

# **INTERNAL CONTROL SYSTEM in FINANCE & ACCOUNTS**

---

**By CA. K. Vidyadaran**

# Objectives of Internal Controls:

- Protect / Safeguard Assets
- Operate Efficiently
- Ensure Accuracy & Reliability in Accounting Data
- Generate Timely & Reliable Fin Reports
- Comply with Rules & Regulations
- Mitigate Risks
- Prevent Fraud / Theft / Pilferage
- Secure outside funding

# What is ICS:

- Rules, Policies & Procedures
- Implemented by an Orgn
- To ensure Accuracy of Fin Info
- To promote Accountability
- To protect Resources against Waste, Inefficiency, Fraud

## ICS comprises of CONTROL ACTIVITIES, such as

- Authorisation
- Documentation
- Reconciliation
- Security
- Segregation of Duties

## Control Activities divided into:-

- Preventive
- Detective
- Corrective

## Examples of Preventive Controls:

- Separation of Duties
- Approval of Transactions
- Access Controls
- Physical Controls
- Employee Screening

## Examples of Detective Controls:

- Reconciliation
- Variance Analysis
- Physical Verification
- Confirmation of Balances
- Audit Trails
- Log File

## Examples of Corrective Controls:

- Internal Audit
- Stock Adj Notes
- Root Cause Analysis

# For ICS to be effective, 5 Elements are essential:

- Control Environment
- Risk Assessment
- Control Activities
- Information & Communication
- Monitoring

These 5 Elements pronounced by COSO.

# COSO - Committee of Sponsoring Organisations

- American Institute of Certified Public Accountants - AICPA
- Institute of Internal Auditors - IIA
- Finance Executives Institute - FEI
- American Accounting Association - AAA
- Institute of Management Accountants - IMA

# COSO - IC Framework

“IC is a process effected by an entity’s Board of Directors, Management & other personnel  
Designed to provide reasonable assurance  
regarding the achievement of objectives in the  
following categories:

- Effectiveness & efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws & regulations
- Safeguarding of assets”



# Five Components / Elements of IC Framework:

## 1. CONTROL ENVIRONMENT:

- Control consciousness to be created
- Managers establish controls in their areas
- Control owners are Managers
- Controls are the responsibility of Auditee
- IC Manuals to be in place
- Policies & Procedure Manuals to be in place
- Controls to be implemented for Risks Mitigation

## 2. RISK ASSESSMENT:

- Risks Identification
- Risk Analysis / Evaluation
- Risk Profiling / Rating
- Risk Mitigation Plans  
(Four Ts: Transfer; Tolerate; Treat; Terminate)

### 3. CONTROL ACTIVITIES:

- Policies & Procedures to be followed
- IC Manuals in Place
- Activities: Preventive / Detective / Corrective
- Rules implemented consistently

### 4. INFORMATION & COMMUNICATION:

- Effective communication to personnel
- Top Mgt to communicate to all that Controls are a must / to be taken seriously

## 5. MONITORING:

- Supervision & Monitoring to see whether controls are operating properly
- Reconciliations, Confirmations, Exception Reports help in Monitoring
- Monitoring should be continuous / consistent
- Evaluation / Assessment of IC Performance to be done
- IC Deficiencies to be reported upstream appropriately
- Serious control weaknesses to be reported in Flash Reports
- Due to changing conditions of business, ICS has to be updated / evolved swiftly
- Timely training of people is essential

# ICS LIMITATIONS:

- Segregation of Duties becomes ineffective if there is Collusion
- No such thing as perfect Control System
- Inadequate staff strength entails weak segregation of Duties
- ICS will be weak due to Human Error, Stress, Fatigue, Mis-understanding of IC
- Encourage Compulsory Earned Leave; Enables unearthing of hidden irregularities
- Job Rotation & Cross Training are helpful
- Cost of Control not to exceed expected benefits

# INTERNAL CONTROLS in F & A

# INTERNAL POLICIES & PROCEDURES


- Leave Policy
- Travel Policy
- Discount Policy
- Credit Policy
- Security Policy
- Safety Policy
- Whistle Blower Policy

# STATUTORY COMPLIANCES

- Cost of non-compliance very high
- GST (3B, R1, 9, 9C)
- TDS (Deduction, Remittance, Returns)
- ITR (Tax, Adv Tax, MAT, ITRs)
- Cos Act (AOC-4, MGT-7, Regn of Charges, Regd Office, Dr Appointments, Minutes AGM, EGM, Board Meets, Virtual AGM - Video Recording)



- SEPARATION OF DUTIES - Authorisation / Custody / Record Keeping.
- APPROVALS - DOA Manual, Second sign in Cheq,
- ACCESS CONTROLS - Phy, Virtual, PW, Multi Level PWs, Lock, Doors, Cash Safe.
- Stock Audit - RM, BOP, WIP, FG, Consumables, Spares, Tools
- FA Audit - Phy Verification
- CASH COUNT
- CASH INSURANCE - Cash-in-Safe, Cash-in-Transit, Cash Fidelity
- STOCK & ASSETS INSURANCE - Fire, Transport, Theft, Loss of Profit, Key Man

- 
- Compliance Calendar
  - Trial Balance - (Compensating Errors excepted)
  - Data Back Ups - On-site, Off-site, Remote Back Up, GF-F-Son Technique
  - Employee Screening / Background Checking
  - Tax Planning / Tax Avoidance Vs Tax Evasion

# RISK MITIGATION MEASURES

- Risk Identification
- Controls Existing & Operating effectively
- Controls Testing
- Controls Gap
- Fix Control Weaknesses & Inadequacies
- Critical RM / Components from one major vendor
- 80% of Revenue from single customer
- Surprise Checks - Cash / Stock / FA
- Budget Vs Actual - Variance Analysis

# INVENTORY VARIANCE ANALYSIS

- Price Variance
- Quantity Variance
- Zero Variance
- FSN - Fast, Slow, Non Moving
- Non-Moving / Obsolete - Realise Scrap Value

# CHALLENGE THE BUDGET

- Budget is not sacro sanct
- Zero Based Expenses

# AGREEMENT WITH SERVICE PROVIDERS

- AMC for Plant / IT Systems
- MTBF - Mean Time Between Failure / Down Time / Up Time
- Confidentiality Agreement - NDA (Non Disclosure Agreement)
- Legal Vetting is a must
- Contract of Employment / Contract of Service with NDA

# PERFORMANCE MEASUREMENT - Ratio Analysis

- GP Ratio / NP Ratio - Productwise / Servicewise / Divisionwise / Branchwise
- Current Ratio
- Debt Equity Ratio
- Return on Capital Employed
- Performance against SMART Target
  - S** - Specific
  - M** - Measurable
  - A** - Achievable
  - R** - Realistic
  - T** - Time bound
- Asset Turnover Ratio

# CREATE RESERVES AS CUSHION

- One third of profit as General Reserve
- For Contingencies & Emergencies
- For Business Expansion
- For Product Recall Expenses
- For Merger & Acquisition
- Invest Reserves in Liquid Funds, FDs



# THANK YOU

---

**K Vidyadaran**  
**kvdharan@gmail.com**  
**9884716160**