The Implementation of Internal Control Over Financial Reporting (ICFR)

Frequently Asked Questions

Introduction

The implementation of Internal Control Over Financial Reporting (ICFR) is a critical aspect of ensuring the accuracy and reliability of financial statements. With the evolving regulatory landscape and the increasing emphasis on corporate governance, many organisations have questions about how to effectively implement and maintain ICFR.

This document aims to address some of the most frequently asked questions regarding ICFR, providing clarity on regulatory and reporting requirements, implementation strategies, handling control deficiencies, the role of internal audit, and other pertinent issues. Whether you are a public interest entity (PIE) or a public company, understanding these aspects is essential for compliance and for fostering stakeholder confidence in your financial reporting processes.

Regulation and Reporting Requirements

1 Which companies are affected by the requirement to report on internal control over financial reporting?

The Financial Reporting Council (FRC) Act of 2011 amended in 2023 requires the management of every PIE to establish and maintain a system of ICFR that provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Generally Accepted Accounting Principles. While the Investment and Securities Act 2007 (ISA 2007) of the Securities and Exchange Commission (SEC) in section 60 to 63, provides the financial reporting requirements for public companies. It requires that 'the board of directors of a public company shall report on the effectiveness of the company's internal control system in its annual report (section 61 (2)).

2 When is the effective date for implementation and reporting?

To ensure compliance with regulatory requirements, two bodies have set specific dates for the implementation and reporting of ICFR:

FRCN: PIEs are required to report on ICFR effective for annual periods ending 31 December 2024.

SEC: SEC requires public companies to report on ICFR in annual reports from December 2023 financial year end.

3 How is this requirement different from previous reporting requirements?

The directors were previously responsible for the preparation of the financial statements that give a true and fair view in the applicable financial reporting framework. They were also responsible for implementing the internal controls deemed necessary by the directors to ensure the preparation of financial statements free from material misstatement, whether due to fraud or error. While the auditors were to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an opinion.
In addition to these responsibilities, the FRC and SEC now require the directors and external auditors of PIE and public companies respectively, to report on the effectiveness of internal control over financial reporting. Based on the FRC Guidance on Assurance Engagement Report on Internal Control over Financial Reporting, external auditors are to give a limited assurance on the effectiveness of ICFR.

4 Is it a statutory/regulatory requirement for auditors to issue two opinions (on the FS and ICFR)?

Yes. According to the FRC Guidance on Management Report on Internal Control over Financial Reporting, an entity is required to file, as part of its annual report, the attestation report of the external auditors that audited its financial statements and its report on the internal control system.

The annual report must include a statement that the external auditors, who audited the financial statements, have issued an attestation report on management's evaluation of the entity's internal control system. An auditor of a PIE shall, in his audit report to the entity, issue a statement as to the existence, adequacy, and effectiveness or otherwise of the internal control system of the PIE. The statement should cover the design, implementation, and test of the effectiveness of the internal control system.

5 What entities are PIE based on the Financial Reporting Council of Nigeria (Amendment) Act, 2023?

The Financial Reporting Council of Nigeria (Amendment) Act, 2023 expanded the scope of entities that fall under the purview of PIE.
PIE means:

- Governments and government organisations
- Listed entities on any recognised exchange in Nigeria
- Non-listed entities that are regulated
- Public limited companies
- Private companies that are holding companies of public or regulated entities
- Concession entities
- Privatised entities in which government retains an interest
- Entities engaged by any tier of government in public works with annual contract sum of ₦1 billion and above, and settled from public funds
- Licensees of government
- All other entities with an annual turnover of ₦30 billion and above

According to a public notice issued by the FRC on 20 December 2023, non-listed entities regulated by various sectoral regulators are expected to comply. These regulators include, but are not limited to

- Central Bank of Nigeria
- National Insurance Commission
- National Pension Commission
- Nigerian Upstream Regulatory Commission
- Nigerian Midstream & Downstream Petroleum Authority
- National Health Insurance Authority
- Nigerian Communications Commission
- National Broadcasting Commission
- National Universities Commission
- National Board of Technical Education
- Nigerian Commission for Colleges of Education
- Nigerian Electricity Regulatory Commission
- Securities and Exchange Commission
- Nigerian Civil Aviation Authority
- National Agency for Food and Drug Administration and Control
- National Automotive Design and Development Council
- Nigeria Shippers Council
- Nigeria Port Authority
- Infrastructure Concession Regulatory Commission
- Estate Surveyors and Valuers Registration Board of Nigeria
- Nigerian Tourism Development Corporation

6 Can you provide examples of companies that qualify as government licensees according to the FRC definition?

Examples of licensees of government are entities with petroleum prospecting and mining licences, banking licences, etc.

7 Are there exemptions for a PIE that is in a Startup Stage?

No. All PIEs must comply with the regulations. It is ideal for a startup to design and implement a strong control environment from an early stage, as it enables businesses to succeed.

The only exemptions permitted by the FRCN - The guidance is applicable to PIEs except the following::

- Small Companies as defined by Companies Allied Matters Act 2020
- Unit Microfinance banks (as defined by Central Bank of Nigeria)
- Insurance Brokers
- Non-Tertiary Educational Institution
- Non-Tertiary Health Institution
- Any other as may be considered by FRC from time to time.

8 Is there a template to follow for implementation?

The FRC Guidance on Management Report on Internal Control over Financial Reporting issued by the FRC is to be utilised for implementation of ICFR by PIEs.

The Guidance on Implementation of Sections 60 – 63 of Investments and Securities Act 2007 issued by the SEC is to be utilised for implementation of ICFR by public companies.

09 Is there a deadline for the implementation of ICFR? When can an organisation start?

Management is expected to evaluate the effectiveness of the entity's internal controls within 90 days prior to the report date. They must present their conclusions about the effectiveness of these controls based on their evaluation as of that date.

ICFR Implementation

10 What are the key factors to make ICFR a success for the whole organisation?

To ensure the success of ICFR across the organisation, consider the following key factors:

Early planning: Start planning early to set a solid foundation.
Project management: Implement effective project management practices.
Training: Provide comprehensive training for all relevant personnel.
Strong Tone at the Top: Ensure leadership sets a strong, supportive tone.
Enforcement: Enforce policies and procedures consistently.
Monitoring and timely remediation: Regularly monitor controls and address issues promptly.
Continuous and effective communication: Maintain ongoing, clear communication with independent auditors and other stakeholders.

11 Who has the responsibility to implement and evaluate ICFR?

Management has the responsibility to implement ICFR. Management can delegate that responsibility to the Business Process Owners and the Internal Control function. The Internal Audit function can support management with evaluation, monitoring and testing of those controls for management's assessment. The external auditor also has the responsibility to perform independent assessment of ICFR.

12 How do you address the situation when leadership views control implementation, including ICFR, as a cost-consuming activity?

Optimising internal control over financial reporting adds to the value of a business. It has financial reporting benefits, operational benefits and other benefits. To correct the notion, we must clearly communicate the benefits to those at the top of the organisation so that the appropriate tone can be set. Additionally, it is important to emphasise that for PIEs and public companies, compliance is mandatory and not optional.

13 When discussing business controls, the emphasis is often on Finance. How can an organisation ensure that all business segments recognize that control is a collective responsibility crucial for the company's survival and the effective implementation of ICFR? What practical steps can be taken to instill and integrate the necessary changes required by ICFR within the non-finance departments of the organisation?

The changes required by ICFR can be driven through effective communication throughout the organisation and the involvement of senior management to set the tone at the top. Additionally, developing a governance structure where employees are accountable for control effectiveness within their business processes, linked to their individual and departmental KPIs, is crucial. Regular monitoring of controls is also essential, as periodic monitoring positively impacts compliance.

14 How do we implement strong financial reporting controls?

This can be done by implementing a solid internal control framework (e.g., COSO Framework), which cuts across the integrated components: control environment, risk assessment, control activities, information and communication, and monitoring activities.
A sustainable ICFR program should have the following:

- **Clear vision:** A focused vision on a quality driven, cost effective program built to keep pace with changes in the business and regulatory environment.
- **Integrated structure:** A governance structure that enables a coordinated approach among multiple stakeholders involved in the ICFR process, and leveraging other compliance activities.
- **Flexible talent model:** An effective balance between having specific expertise and managing fluctuating resource demands to deliver quality at the most effective cost.
- **Risk focus:** A top-down focus on risks of material financial statement misstatements throughout the ICFR life cycle to enable a right-sized scope.
- **Innovative technology:** Technology and innovation enables the ICFR activities to drive efficiency, provide greater insight and lower the cost of compliance.

15 How do we proceed to test the operating effectiveness of ICFR? Via sampling or testing of full review? Is there any threshold to perform the tests?

The extent of testing of the operating effectiveness of an entity's control is dependent on the testing methodology adopted by the entity. The testing methodology can be determined by considering the risk, nature and frequency of each control.
A full review is not efficient or feasible, as management is expected to give a reasonable assurance and not absolute assurance.

16 What role will a risk register play in evaluating the adequacy of the ICFR? Can a risk register be an integral part of compliance to ICFR?

A risk register plays a crucial role in evaluating the adequacy of ICFR. A comprehensive risk register demonstrates that the organisation has a structured approach to identifying and managing financial reporting risks.

It serves as a central repository for documenting identified risks, their assessment, and the controls in place to mitigate them.

17 What processes are in place to identify and mitigate risks related to financial reporting?

Identifying and mitigating risks related to financial reporting involves several key processes. These include risk identification, assessment and scoping, control documentation and design, control testing and operating effectiveness, and evaluation and aggregation of control deficiencies.
Entities can also provide training for employees on financial reporting standards, internal controls, and risk management practices or implement awareness programs to keep employees informed about the importance of accurate financial reporting and the risks associated with it.

18 Since materiality is key, how do we manage this challenge when undergoing this process?

In performing risk assessment and scoping activities, management has to determine its materiality. This should be based on both quantitative and qualitative factors.

19 Can a company's external auditor support it towards the ICFR journey?

Management is responsible for maintaining a system of internal control over financial reporting, evaluating its effectiveness, supporting its evaluation with sufficient evidence and reporting on its effectiveness. An entity's external auditor should not be involved in the designing and implementation of ICFR as it could pose a self-review threat, considering that the auditor is responsible for obtaining limited assurance on the effectiveness of ICFR.
However, it is important to engage the external auditor early to ensure alignment with management on the decisions on all phases of the ICFR journey.

20 What internal control framework can management adopt?

Management has the responsibility to determine the internal control framework to adopt, e.g. COCO, COSO, ISO etc. COCO means Criteria of Control, which is by the Canadian Institute of Chartered Accountants. COSO means Committee of Sponsoring Organisations of the Treadway Commission. The International Organization for Standards creates ISOs on a wide variety of topics including risk management.

21 Is there a checklist that can be used to track controls for all the principles within the framework of COSO

COSO lays out principles. The 17 principles are the checklist. It is not prescriptive as it does not list out the entire population of controls.
Controls are developed by organisations to achieve Operational objectives, Reporting objectives or Compliance objectives.
The coverage areas are Entity, Division, Operating Unit of Function. This is entity specific based on its structure.

22 How do organisations assess the implementation of ICFR in the prior year with the current year activities?

At the end of every cycle, it is expected that there will be a gap register if there were deficiencies identified in the previous period. The current period should begin with a remediation plan for the gaps, which should be adequately monitored.

23 Is the ICFR implementation process a one-off or continuous process?

No, it is not one-off. It is an assessment required on an annual basis.

Control Deficiencies & Remediation

24 To what extent do audit adjustments reveal the material weaknesses and significant deficiencies?

To a very large extent, an audit adjustment could either indicate that a control is not well designed or implemented, or a control does not exist to prevent or detect a misstatement on a timely basis.
Additionally, the severity of the audit adjustment would determine the severity of the classification of the control deficiencies. A quantitative and qualitative assessment must be done to determine the class of deficiency.

25 How do we determine what is a material weakness or a significant deficiency?

In order to determine whether a control deficiency, or combination of control deficiencies, is a material weakness or significant deficiency, management evaluates the severity of each control deficiency that comes to its attention. The evaluation of the severity of a control deficiency should include both quantitative and qualitative factors.

A material weakness is a deficiency, or a combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented or detected on a timely basis.
A significant deficiency is a deficiency, or a combination of deficiencies, that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting. Communication to the audit committee required.

26 Some controls have an annual frequency. How will a failed annual control have the chance to be remediated by the financial year end?

There will be no chance to remediate an annual control that has failed; hence, the need to design relevant controls to mitigate the risks and reiterate the importance of proper operation of these controls to business process and control owners.

Internal Audit Function

27 Does the ICFR program involve a review of the Internal Audit and Risk Management activities/function or just Internal Control?

The ICFR program involves the review of relevant key controls mitigating identified financial reporting risks.

28 Can a startup with no Internal Audit Unit still implement ICFR?

Yes. However, it is important to note that the role of the Internal Audit and Internal Control function plays is to support management in the identification and assessment of risks and controls, testing and remediation of controls, as well as perform the monitoring function.
So if management is satisfied that it has people with the required skill set and competencies to perform these roles, it is fine. However, it must be unbiased i.e. the person responsible for implementing the process should be separate from the person testing the implementation.
Additionally, management can seek external support in performing the required functions.

29 As an internal control personnel, how do we ensure continuous monitoring of the ICFR within the organisation, especially around post implementation?

The control monitoring function must be prioritised and more stakeholders must be involved (right from the Board down to the process owners).

Other Questions

30 **What risk-based controls can be adopted in a National Microfinance Bank?**

The controls to be adopted will depend on management risk assessment i.e. management has to identify risks to its financial reporting and then design and implement controls to mitigate those risks.

31 **Are there any best practice internal control templates that can be adopted by entities for every control area (e.g. inventory, treasury, fixed assets) as a benchmark against existing internal control practices to determine the extent of additional work and resources that are required to close the gap?**

Yes, we offer best practice internal control templates that can be adopted for various control areas such as inventory, treasury, and fixed assets. These templates serve as benchmarks to evaluate existing internal control practices and identify any gaps that need to be addressed.
For more information, please reach out to our Contacts.

32 **Can PwC assist participants with a typical ICFR program, especially in the first year of implementation, by working closely with clients to ensure proper control design, documentation, and evaluation for effective compliance? Additionally, what steps can organisations take to address gaps in control, and does PwC support these efforts through training programs?**

Yes, we are committed to supporting our clients and other organisations to implement ICFR. We also provide ICFR training services.

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