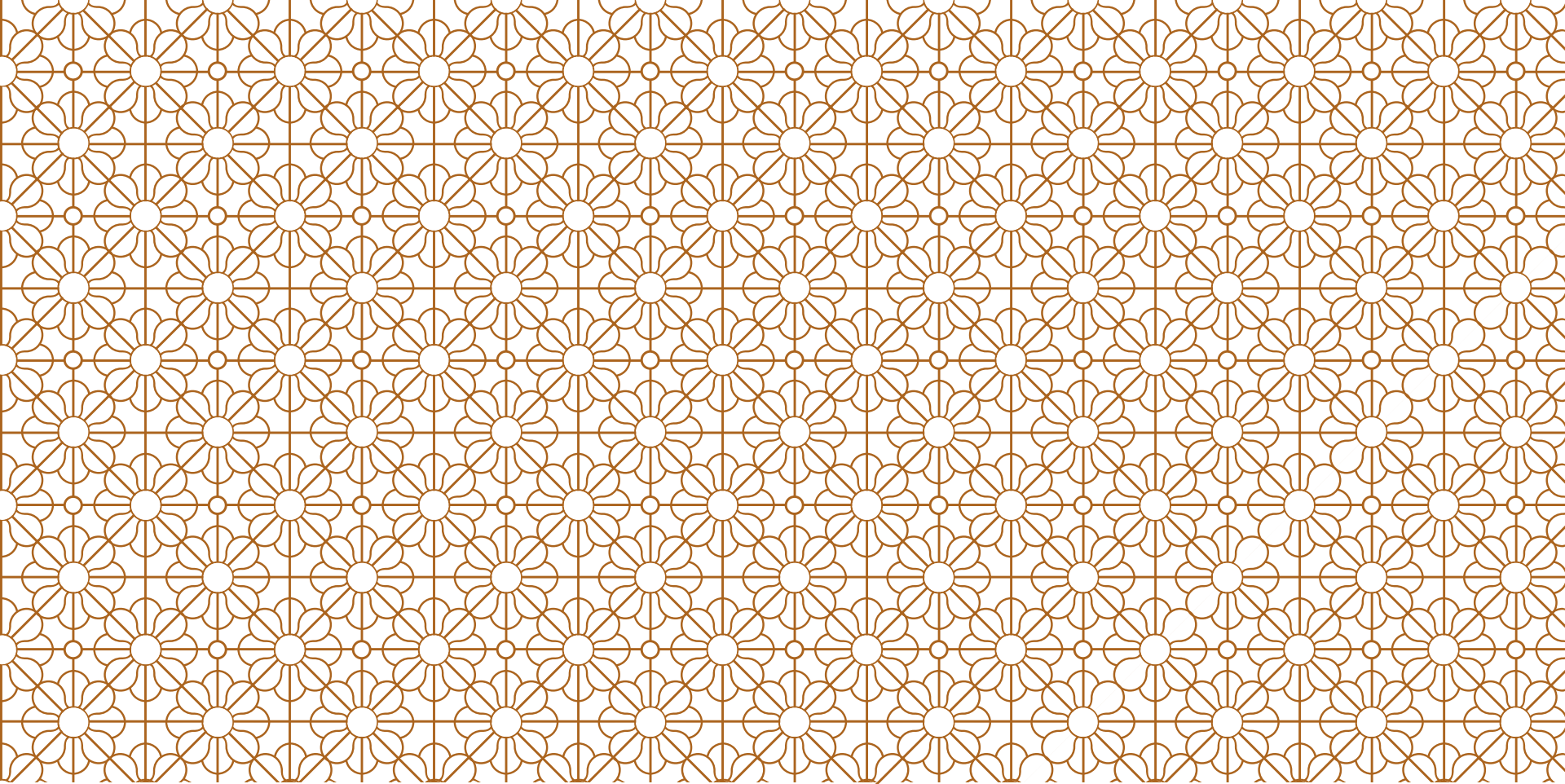
AUDIT COMMITTEE & INDEPENDENT DIRECTORS

Section 149 (8), Schedule IV of Companies Act 2013

- Satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible

Section 177 of Companies Act 2013 for Audit Committee

- Sub Section (4) - “Evaluation of internal financial controls and risk management systems”
- Sub Section (5) — “Call on auditors to comment on internal control systems & before their submission of Financial Statements to the Board, may also discuss any related issues with the internal & statutory auditors and the management”



IMPACT OF IND-AS ON IFC

SHARP & TANNAN ASSOCIATES
CHARTERED ACCOUNTANTS
www.sharp-tannan.com

IFC, IT AND IND-AS

From Accounting to Information Technology:

- Greater interface between IT and Finance Functions.
- Ind-AS impact assessment to assess structural information collection, processing, treatment and reporting changes vis-à-vis existing IT Infrastructure.

Information Technology and Ind-AS

- Additional data requirements.
- Configuration challenges
- Modified Reports

Internal Control Assessment

- Internal Controls to be build around existing/new processes implemented for the IT changes specified
- Process mapping control, design, review, control effectiveness assessment for such additional processes/changes to be incorporated in IFCFR checklists

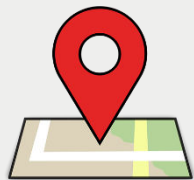


OPERATING SEGMENTS - IDENTIFICATION OF SEGMENTS

AS - 17

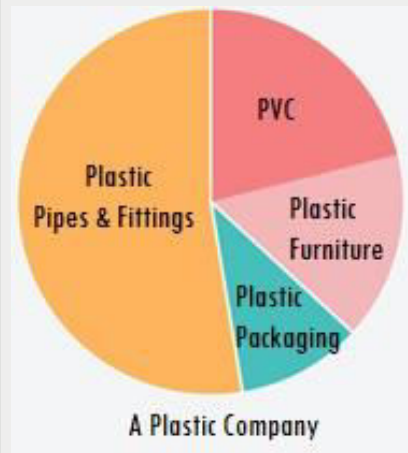
Identification of two sets of segments:

1. Related products and services
 2. Geographical areas.
- One regarded as primary and the other as secondary segments.
 - Because of ambiguity, Entities claimed to have only 'one' segment.



Ind-AS - 108

- Segment identification is based on 'management approach'.
- Operating segments are identified based on the internal reports regularly reviewed by the entity's chief operating decision maker (CODM).



Implication on IFC

CODM, a person/function to allocate resources to & conduct a regular review of the performance of the operating segment, consider implications and decide for the criteria, will be in place.

Changes in Process:

- IT System Change: Criteria for Segregation in the Vendor Master, Assets, Liabilities.
- Inter Segment Revenues: The basis of accounting for transactions.
- Change in Reconciliation Procedure:
- Inter segmental effectiveness and benchmarking can be set up & reviewed so as to channelize resources to efficient segments.

Implication:

- Diversity in reported segment information, may not ideal for comparisons of similar entities.
- Entities, no longer need to prepare 2 sets of information for internal and external reporting. Popular with management as more aligned with internal reporting.
- Implementation could be costly and will require time.

OPERATING SEGMENTS - RESTATEMENT

AS - 17

If new segment is identified:

Corresponding data for comparative purpose is required

Ind-AS - 108

If Entity changes the structure of its internal organization, causing composition of reportable segment to change:

Corresponding information for earlier periods, including interim periods will be restated.

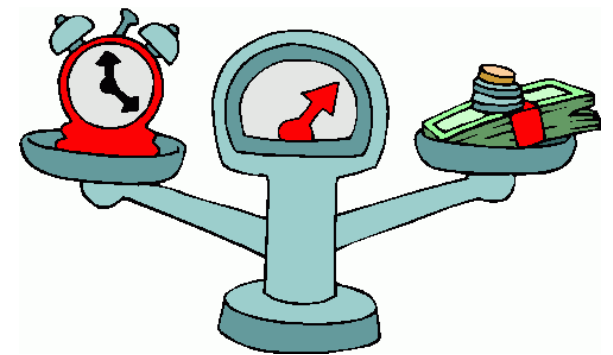
Implication on IFC

Changes in Process:


- Retrospective IT System Change: Criteria for Segregation in the Vendor Master, Assets, Liabilities.
- Assumptions: Resolve any issues and begin capturing the relevant data and make basis for assumptions for retrospective comparatives change.
- Review processes to revisit goodwill impairment, Restate the comparatives, Audit trails between the management accounts and the consolidated financial information.

PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Particulars	AS - 29	Ind-AS - 37	Implication on IFC
Discounting of provisions	Discounting the amounts of provision is <u>prohibited</u>	<ul style="list-style-type: none"> If time value of money is material, Provisions to be at <u>Present value</u>. E.g. Provision for decommissioning of restoration. The increase in liability is treated as Borrowing cost. 	<ul style="list-style-type: none"> Annual Review mechanism could be established. Change in IT System to incorporate present value computation and trigger annual review.

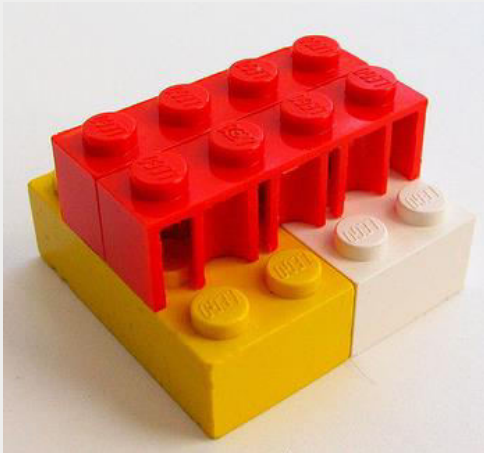


PROPERTY, PLANT AND EQUIPMENTS (PPE)

Particulars	AS - 6,10	Ind-AS - 16	Implication on IFC
Review of residual value	Periodical review of Estimates with respect to Realisable Value (RV)	<ul style="list-style-type: none"> Review at least at each financial year-end and Change accounted for as a change in an accounting estimate in accordance with Ind AS 8. 	Yearly – PPE Review of residual value, Reassessment of useful life will have to be done.
Reassessment of useful life	<ul style="list-style-type: none"> Periodical Review Prospective application 	<ul style="list-style-type: none"> Reviewed at least at each financial yearend. Prospective application. 	
Estimated costs of dismantling, removing or restoring items of PPE	No specific guidance in AS 10. 	Initial estimate of such costs – Required to be included in the cost of the respective item of PPE.	Corresponding changes in the Finance Module of the IT system should trigger an alert at the initial stage for capitalization of the same.

PROPERTY, PLANT AND EQUIPMENTS (PPE)

Particulars	AS - 6,10	Ind-AS - 16	Implication on IFC
Componentization of assets	<p><u>AS 10</u> - Slight reference of the same</p> <p><u>Companies Act, 2013 - Schedule II</u>, Mandates FA to be componentised for depreciation purposes.</p>	<ul style="list-style-type: none">■ Componentization approach mandatory for PPE.■ These are depreciated separately.	<ul style="list-style-type: none">■ PPE physical verification review■ Segregation of PPE if it is itself as a component■ Tagging and capitalization of the individual component■ Separate master data to track costs, useful lives, depreciation rates and residual values, which requires extensive data conversion and mapping of historical data.■ Verification of this historic data of these newly formed individual components, Vouching of invoices, Assumptions and FV valuation■ IT System Changes and FAR Changes for creation of new asset types and definitions of the useful life of each asset.



PPE – REVALUATION OF ASSETS

AS - 6,10

- Approach: Revaluation approach adopted
- Adoption does not require as a part of accounting policy, Independent asset can be revalued.
- Frequency of revaluation: Not specified.
- ✓ Downward Revaluation:
Debit revaluation Surplus to the extent recognized previously and balance -Charge to Profit or Loss A/c.
- ✓ Upward Revaluation:
Recognized in Revaluation Reserve.

Ind-AS - 16


- Approach: Can choose Cost Model or Revaluation Model as its accounting policy
- Adopted option as accounting policy will apply to entire class of PPE
- Frequency of revaluation: Sufficient regularity
- To ensure no material difference between Carrying Value (CV) & Fair Value (FV) at the end of the previous reporting period.
- ✓ Downward Revaluation:
Debit revaluation Surplus to the extent recognized previously and balance -Charge to Profit or Loss A/c.
- ✓ Upward Revaluation:
Recognized directly in Other Comprehensive Income & accumulated under Equity in revaluation surplus
- ✓ May be transferred to 'retained earnings', When assets is derecognized/ used by the entity (not through Profit & Loss)

Implication on IFC

- For First Time adoption of Ind-AS, The Process of Valuation of PPE from valuers for FV will need to be carried out.
- Corresponding changes in the Finance Module of the IT system regarding Revaluation Reserve and Retained Earnings will be needed to be made.

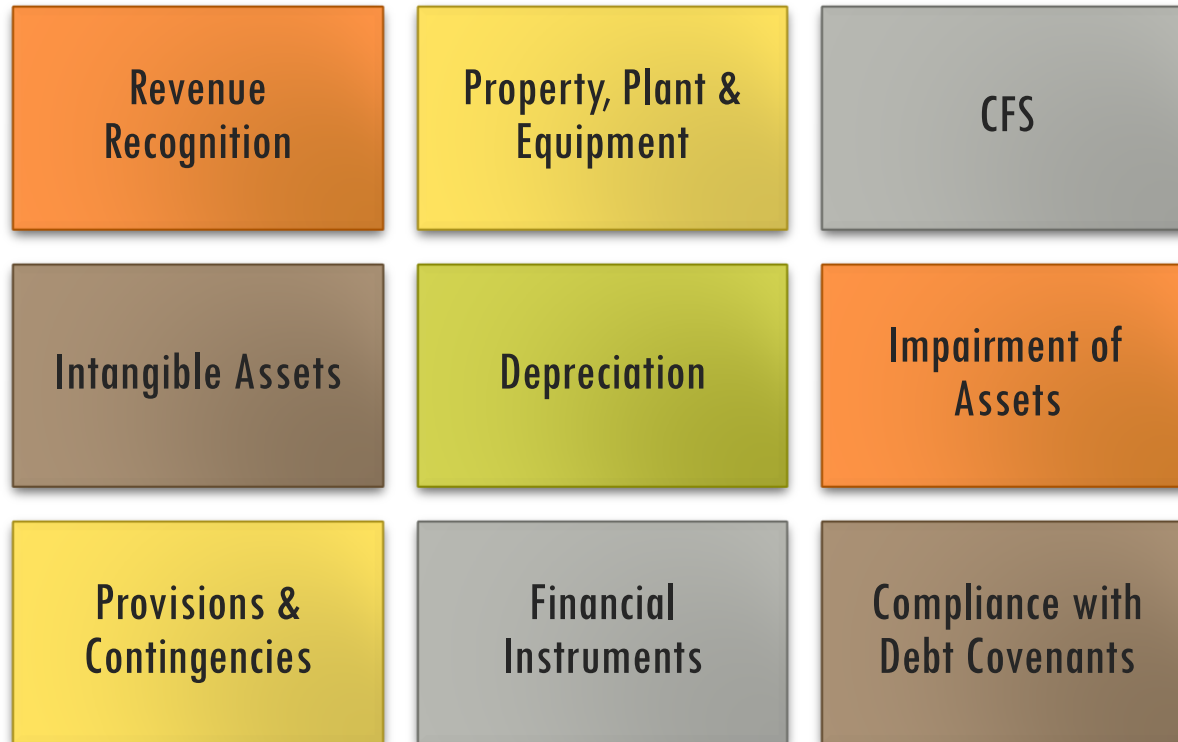


REVENUE RECOGNITION

Particulars	AS - 9	Ind-AS - 18	Implication on IFC
Customer Loyalty programmes (CLP)	<ul style="list-style-type: none"> ■ Technical guide on retail sector ■ Recognize 'Deferment Model' and 'Provision Model' ■ Per guide, deferment model is preferred 	<ul style="list-style-type: none"> ■ Award credits treated as different component of sales transaction. ■ Fair value of the award credits/ points - Estimated separately at the time of sales transactions and recorded separately. ■ Revenue of award services is required to be recognized when award credits are redeemed. 	<i>To be discussed</i>
<p>Multiple element arrangements</p> 	<ul style="list-style-type: none"> ■ ICAI issued technical guide on Accounting issues in retail sector ■ Deferment model is preferred model 	<ul style="list-style-type: none"> ■ Requires application of recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction ■ Book revenue when revenue recognition criteria is met 	<i>To be discussed</i>

CONCLUSION

It is clear the consequences are far wider than financial reporting issues and extend to various significant business and regulatory matters including :



To conclude, Ind-AS is not merely an accounting challenge. The impact on IT systems is also significant. The solutions lies in understanding the change, proper planning and starting early.



THANK YOU!

CA. Arnob Choudhuri

