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Internal Financial Controls /
Internal Control on Financial Reports

How SAP Business One helps?

IFC/ICFR Compliance – How SAP Business One helps?

As companies prepare to submit their financial reports for Audit and subsequently the audited ones to concerned government authorities, the subject of ICFR (Internal Controls on Financial Reporting) keeps bubbling up. As per the companies Act 2013, both the management (CEO, CFO, and Independent Directors) and Auditors have their responsibilities cut out. Top management has to ensure that the required policies and procedures are established to implement robust financial control mechanisms, systems are set up to ensure compliance with the provisions of all applicable laws, review that they are adequate & are being followed and finally certifying the same as a part of the Financial Reporting. Auditors report needs to have a section where they comment on whether the company has adequate internal financial control system and the operating effectiveness of the same.

This short article is an attempt to bring out the key high lights of expected compliance in the context of how SAP Business One, world class ERP solution for SME, has the required capabilities to make a strong contribution to this process.

What is Internal Financial Controls (IFC)?

As per Section 134 of the Companies Act 2013, the term 'Internal Financial Controls' means the policies and procedures adopted by the company for ensuring:

> Orderly and efficient conduct of its business, including adherence to company's policies,

> Safeguarding of its assets,

> Prevention and detection of frauds and errors,

> Accuracy and completeness of the accounting records, and

> Timely preparation of reliable financial information.

What is Internal Financial Controls over Financial Reporting (ICFR)?

A process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal financial control over financial reporting includes those policies and procedures:

> Pertain to the maintenance of record that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;

> Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

> Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements."

In other words, internal control over financial reporting (ICFR) may be defined as a process effected by a company's board of directors, management and other personnel, designed to provide reasonable assurance regarding the reliability of the financial reporting process and the preparation of the financial statements of the company in accordance with the generally accepted accounting practices.

Setting up Internal controls and monitoring them regularly is process that is effected by people from every level of the organization. The internal control system is intertwined with an entity's operating activities and exists for fundamental business reasons. Internal controls are most effective when they are built into the entity's infrastructure and are part of the essence of the enterprise. They should be "built in" rather than "built on." "Building in" controls can directly affect an entity's ability to reach its goals, and supports businesses' quality initiatives.

This is where SAP solutions in general and SAP Business One in specific comes into play in the context of SMEs. This application has the capability to allow the company to set any number of controls in the processes based on certain business logic. Since these controls are built into the system they are very effective. Also, since this application runs the entire business in an integrated manner, controls in one function has a corresponding effect on others. For example, if a control is set in such a way that vendor's invoice booking has to be necessarily done with reference to the goods receipt document, it not only prevents discrepancies between goods actually received versus billed quantity, but it also ensures that the accounts person cannot book the invoice, even inadvertently, without a supporting goods receipt transaction in the system.

Be it in the form of segregation of duties, user based authorizations, triggering approvals of documents automatically based on amount involved, controlling inventory level of items, auto closure of documents like PO and SO when the stated quantities are either received or dispatched respectively, controlling credit limits for customers, controlling payment terms with business partners etc., SAP Business One is equipped to handle a wide variety of controls in an automated manner, which helps companies in complying with the IFC/ICFR norms easily. Needless to mention, there are several other policies and procedures that may need to be defined outside of the system which will form the overall framework within which the company defines, implements, tracks and reports on the internal controls.

Following illustration puts the internal control concepts in perspective. As an example a simple customer invoice process has been considered. Last column which is titled as "Mapping in SAP Business One" has remarks indicating availability of such controls in SAP Business One.

Financial Statement Component	Significant Account	Process	Sub-Process	Control Objectives	Control Activity	Mapping in SAP Business One
Turnover	Sales	Revenue and Receivables	Customer Master	Only Authorised customer code exists	Access to Costomer Master is restricted per terms of the company policy.	Available in SAP Business One
			Product Master	Only the correct prices are used	Access to the Product Master is restricted.	Available in SAP Business One
					Prices field is automatically updated from the Product Master	Available in SAP Business One
			Order Processing	Product are dispatched in accordance with sales order	Delivery note is generated with reference to sales order	Available in SAP Business One
			Invoicing	Sale Invoice are accurate	Prices field is automatically updated from the Product Master	Available in SAP Business One
				Sale Invoice is generated for every shipment and work order	Customer invoices are automatically generated along with delivery note.	Available in SAP Business One
				Sale are recorded in the proper period	Management monitors sales and margins to ensure that they are aligned with expectations.	All information is available in SAP Business One, which can be drawn up as a report for management review

					The finance department reconciles sales in the general ledger with shipments on a weekly basis and follows up any reconciling items. This reconciliation is signed and filed.	Reconciliation process is available as standard in SAP Business One. Signing and filing is a manual process.
			Credit Limits	Credit period given are per the policy	There exists a pre-approval mechanism for deviations from the credit policy	Available in SAP Business One
			Sales Returns	Goods returned by customers are recorded in the appropriate period	Goods returned by customer at, before, or after end of an accounting period are scrutinized and reconciled to ensure complete and consistent recording in the appropriate accounting period.	Available in SAP Business One
Turnover	Sales	Revenue and Receivables	Sales Returns	Credit nots are accurately calculated and properly recorded	All credit notes are approved by senior management	Approval mechanism can be set in SAP Business One.

			Product Master	Only the correct prices are used	Nature, volume and amount of credit notes are reviewed every month	SAP Business One will give the report for the concerned teams to review.
					All returned goods are recorded in a register with customer name, nature of defect, quantity, date of receipt, quality assessment	Available in SAP Business One
	Excise Duty Collected	Revenue and Receivables	Domestic Sales	Excise duty has been correctly charged	Excise duty is defined in the Product Master and Customer Master	In SAP Business One excise duty is determined using customer master, vendor master and tax code.
					Billing system automatically captures excise duty while invoicing	Available in SAP Business One
Cash and Bank Balances	Bank Balances	Revenue and Receivables	Collections	All collections are recorded accurately and completely	All cheques/ drafts are centrally received by a designated authority	**This is a manual process**
					Bank reconciliations are prepared on a weekly basis and reviewed	**Bank reconciliation functionality is available in SAP Business One.**
					Management reviews the status of receivables each month.	**This is a manual process**

Another example could be related to cost of goods sold where a control objective could be to have accurate costing of produced items. This has a dependency on several factors like cost of raw material, consumables, packing and final cost of direct overheads. SAP provides robust controls to ensure that these cost elements are controlled by authorised persons, material consumption tracking as per Bill of material, tracking of variance in any and so on.

Companies may note that SAP Business One comes out with flying colours when it comes to enabling any company on complying with IFC/ICFR to the extent of providing "Built In" controls on several business transactions to prevent any misuse.

References:

1. Guide to Internal Controls over financial reporting published by ICAI
2. Article on IFC by Nikunj Parekh

"Please get in touch with Praxis Info Solutions by writing to - **marketing@praxisinfosolutions.com** to know more about Value Adding Potential of SAP Business One."