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Adani Power Group

Internal Financial Controls ("IFC") Policy

April 2015

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## DOCUMENT CONTROL SHEET

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**Authorized By: Board of Directors and Audit Committee**

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## **1. Applicability**

This policy is applicable to Adani Power Group and covers regional offices, manufacturing units and corporate functions.

"Power group" includes Adani power limited and its subsidiaries.

This framework shall be applicable from **1<sup>st</sup> April, 2015**.

### **Introduction**

The Internal Financial Controls ("IFC") policy is an integral part of the overall internal financial controls framework of the Company. It supports compliance with requirements of the Companies Act 2013 in relation to Directors' Responsibility Statement. It may be applied for evaluation of internal financial controls by the respective control owners. This would enable them to sign off that the internal financial controls are operating effectively in their respective functional area.

The purpose of this document is to provide a framework to govern and evaluate the process of internal financial controls assessment. The Committee of Sponsoring Organisations of the Treadway Commission ("COSO") has issued the Internal Control - Integrated Framework 2013, which forms the guidance used in developing this policy.

The objective of this policy is to assist the Power Group in evaluating the operating effectiveness of internal financial controls in a consistent manner. This policy gives guidelines for the procedures to be adopted to identify, report, and remediate deficiencies existing in the Power Group's controls. The framework may be integrated with the Internal Audit Plan.

## **2. Legal requirements In India**

### **Section 134(5)(e) of the Companies Act, 2013**

*"The Directors' Responsibility Statement referred to in clause (c) of sub-section (3) shall state that, the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively."*

### **Section 143(3)(i) of the Companies Act, 2013**

*"The auditor's report shall also state whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls"*

### **Section 177 of the Companies Act, 2013**

*"Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall inter alia include evaluation of internal financial controls and risk management systems".*

### **Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014**

*"The report of the Board shall also contain the details in respect of adequacy of internal financial controls with reference to the Financial Statements".*

**Section IX of the Revised Clause 49 in the Listing Agreement with SEBI dated April 17, 2014 and Corporate Governance in listed entities - Amendments to Clause 49 of the Equity Listing Agreement dated September 15, 2014**

*"The CEO or the Managing Director or manager or in their absence, a Whole Time Director appointed in terms of Companies Act, 2013 and the CFO shall certify to the Board that:*

*They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.*

### **3. Internal Financial Controls and Internal Controls over Financial Reporting**

#### **3.1 Internal Financial Control ("IFC")**

Internal financial control as defined under **Section 134(5) (e) of the Companies Act, 2013** refers to "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,
- timely preparation of reliable financial information. Internal Financial Control is not solely a policy or procedure that is performed at a certain point in time, but rather a continuous process operating at all levels within the Company."

It is a process affected by the Board of Directors, Audit Committee, CEO / COO/ CFO, and all levels of personnel, by which the organization gains assurance that its risks are understood and managed in dynamically changing contexts.

#### **3.2 Internal Control over Financial Reporting ("ICFR")**

This policy also focuses on internal controls over financial reporting that are put in place to develop and maintain reliable financial data, and to accurately present the same in a timely and appropriate manner.

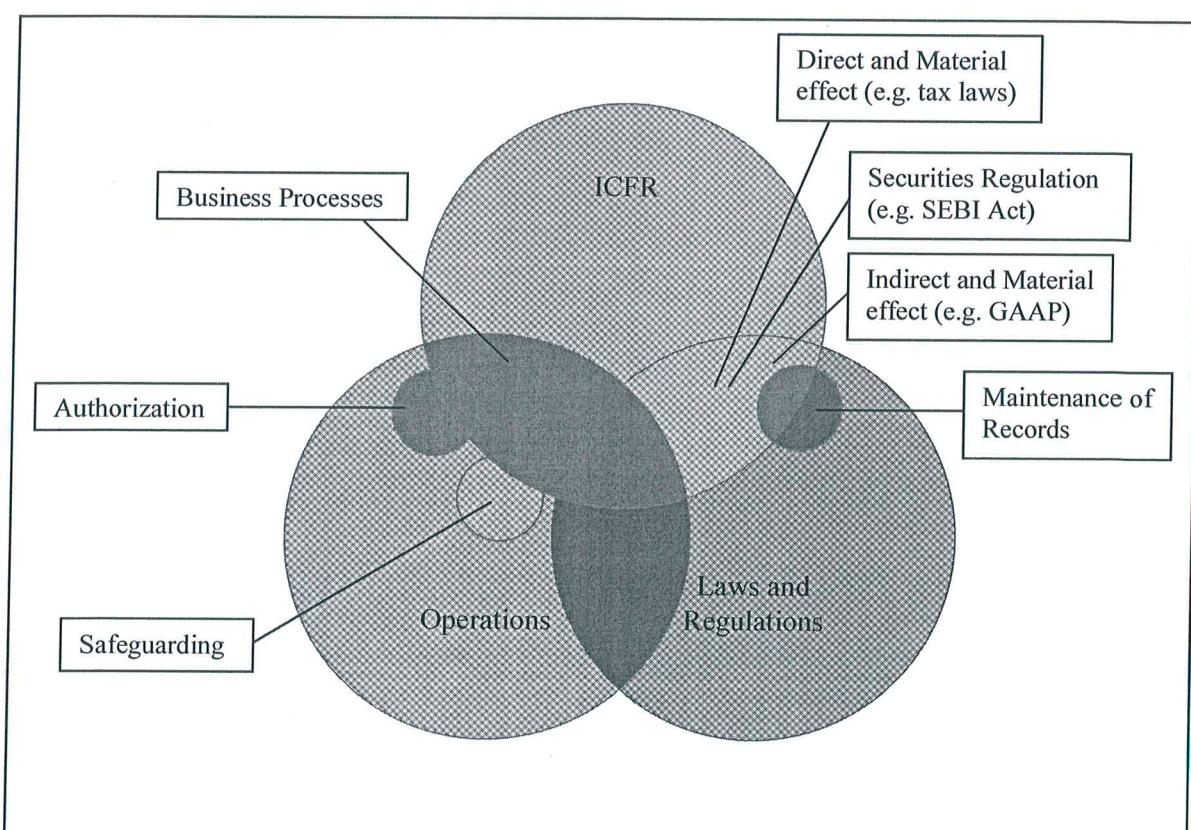
ICFR as defined in guidance note on "Audit of IFC over Financial Reporting" refers to :

"A process designed by, or under the supervision of, the Company's principal executive (CEO) and principal financial officers (CFO), or persons performing similar functions and effected by the Company's Board of Directors, management, and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records 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 the 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.

The above definition of ICFR includes the controls that ensure 'effectiveness and efficiency' of a Company's operations and 'compliance with applicable laws and regulations' *to the extent that those directly relate to the preparation of financial statements*.

The inter-section of controls that are considered under this policy is depicted in the diagram given below:



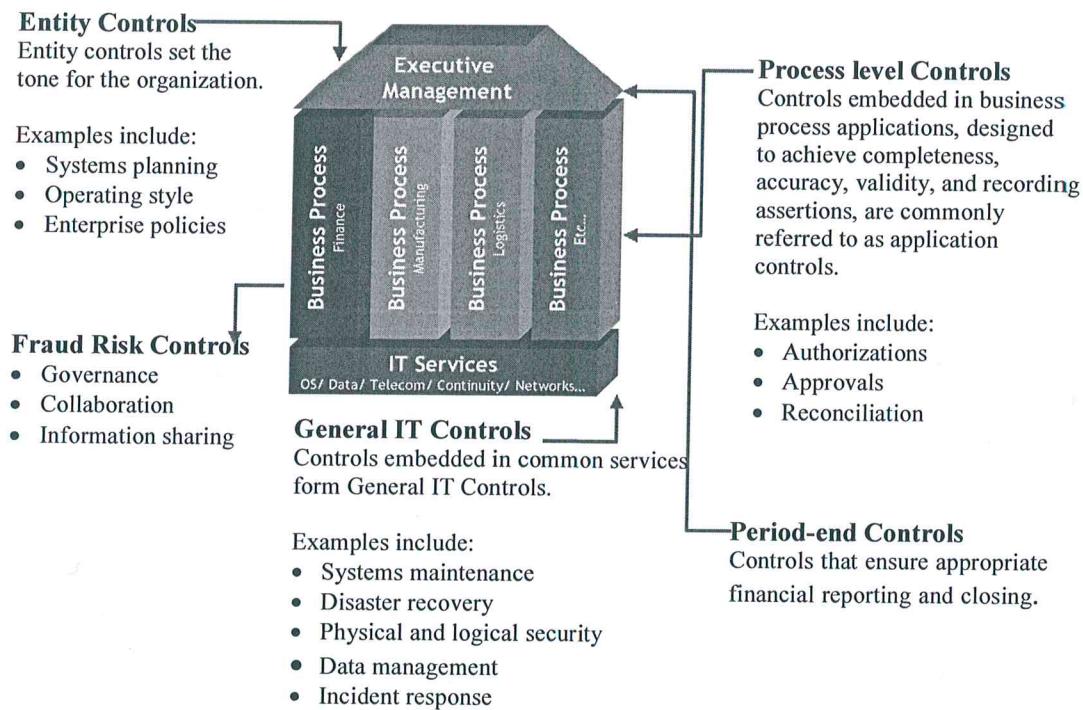
### 3.3 Internal Financial Controls Components

IFC framework consists of internal controls defined at following levels:

- Entity Level ("ELC")
- Process Level ("PLC")
- General IT Controls Level ("ITGC")

In addition, there may be internal controls that deter or detect frauds (termed as "Fraud risk controls") and controls that ensure appropriate financial reporting and closing procedures (termed as 'period-end financial reporting and closing controls'). Such controls may be combination of category mentioned above.

A diagrammatic representation as to where the controls are placed in any organization is given below.



Each component is explained briefly in ensuing paragraphs.

#### 1. Entity Level Controls

Entity level controls are the controls that management relies on to establish the appropriate "tone at top." These often have a pervasive impact on the effectiveness of controls at the process, transaction, or application level.

Examples of entity level controls would include:

- Controls to monitor ethics and integrity within the organisation (Code of conduct/Vigil policy)

- management's risk assessment process (Enterprise Risk Management);
- controls to monitor results of operations; (Board of Directors and Audit Committee)
- period – end financial reporting controls (Finance Statement Closure)
- approved policies and procedures (Accounting policies and procedures).

## **2. Process Level Controls**

Process level controls are those aimed towards achieving objectives of each process within the Company. Each of these controls will usually address objectives of a particular business function, such as Sales, Manufacturing, Supply Chain, treasury, payroll, etc. and are placed within operational processes. These controls would primarily impact only the processes within which these are placed.

Examples of process level controls:

- Bank reconciliation process
- Authorisation limits for approvals
- Controls over fixed assets register
- Master File maintenance

The process level controls may be manual or automated controls. Testing of Process Control affecting financial reporting is being continuously monitored and the testing is also being done by the Statutory Auditors.

## **3. General IT Controls**

General IT controls are "controls that provide reasonable assurance of achieving the control objectives related to the processing of financial information within the computer processing environment". These controls ensure appropriate functioning of IT applications and systems built by the organization to enable accurate and timely processing of financial data. General IT controls are embedded in the common IT services across systems, data and infrastructure of the organization.

These controls have a 'pervasive' impact on all the processes and functions supported by those systems. As a general rule, these controls impact the achievement of the financial statement assertions germane to critical processes by supporting an environment that provides for the integrity of processing and data.

Example of general IT controls would include:

- Security administration controls
- Application change management controls
- Database management and back-up / recovery controls
- Data centre operational controls and problem management procedures
- Access controls at database, application and OS level.

SAP including other applications having impact on the financial statements would be considered for evaluating ITGC:

*\* Any change in adding/deleting IT system in the scope of ITGC will be approved by the IFC Steering Committee.*

#### **4. Fraud Risk Controls**

Fraud Risk controls are related to the prevention, deterrence, and detection of fraud. These are controls intended to mitigate the risk of fraudulent actions that could have an impact on financial reporting. Adani Power Group has considered Fraud Risk controls as part of either the entity level controls or process level controls, wherever applicable.

##### **3.4 Inherent limitation to Internal Controls**

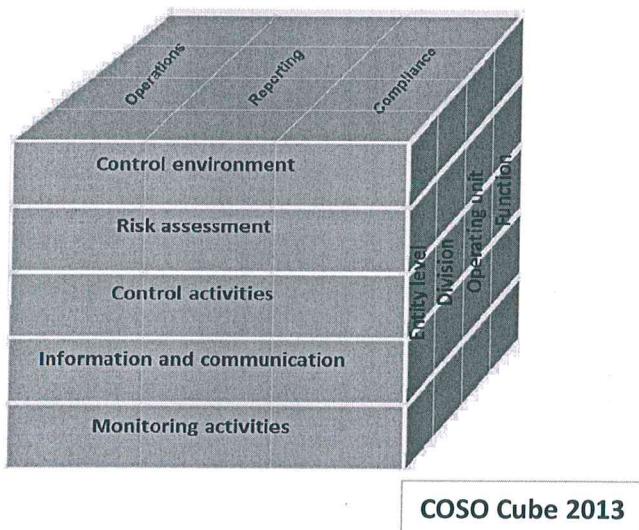
Internal controls cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal controls is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

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## 4. Internal Controls Framework

### 4.1 COSO Framework – Components and Principles

Adani Power Group has adopted the COSO framework as guidance, for formation of its Internal Financial Controls Framework. The Framework sets out seventeen principles representing the fundamental concepts associated with each component. Because these principles are drawn directly from the components, an entity can achieve effective internal control by applying all principles. All principles apply to operations, reporting, and compliance objectives.



The principles supporting the components of internal controls are listed below.

#### Control Environment

1. The organization demonstrates a commitment to integrity and ethical values.
2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.
3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

#### Risk Assessment

6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.

8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.
9. The organization identifies and assesses changes that could significantly impact the system of internal control.

### **Control Activities**

10. The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
11. The organization selects and develops general control activities over technology to support the achievement of objectives.
12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.

### **Information and Communication**

13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.
14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
15. The organization communicates with external parties regarding matters affecting the functioning of internal control.

### **Monitoring Activities**

16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.
17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

## **4.2 Definitions (of words used in design of Risk and Control Matrices)**

### **Risk**

Risk is a direct or indirect loss resulting from inadequate or failed internal processes, people and systems, or from external events. It also can be defined as an anticipated event or action that has a chance of occurring, which may result in a negative impact.

### **Control activities**

The policies, procedures, practices, and organizational structures designed to provide reasonable assurance that the business objectives will be achieved and undesired events will be prevented or detected.

### **Control owner**

Person who has been assigned responsibility to manage process and control activities to achieve the desired objective.

### **Key Control**

A key control is a control that, if it fails, means there is at least a reasonable likelihood that there would be a material impact on the company which would not be prevented or detected on a timely basis. In other words, a key control is one that is required to provide reasonable assurance that material errors will be prevented or timely detected.

Example:

- Existence of inventory provisioning policy

### **Non-Key Control**

Any control which is not a key control to be classified as Non key Control.

### **Preventive Control**

Preventive controls are intended to prevent the occurrence of an activity that is not consistent with control objectives.

Example:

- An automated control that automatically rejects disbursement requests beyond the established credit limit occurs at the point of initiation of a transaction.
- A manual control that requires a separate review of each journal entry prior to its posting
- Application access controls.

### **Detective control**

Detective controls are intended to identify errors or unauthorized activities after they have occurred so that corrections can be made in a timely manner

Example:

- Review and analysis of financial results
- Review of bank reconciliations

### **Fraud Risk Controls**

Fraud Risk controls are related to the prevention, deterrence, and detection of fraud. These are controls intended to mitigate the risk of fraudulent actions that could have an impact on financial reporting.

Example:

- Change of vendor bank account without requisite approvals and supporting
- Business conducted with related parties without providing appropriate declarations

### **4.3 Financial Statement Assertions**

Financial statement assertions are management's explanation about the recognition, measurement, presentation and disclosure of information in the financial statements

- |                            |   |
|----------------------------|---|
| ■ Completeness             | - All transactions are not recorded                         |
| ■ Validity                 | - Recorded transactions are not valid                       |
| ■ Accuracy                 | - Transactions are inaccurately recorded                    |
| ■ Cut-off                  | - Transactions are recorded in accounts in the wrong period |
| ■ Valuation                | - Assets or liabilities are incorrectly valued              |
| ■ Presentation             | - Account balances are presented in a misleading way        |
| ■ Existence/Occurrence     | - Relevant supporting does not exist for the control        |
| ■ Management Authorisation | All transactions are not authorized                         |

### **4.4 Controls Documentation**

Adani Power Group maintains the following documentation that provides reasonable support for its assessment of the effectiveness of IFC covering:

- Standard Operating Policies and Procedures ("SOPs") – This document captures the logical flow of processes within each business cycle and includes
  - Roles and responsibilities of the personnel involved in the process
  - Information about how significant transactions are initiated, authorized, recorded
- Risk Control Matrices – This document captures controls over relevant assertions related to all significant processes: Controls designed to prevent or detect fraud, including who performs the controls and the related segregation of duties
  - Controls over the period end reporting process
  - Controls over safeguarding of assets

Controls would be categorized as key/ non – key. Any preventive control which by itself mitigates the risk would be categorized as key control and control which operates in Correlation with other controls to mitigate the risk would be categorized as a non-key control.

- The results of operating effectiveness testing and evaluation by management

### **4.5 Change Management Process for controls documentation**

- Any changes made to the designed key control will be required to be go through a change management procedure
- All changes to key controls activities will be required to be approved by the IFC SteerCo
- All other changes will be approved by the Process and Control Owners
- Changes needs to be recorded in the Change Management template

- Summary of all changes would be presented to the Audit Committee by IFC SteerCo. on periodic basis.

## 5. Internal Financial Controls Organization

The process of assessment of IFC would require setting up of an internal controls function in the organization. IFC SteerCo has been put in place to implement and evaluate the design and operating effectiveness of the IFC framework (ELC, PLC, ITGC)

- The Structure and roles and responsibilities of the IFC SteerCo. is given below:

***Steering Committee:***

- Chief Executive Officer
- Chief Financial Officer
- Head Business Development
- Chief Operational Officer
- Head IT
- Head Internal Audit
- Head ABEX
- Controller's

***Internal Financial Control team:***

- Internal Auditor
- Process and control Owners
- IT personnel's

- Roles and Responsibilities:

Entity	Responsibility
IFC SteerCo	<ul style="list-style-type: none"> <li>▪ Monitoring the implementation of this policy across the organization</li> <li>▪ Monitoring implementation of IFC framework (ELC, PLC, ITGC)</li> <li>▪ Decide materiality thresholds and testing strategies and frequency</li> <li>▪ Review of reports on testing of internal controls</li> <li>▪ Review of the action plans recommended for strengthening the internal controls and place significant deficiencies/material weakness to the Audit Committee</li> <li>▪ Obtain certificates from identified process and control owners as to the assessment of the internal financial controls</li> <li>▪ Maintain the framework up-to-date for changes in organizational practices</li> </ul>
IFC team (also known as testing team/evaluator)	<ul style="list-style-type: none"> <li>▪ Implementation of IFC framework</li> <li>▪ Draw up the testing plan (Test of Design – TOD and Test of Operating Effectiveness - TOE)</li> <li>▪ Conduct testing of TOD and TOE</li> </ul>

	<ul style="list-style-type: none"> <li>▪ Discuss deficiencies with process / control owners and agree upon the remediation plan</li> <li>▪ Submit reports on testing of internal controls <del>to</del> the IFC SteerCo</li> <li>▪ Ensure change management</li> </ul>
Process and Control Owners	<ul style="list-style-type: none"> <li>▪ Responsible for the implementation and operating effectiveness of the controls</li> <li>▪ Communicate with the IFC team any changes in the process or internal control in their respective functional area</li> <li>▪ Co-operate with the IFC team to conduct test of controls</li> <li>▪ Discuss the control deficiencies and agree upon the remediation plans</li> <li>▪ Implement remediation plan</li> <li>▪ Sign-off risk-control matrices to evidence the results of tests / remediation actions</li> </ul>

## 6. Internal Financial Controls Testing

### 6.1 Approach

Testing of controls are proposed to be carried out to determine whether implemented internal controls are operating effectively during a relevant period.

Testing is proposed to be carried out for all categories of internal financial controls, viz. entity controls, process controls and IT controls. The frequency of testing of the IFC framework would as recommended by the IFC SteerCo. Based on the recommendation, the testing plan should be drawn up to ensure that entity and IT controls are tested prior to testing of the process level controls.

Entity and IT controls are pervasive controls that have impact on processes of the Company. If entity and IT controls are strong, it creates a strong controls environment that ensures better working for process level controls. Hence consideration should be given to the effectiveness of pervasive controls while determining approach and extent of testing of process controls.

Testing of IFC provides only a *reasonable assurance* and not *absolute assurance* about controls effectiveness. To arrive at the standard of *reasonable assurance* management must consider what a reasonable person might conclude given the facts and circumstances.

### 6.2 Independence in testing

The testing team (also referred to as IFC team/Evaluator) will be independent from day to day functioning of the respective controls, since a person cannot test his or her own area of operation. The testing team may be selected from other functions, from independent internal audit or third party agencies, to bring the necessary independence.

### **6.3 Test of Design ("TOD")**

- Test of Design of controls is performed to obtain understanding of each controls to ensure reasonable assurance that the controls are designed effectively to address/mitigate the risks in the identified process. The TOD enables planning the nature, extent and timing of Test of Operating Effectiveness of controls

The test of design of a relevant control confirms the understanding of the controls (e.g., the detailed control description) and provides the basis to evaluate whether the controls are designed effectively.

### **6.4 Test of Operating Effectiveness ("TOE")**

Operating effectiveness refers to whether the control is functioning as expected. The testing team will gather evidence regarding how the control was applied, the consistency with which it was applied, and who applied it.

A deficiency in operation exists when a properly designed control does not operate as designed, or when person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

For example, having lock and key system for the server room, but failure to lock the room on a daily basis would mean operating deficiency.

### **6.5 Types of deficiencies**

The deficiencies identified during testing will be categorized on the following basis:

#### **Control Deficiency**

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. Any control weakness observed during testing may be *first classified as control deficiency*.

#### **Significant Deficiency**

A significant deficiency is a control deficiency if any of the key control is failed.

#### **Material Weakness**

A material weakness is a control deficiency if any of the key control is failed having material impact as defined below.

### **6.6 Testing Techniques**

#### **6.6.1 Test of Design:**

- A "test of design" of a relevant control includes inquiry of personnel involved in the performance of the control, supplemented by a mix of observation of how the control is performed

- The test of design for each process can be undertaken based on changes in people, process and technology either on periodic basis or as determined by Steer Co

### 6.6.2 Test of Operating Effectiveness

Tests may be conducted through one or more of the following procedures:

- |               |   |
|---------------|---|
| ▪ Inquiry     | - Questionnaire or Interviews with the concerned personnel                                    |
| ▪ Inspection  | - Verifying the relevant documentation  |
| ▪ Observation | - Observing personnel perform the control activity  |
| ▪ Retesting   | - Reprocessing of a sample of transactions to determine whether they were processed correctly |

Each of the techniques is explained briefly:

#### Inquiry:

This can be an effective way to corroborate or follow up on evidence gained through other testing methods. Following are certain examples for information that responses to inquiries might provide:

- The skill and competency of those individuals performing the control
- The relative sensitivity of the control to prevent or detect errors
- The frequency with which the control operates

Effective inquiries lead to subsequent inspection and observation techniques. Inquiry, by itself, is inadequate to support controls assessment. However, it acts as a technique for assessing operating effectiveness of controls.

#### Inspection:

This provides higher level of evidence. For e.g. sampling for attributes can provide compelling evidence that controls over routine transactions are performing as intended. It involves inspecting documents, review of procedures, etc.

#### Observation:

This is an effective technique for testing such controls as physical safeguards and segregation of duties as well as noting specific individuals in action as they execute documented controls.

#### Re-testing:

This method provides highest level of evidence. It involves selecting transactions and re-performing the control, including all procedures and processes involved, to check if it is working as intended. For example, re-calculating the interest/ depreciation amount, and then comparing the same with amounts booked is a re-testing technique.

## **6.7 Extent of testing**

While drawing up the testing plan, the IFC team along with the Process and Control owners has to decide following aspects to determine the extent of testing required:

- Nature, size and composition of an account or group of accounts (e.g. revenue)
- Accounting and reporting complexities associated with an account
- Volume, size, complexity, and homogeneity of the individual transactions processed through a given account or group of accounts
- Materiality and significance of possible errors and omissions (defined below)
- Problem areas from prior years that may require attention
- Changes in account characteristics since the prior year

### **Materiality:**

Materiality to decide the extent of testing and reporting on control deficiencies may be decided on the basis of previous audited financial based on either of the following:

- 10% of Profit after Tax
- 3% of Net Assets (Total Assets minus Current Liabilities)
- 1% of the revenue

\* The materiality level may be decided/revised in mutual consultation with the Statutory Auditors on an annual basis.

Using the criteria selected and approved by the management, the testing team shall prioritize the internal financial controls to be included in the testing plan.

## **6.8 Developing a test plan**

The steps involved in developing a test plan would be as follows:

### **6.8.1 Determining testing objectives**

Tests of controls provide evidence about effectiveness of operations of controls. Objective of operating effectiveness testing is to answer two questions

- Do the controls perform as designed?
- Do authorized and competent people execute the controls?

### **6.8.2 Define failure conditions**

Defining what constitutes a "control failure" up front for each control tested before beginning testing is an effective way for management to direct the testing effort. A "failure condition" in testing is a departure from "acceptable" or "effective" performance of the prescribed control activity. For e.g. a failure condition may be defined as an error rate in the sample that management is unwilling to accept because it exceeds management's maximum tolerable error rate. Accordingly, as per the testing plan in a sample size of 25, in case if there is failure in 1 sample, the sample size to be revised to 40 and the control will be treated as "fail" in case of failure in 2 samples.

### **6.8.3 Define the population**

In financial reporting, the "population" consists of all the items constituting an account balance or a class of transactions subject to testing. It is important to articulate the characteristics of the population from which a sample is to be selected in a manner that can be related to specific control objectives.

For example, a risk that income may not be recorded for all loans (relevant to the assertion 'completeness') should be tested based on the population of loans and not from the population of recorded incomes. Similarly for testing the risk of incomes being recorded without corresponding loans being disbursed (relevant to the assertions 'existence' and 'cut off'), the sample should be selected from the recorded population of income.

All items in the population should have an opportunity to be selected. Random-based selection of items represents one means of obtaining such samples.

### **6.8.4 Determine sample size**

Process Level Controls:

Following guidance should be considered when determining the sample size to be selected:

- If these controls are critical to the achievement of stated financial reporting assertions and oversight is limited to manual supervision, management should consider more extensive sample sizes
- More frequently a manual control operates and / or the more important the control, more extensive the testing
- If there is a single control relied on versus a number of compensating controls, then management should expect to test more items for that particular control
- As a general rule, the more complex a manual control, the greater number of items to test
- Test more extensively the controls that support effectiveness of other controls
- For an automated control, the number of items that should be tested is generally minimal assuming IT general controls have been tested and found to be effective

Number of samples to be drawn would depend upon:

### **6.8.5 Frequency of operation of controls**

Generally, more frequently a manual control operates, more operations of the control the evaluator should test. For example, for a manual control that operates in connection with each transaction, the evaluator should test multiple operations of the control over a sufficient period of time to obtain a high level of assurance that the control operated effectively. For controls that operate less frequently, such as monthly account reconciliations and controls over the period-end financial reporting process, the evaluator may test significantly fewer operations of the control to arrive at the same conclusion.

### **6.8.6 Importance of the control**

Controls that are relatively more important should be tested more extensively. For example, some controls may address multiple financial statement assertions, and certain

period-end detective controls might be considered more important than related preventive controls. The evaluator should test more operations of such controls or, if such controls operate infrequently, the evaluator should evaluate each operation *of* the control more extensively.

Sampling table may be drawn-up based on the parameters discussed above. An illustrative sampling table is given below:

The sample sizes\* are given below:

### **Process Level Controls**

<b>Frequency of performance of the control</b>	<b>Minimum number of Selections</b>	
	<b>Lower risk of failure</b>	<b>Higher risk of failure</b>
Recurring manual controls (multiple times a day)	25	40
Daily	15	25
Weekly	5	8
Monthly	2	3
Quarterly (including period end)	2	2
Annual	1	1

\* The sample size may be increased depending upon criticality of the controls as decided by the IFC SteerCo.

### **Entity Level Controls ("ELC")/ Information Technology General Controls ("ITGC"):**

**ELC:** Entity level Controls are critical controls which needs to be adhered to irrespective of frequency and type of controls. All the controls are classified as "key controls" and needs to be tested for one sample transaction. Failure of this sample would be treated as significant deficiency.

**ITGCs:** All the controls needs to be tested for one sample transaction. Failure of this sample would be treated as significant deficiency

#### **6.8.7 Testing Documentation**

Documentation should be maintained for the test plans, test results and samples. Correct documentation of test plans, test results, and the evidence collected is of paramount importance. The drafting should be in such a manner so as to satisfy the "re-testing" of the test plan. (i.e. if any other team, such as external auditor, performs the same test plan at a later time, the same result is obtained.) This is important to provide a basis for potential reliance on management's work by third parties.

### **6.8.8 Evidence**

For all the tests performed, it is essential that evidence should be documented and retained appropriately. The evidence should be sufficient to prove the results of testing and to enable the re-testing by independent person, if need be.

Following guidelines may be followed in this regard:

- For tests through inquiry, the names and designations of persons interviewed, location, etc. should be documented. If any questionnaire has been circulated, the copies of the same should filed appropriately;
- For tests through inspection, the details of the document inspected should be recorded. If relevant, photocopies of the extracts of relevant documents inspected may be filed as evidence;
- For tests through observation, the details of function observed, for e.g. name of person doing the activity, date and time of observation, location, should be recorded;
- For tests through re-testing the details of the documents referred to and verified should be recorded. The photocopies of relevant documents may also be filed;
- Supporting documents, like minutes of the meeting, e-mails, other correspondence may be added as evidence, wherever appropriate.

### **6.8.9 Evaluating exceptions**

The results of each test must be evaluated. When exceptions to or deviations from the control design occur, the evaluator should understand the reasons for exception or deviation. The evaluator would collaborate with the process owner to consider whether:

- The error rate noted in the sample exceeds the predefined acceptable error rate planned for the test (i.e., management's tolerable error)
- An exception noted for a small judgmental sample is potentially a problem
- The identified error(s) is(are) inadvertent or intentional
- Failure of an automated control requires input from a technology expert to understand the implications
- The degree of intervention by process personnel contributes to the exception or deviation
- Management became aware of the exception or deviation on a timely basis
- Management responds to the exception or deviation on timely basis
- The root cause of exception or deviation is understood
- Remediation is necessary.

The evaluator would also need to consider compensating, complementary or redundant controls that may achieve the control objective, even if control in question has failed. Each of these control types are explained below in brief:

- Compensating controls: are controls that operate at the same level of precision that would result in the prevention or detection of a misstatement, if any, in annual or interim financial statements.
- Complementary controls: controls that function together to achieve the same control objective.
- Redundant controls: controls that achieve the same control objective.

The evaluators and process owners should understand:

- What constitutes effective and ineffective control operating performance

- The sampling approach used and the nature of errors identified
- Implications of control failures
- Approach to communicating and remediating control deficiencies.

All exceptions should be discussed with the process/control owners and their management response should be incorporated.

#### **6.8.10 Finalizing conclusions and sign-off with the process and control owners**

Once the evaluator and process and control owner have analyzed each exception or deviation (as mentioned above, the conclusion for each test should be finalized and documented. These should be escalated to the required levels of management for remediation.

All controls should be signed-off by the testing team and respective control owner to indicate their agreement on the results of the testing.

#### **6.8.11 Escalation of exceptions**

When the testing team faces control deficiencies or gaps, the team must evaluate the nature of the identified deficiencies and accordingly escalate them for remediation action to the respective control owner or the steering committee. The escalation levels may depend on the nature of control in question, remediation effort required, cost and time considerations for remediation and locational considerations.

### **6.9 Dealing with Deficiencies**

#### **6.9.1 Control Deficiencies**

These may be dealt with at the level of process/control owners. The process owners would obtain approval from the respective functional heads/Business Head and implement the action plan for remediating the deficiency.

#### **6.9.2 Significant Deficiencies and Material Weaknesses**

Significant Deficiencies and Material weaknesses have to be evaluated by the IFC team along with the process and control owners and reported to the IFC SteerCo on a periodic basis (Annually or shorter term) along with the agreed remediation plan. The responsibility for implementation of the remediation plan within the defined timeline would be with the process owner / person specified for taking the action.

The IFC SteerCo will validate the report and submit to the Audit Committee.

#### **6.9.3 Remediation monitoring**

Remediation plan approved by the IFC process and control owners needs to be monitored for implementation as per the defined timeline. IFC team needs to periodically monitor the implementation of the remediation plan by the process and control owners. Deviation from the agreed remediation plan/timeline would be highlighted to the IFC SteerCo.

## **7. Certification**

Based on the results of the testing, the process and control owners have to issue the certificate to the IFC SteerCo.

Report on significant deficiencies and material weakness will be reviewed and validated by the IFC SteerCo and submitted to the Audit Committee on periodic basis.

The above certifications/signoffs would provide a basis for the Audit Committee to evaluate IFC framework and the Board of Directors to sign-off on adequacy and operating effectiveness of IFC framework.

## **8. Re – testing**

Once remediation plans have been implemented successfully and the controls are fully functional, the controls would have to be tested again. The testing for these should be conducted only after sizeable transactions have occurred under the purview of these controls. For e.g.

- If the control is being used several times a day or once a day, at least one month should have passed before the control effectiveness can be tested;
- If the control is being used once a month, at least one quarter should have passed before it can be tested;
- If the control is being used once a quarter, at least six months should have passed before it can be tested.

Based on the results of re-testing, the IFC team and respective process and control owners responsible for functioning of the control will certify to the IFC SteerCo as to operating effectiveness of the control.

## **9. Engaging with external auditors for IFC opinion**

As per the recent Companies Act 2013 and other related regulation, the external auditor is required to state in auditor's report about the adequacy and the operating effectiveness of the Internal Financial controls of a company.

In exercising the duties and forming opinion, the external auditor would seek help in understanding the financial process and controls around it. In this regard Internal Financial Control team will make the organization ready to face the audit on internal controls and also assist auditor to understand controls and form their opinion on design and operating effectiveness.

## **10. Role of Internal Auditor in Internal Financial Controls**

- Internal Audit and Internal Financial Control are both component of management controls, established at Power Group level for achieving the identical objectives.
- The audit plan of the Internal Audit may be integrated to cover the design and operating effectiveness testing of the controls identified in the Risk and Control Matrix of the respective processes which may form a basis for Audit Committee/Board to comment on adequacy and the operating effectiveness of the Internal Financial controls of a Power Group.

## **11. IFC Policy Change Management**

All changes to IFC policy due to changes in legal requirements/framework/management to be initiated by IFC SteerCo and approved by the Audit Committee. The review of the IFC policy would be made at periodic interval (once in three years).