

Internal Control over Financial Reporting (ICFR)

Driving governance through effective
financial reporting

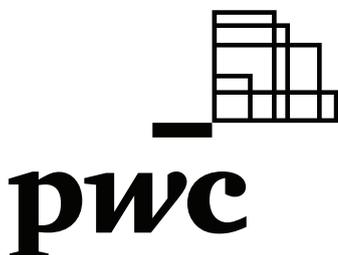


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Executive Summary

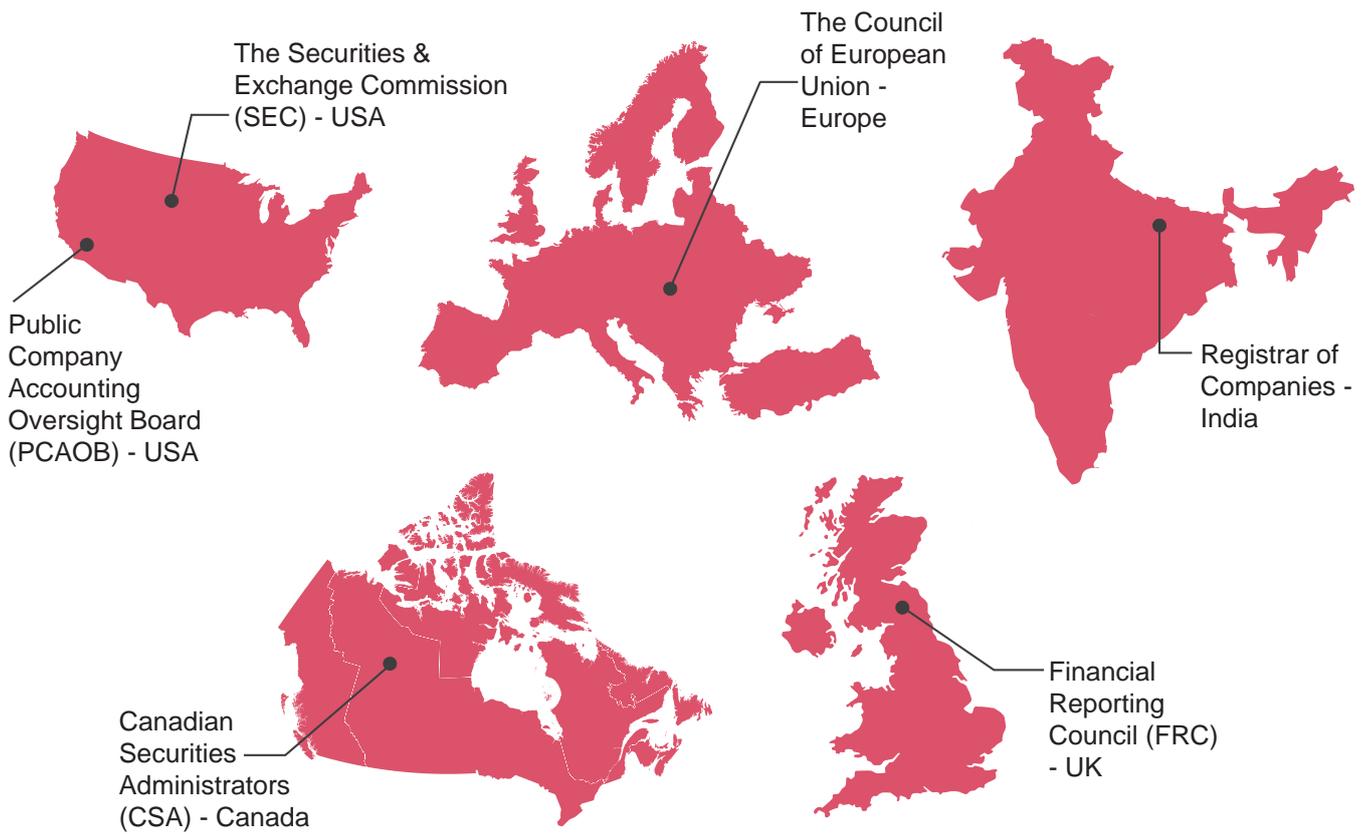
The vision for ICFR

The current landscape for ICFR

The Internal Control over Financial Reporting (ICFR) remains an essential part of the Chief Financial Officer (CFO) agenda in order to ensure that the information reported in the financial statements is accurate and does not contain any material misstatement.

The Internal Control and financial reporting disciplines have evolved significantly over past two decades due to various international business incidents including the Enron collapse, global financial crisis, oil price volatility, amongst other events. This has resulted in major regulatory reforms that aims for governing the internal control environment, especially focused towards the financial reporting. Many international and regional regulators have since implemented various laws, regulations and guidelines in relation to ICFR, a few of which are listed below:

International



Regional



Over more recent years, the Middle East region has unfortunately witnessed some organisational crises within various sectors including healthcare, private equity, financial services and construction. This, paired with the overall increase of business challenges due to COVID-19 situation, have raised concerns from the following key stakeholders on the quality of ICFR. In this paper, we have captured the expectations of these stakeholders as well as their key responsibilities.



Internal

- Boards
- Audit Committees
- Senior Management
- Finance Department
- Audit department



External

- Regulators
- Shareholders / Owners
- Investors
- Creditors
- Statutory Auditors

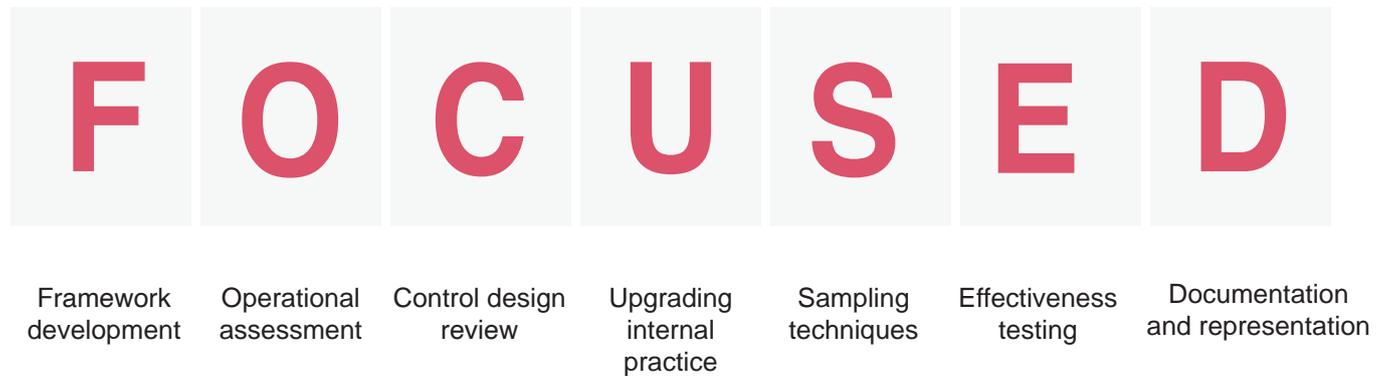
Extracting maximum value from ICFR investment

The value an organisation extracts from ICFR exercise depends on various factors, including the size, operations, accounting framework, complexities, internal control team, governance, and culture of the business. The below “PwC Maturity Landscape” not only helps organisations to assess their maturity level in ICFR domain but also helps them in getting the maximum value from the investment in ICFR agenda.

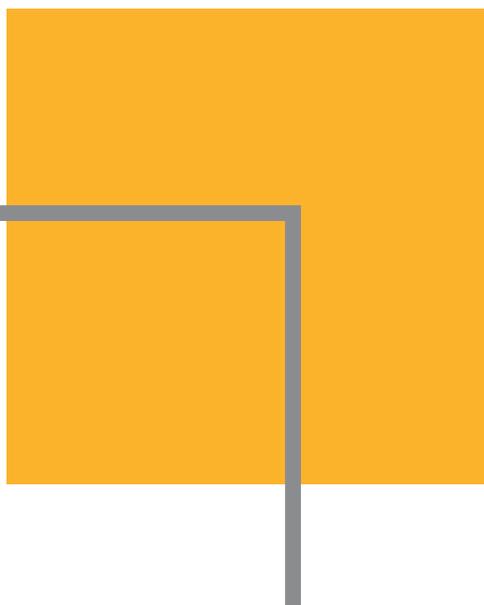
Maturity Dimensions	Maturity Level		
	Level 1 - Regulatory Compliance	Level 2 - Controls Insights	Level 3 - Value Enhancement
 Role Clarity	Unclear	 Informal	 Formal
 Governance Culture	Defensive	 Responsive	 Collaborative
 Data Analytics	Beginner	 Intermediate	 Advanced
 Value	Cost focus	 Efficiency focus	 Value focus

Rethinking ICFR to help you stay “FOCUSED” and achieve resilience

At PwC we have recognised how important ICFR is for the Middle East region in terms of scope, maturity landscape, reporting and digital upskilling, when compared with the rest of the world. Therefore, we have analysed international leading practices and considered Middle East business practices to develop our bespoke “FOCUSED” approach.



The **FOCUSED** approach, extends beyond just achieving regulatory compliance is based on international leading practices, internal control frameworks (COSO, SOX etc.) and lessons learned from advanced economies tailored to the specific requirements of organisations in the Middle East region operating in various sectors. At PwC we leverage from FOCUSED approach to help organization in their ICFR maturity journey and get maximum value from it. A couple of case studies are added in the later part of this paper.



Introducing the importance of ICFR

How does ICFR make a difference in the financial reporting world?

Defining ICFR: In simple terms, ICFR means a process which is implemented by those charged with governance and management to provide reasonable assurance that a mechanism of Internal Control is in place to achieve the following objectives:



The financial statements are prepared as per the **applicable financial reporting framework** e.g. IFRS, local GAAPs e.g. IPSAS, SOCPA



The transactions and events reported in the financial statements are **duly authorised** as per the protocols implemented by management and those charged with governance.



A process is in place **to prevent or timely detect and amend** any unauthorized use of assets / resources employed by the organisation.



The organisation maintains **accurate records / evidence** to back all transactions which are reported in a financial period.



International Regulatory Regime on ICFR to achieve resilience

Internal Control are often an area of focus for investors, creditors, shareholders and Board members, among other stakeholders, when ensuring that the organisation provides accurate financial reporting which shows its state of operations in today's constantly changing business environment.

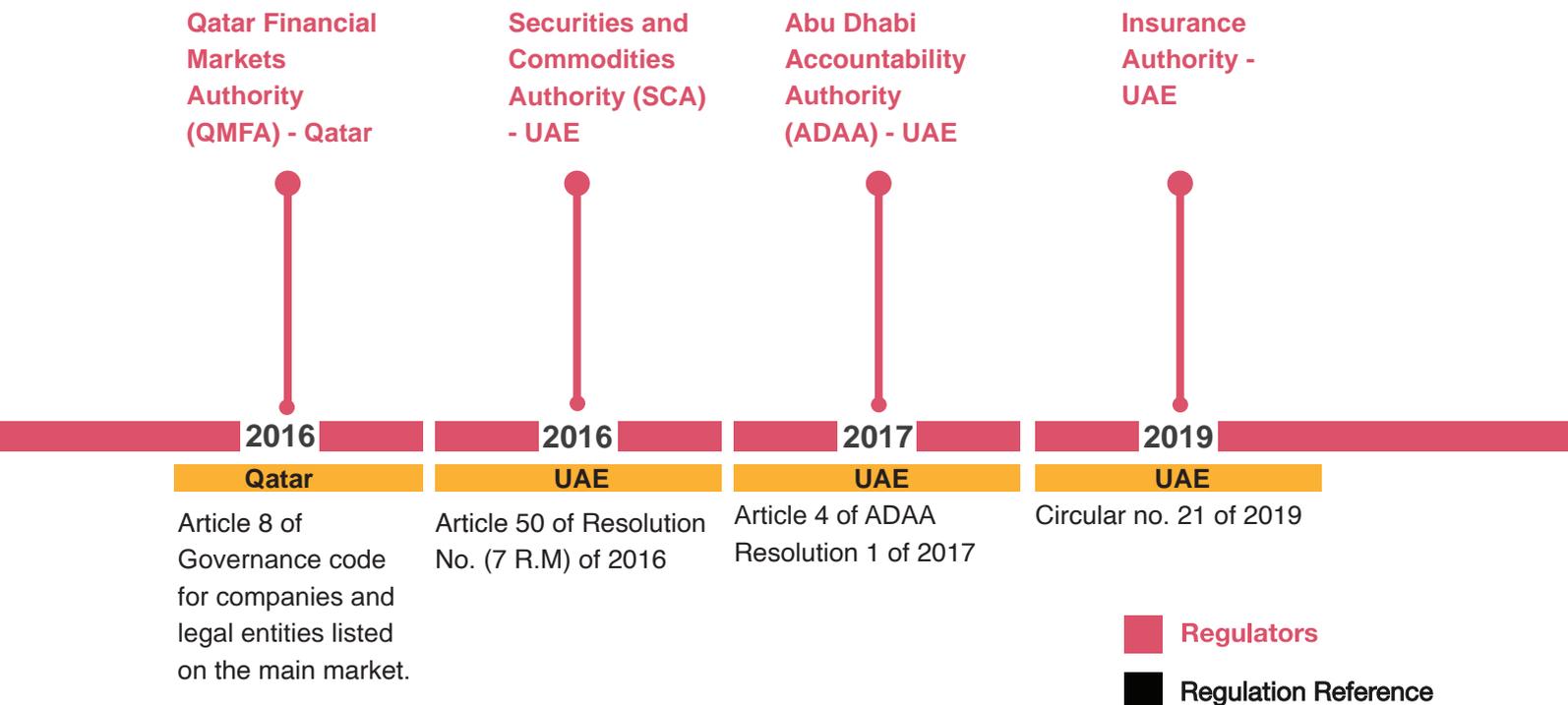
However, the ICFR agenda became more critical with situations such as those raised in 2002 (Enron), 2008 (global financial crisis), and 2016 (oil price slump) etc. Each of these historical business world challenges brought key stakeholders (regulators, investors, creditors etc.) together to better legislate reporting protocols and introduce new practices to assess the risks facing the businesses and having sound Internal Control to mitigate those risks. In this regard many initiatives were taken by regulators across the globe to implement an ICFR agenda, such as the below:



The introduction of Middle East regulatory initiatives

In recent years, the collapse of many Middle East businesses in the private equity domain, financial services, healthcare and construction sectors has raised many concerns among the stakeholder community. The year 2020 brought another major challenge with the unforeseen COVID-19 pandemic, which created even more pressure on the business world.

In this situation many regulators have taken initiatives to further strengthen the Internal Control environment especially around the financial reporting domain. The regulations mentioned in the below table are a few examples where subject entities are required to implement an ICFR framework. At present, many other regulators in the region are exploring this agenda to better manage financial reporting.



PwC 2020 Internal Controls survey

76%

of the respondents perceive Internal Control as valuable but feel that not all levels in the organisation are proactively participating in the internal control journey

60%

Almost 60% of the respondents declared that they do not have a specific governance, risk management and compliance system for managing Internal Control





Understanding ICFR
stakeholder's
expectations and
responsibilities

ICFR agenda allows organisations to work collaboratively as a single unit and ensure that the operations are accurately translated into figures which are reported in the financial statements. As many stakeholders have different expectations on this agenda, there are certain responsibilities which are expected from them to implement an effective ICFR model.

External Stakeholders



Regulators

ICFR expectations

Adopt an internationally acclaimed internal control framework.

Responsibilities

Develop a monitoring mechanism to assess the effective implementation across regulated organisations.



Investors & Creditors

ICFR expectations

The financial statements provide accurate information about the organisation's state of affairs.

Responsibilities

Encourage organisations to provide ICFR audit opinions.



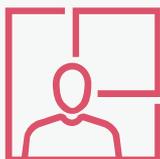
Shareholders

ICFR expectations

Accurate financial reporting through deployment of sound Internal Control.

Responsibilities

Encourage the culture of leading practices around Internal Control and governance.



Statutory Auditors

ICFR expectations

Management should adopt and effectively implement an ICFR framework.

Responsibilities

Perform independent assessment of management ICFR practices..



Board / Audit Committees

ICFR expectations

The financial statements prepared by management is based on effective ICFR framework.

Responsibilities

Approve required budgets, policies, procedures etc. associated with ICFR.



Senior Management - CEO / CFO

ICFR expectations

Receive required budget approvals from Board / AC and authority to implement effective ICFR practices.

Responsibilities

Sign off organisation's conformance with effective ICFR practices and endorsing it for Board / AC approval.



Process Owners

ICFR expectations

Obtain required guidance from the IC team in understanding financial reporting controls and their role in managing it.

Responsibilities

Exercise the compliance with organisation's internal control practices during day to day operations.



Internal Control (IC) Team under (Finance / Risk Management)

ICFR expectations

Obtain due support from senior management in terms of resources, skill set, training and governance.

Responsibilities

Lead the ICFR mandate in the organisation to ensure controls are adequately designed and operating effectively.



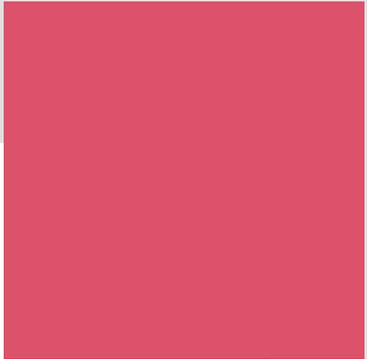
Internal Audit

ICFR expectations

Involve in discussion with the IC team where any specific input is required on critical or complex controls.

Responsibilities

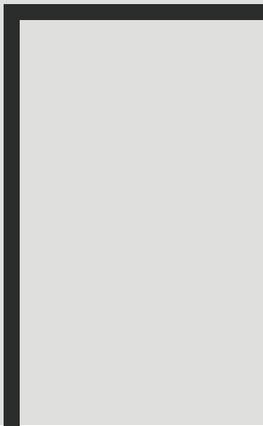
Provide advisory support to the finance department in effective implementation of ICFR.



ICFR Maturity



Landscape



The value a company can extract by implementing ICFR is highly dependent on the maturity level of the organisation from ICFR perspective. Based on the international leading practices, we have developed a **four dimensions of ICFR maturity landscape** which provide a basis to assess at which level your organisation sits among the three maturity levels:

Maturity Level 1: Regulatory Compliance

Organisations consider ICFR as a regulatory burden and mainly focus to comply with regulatory requirements.



Role clarity

Unclear: Lack of clarity on the overall roles and responsibilities in relation to ICFR project among finance and other departments.



Governance Culture

Defensive: Highlighting Internal Control failures are discouraged in a fear to get a qualified opinion from the statutory auditors.



Data Analytics

Beginner: Internal Control are tested on conventional sample testing basis with review of limited transactions, without use of any digital tools or data analysis.



Value

Cost Focus: ICFR exercise is considered as a cost center with a perception of minimum value addition to comply with regulations.

Maturity Level 2: Process Efficiencies

Organisations take ICFR as an opportunity to bring processes efficiencies through control optimization, eliminate redundant / duplicate controls and extend control automation.



Role clarity

Informal: The Internal Control Team leads the ICFR exercise while educating other process owners to play the required role.



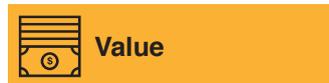
Governance Culture

Responsive: Each stakeholder is encouraged to highlight any control deficiency to put remediations on a timely basis.



Data Analytics

Intermediate: Various data tools are used to analyze the whole population for targeted sample testing.

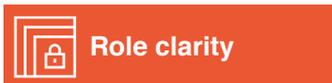


Value

Efficiency Focus: ICFR exercise is considered as a business process re-engineering project to eliminate duplication and introduce efficiencies.

Maturity Level 3: Value Enhancement

Organisations focus more on controls issues related to new projects / ventures whereas existing critical controls get monitored through continuous monitoring tools.



Role clarity

Formalised: The user departments clearly understand their role and proactively manage control agenda with oversight support from the Internal Control Team.



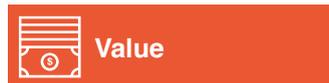
Governance Culture

Collaborative: Control failures are corrected on a real-time basis by collaboration across functions and are taken as an opportunity to improve internal practices



Data Analytics

Advanced: Continuous monitoring tools are used to monitor controls on a real-time basis and focus more on value-added areas.



Value

Value Focus: ICFR exercise is taken as an opportunity to enhance value by introducing leading practices in the existing control environment.

PwC 2019 ICFR

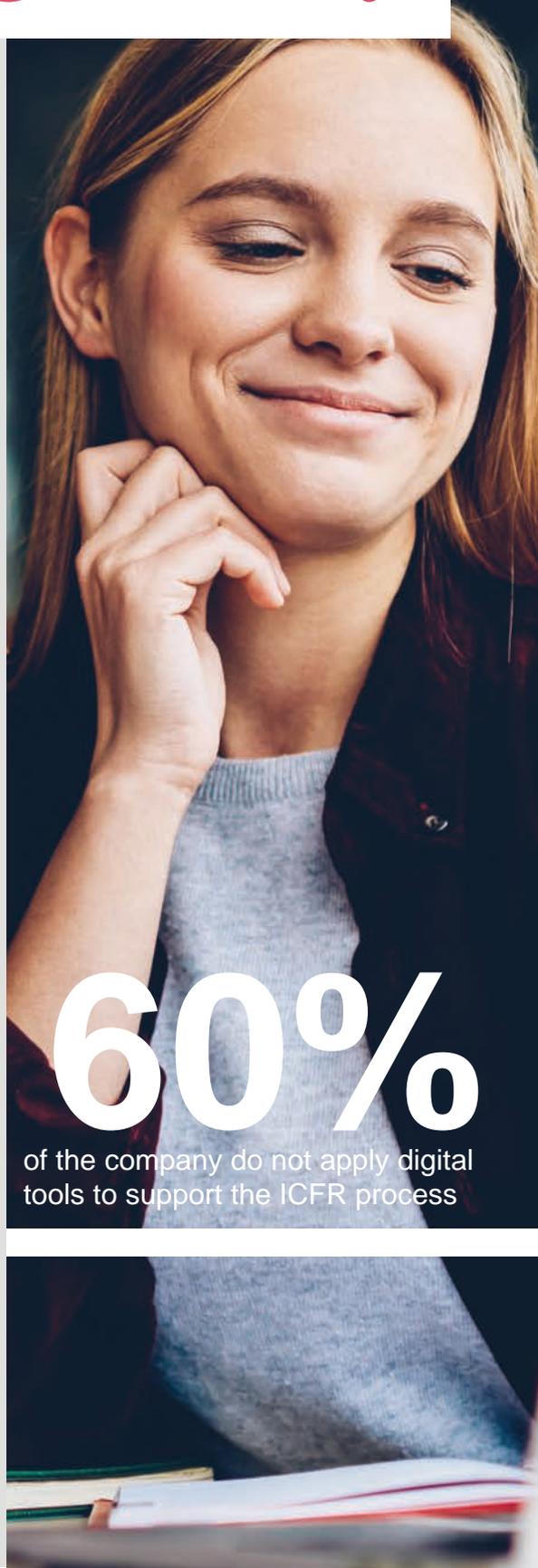
benchmarking survey

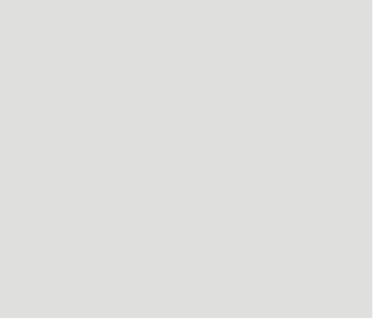
41%

of the company do not have a process for scoping to identify to which extent and level the ICFR framework is applied.

60%

of the company do not apply digital tools to support the ICFR process

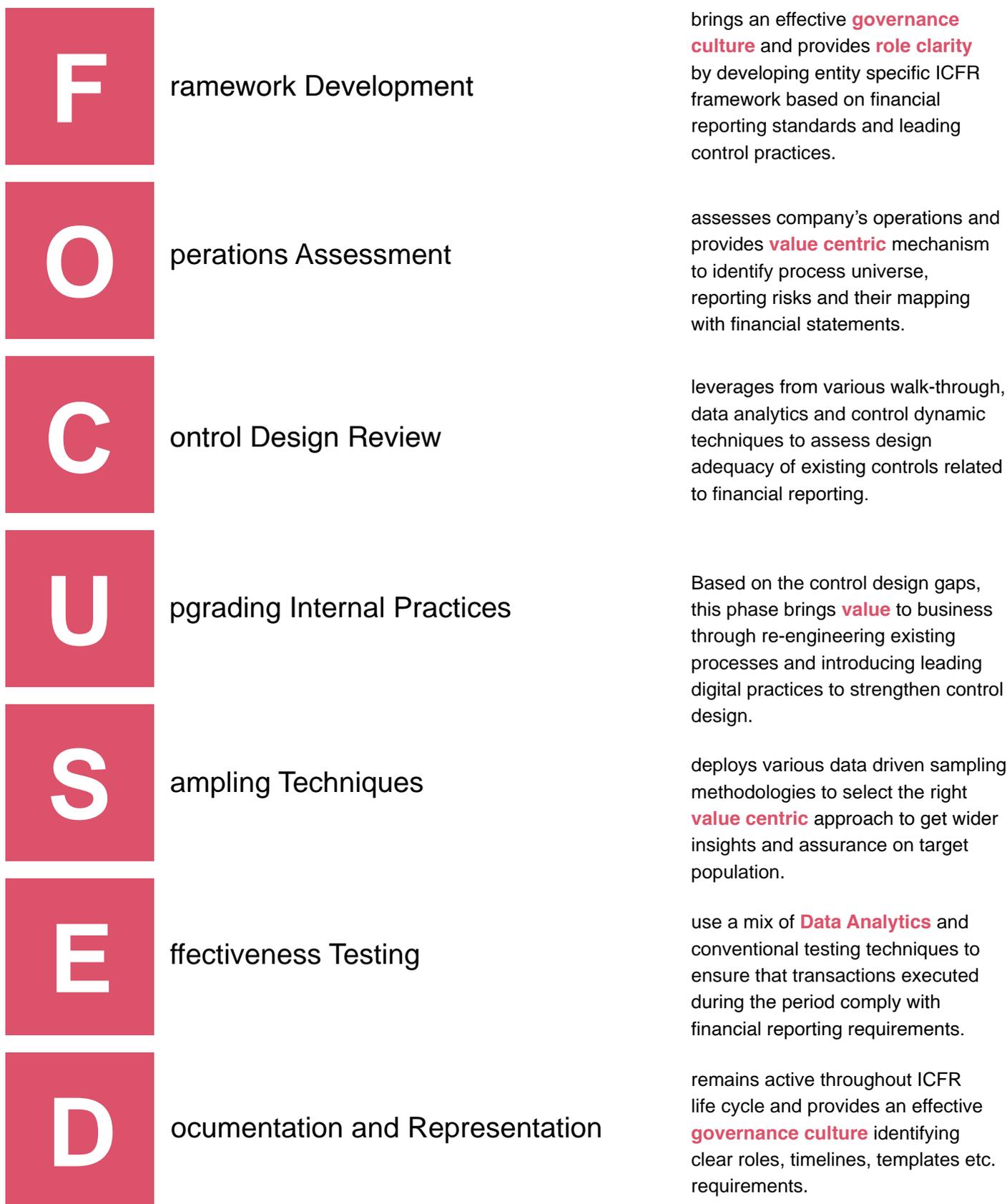




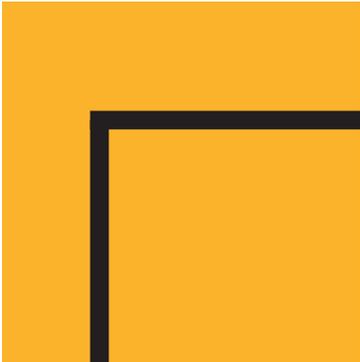
How PwC's FOCUSED
approach can help
your organisation in
the ICFR journey

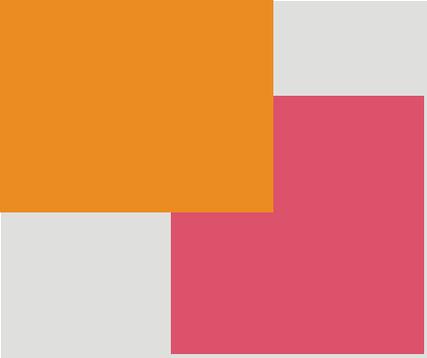


The success of an ICFR exercise highly depends on the way it is planned, executed and monitored. An ICFR exercise complying with all requirements may not be able to highlight key control design or operating failures if a correct approach is not used. Therefore, based on the leading practices in the regulated economies along with the specific business needs of the Middle East region, PwC has developed its ICFR-centric approach “**FOCUSED**” that addresses all of the key pain points for organisations of any size and support them in the ICFR maturity journey.



At PwC, we leverage the **FOCUSED** approach to help organisations in their maturity journey. Our tools, techniques and team members are well versed with ICFR requirements and comfortably diagnose the maturity level of an organisation as well as the dimension which require more focus.





Case Studies



We have listed below a couple of examples where we partnered with some organisations in the Middle East region while leveraging our **FOCUSED** approach and helping them in various dimensions of ICFR maturity landscape:

Client Industry and Region: Energy Sector | Middle East Region



Client Situation

The client was involved in issuing multiple sets of financial statements on two different accounting frameworks. The ICFR agenda was implemented a few years ago, however the management was not confident that all key risks / gaps were identified and addressed.

How PwC supported the client to resolve the issue

Through deploying the FOCUSED approach, the PwC team employed various data analytical tools to re-analyze the scoping model. The work helped to identify multiple areas which were not considered in the previous ICFR exercises. This identification not only helped to enhance finance department oversight on those processes but also helped management to fix numerous gaps which could result in material errors in overall financial reporting.

Client Industry and Region: Government Funded Investment Conglomerate | Middle East Region



Client Situation

The client managed a portfolio of more than 100+ subsidiaries, associates, joint ventures, etc. The parent was required to issue ICFR opinion on individual as well on group level financial statements. However, there was no precedent in the region to manage a similar ICFR mandate especially with such a diversified portfolio and the complex nature of group entities (listed, private, foreign, greenfield projects, etc.).

How PwC supported the client to resolve the issue

Through deploying the FOCUSED approach PwC team developed a group tailored ICFR framework which provided synergies through optimising design and effectiveness testing process. In addition, the PwC team performed a comprehensive analysis over group structure and proposed a data model which classifies entities based on multiple risk factors. This data model helped the group in objectively identifying high risk entities and steer the efforts towards the most important controls.

Contacts



John Saeed

Middle East Internal Audit
& GRC Leader

T: +966 56 007 9699
E: john.saeed@pwc.com



Adnan Zaidi

Middle East Assurance
Clients & Markets Leader

T: + 971 56 682 0630
E: adnan.zaidi@pwc.com

About PwC

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Established in the Middle East for 40 years, PwC has 22 offices across 12 countries in the region with around 6,000 people. (www.pwc.com/me).

PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

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