



Ideal Spinning Mills Ltd.



INTERNAL CONTROL POLICY

OBJECTIVE

This document aims to establish the guidelines for the assessment of internal control, considering the main operational processes of **Ideal Spinning Mills Limited**, focusing on the disclosure of financial reports and operations efficiency. These guidelines are complemented, when applicable, by specific business rules and procedures, which are fully disclosed and available to all members of the Company.

RESPONSIBILITY

The responsible areas are:

- Risk Management and Internal Controls;
- Internal Audit and Company coordinators whose business processes are part of the scope of the periodic assessment of internal controls.

DEFINITIONS

Internal controls: According to the COSO ERM model, internal control is defined as a process that is executed by the Company's senior management, managers or other persons associated with the Company, and considers policies, procedures, activities and mechanisms that are aimed at providing a significant degree of reliability on the following objectives:

- effectiveness and efficiency of resources;
- reliability of the financial information; and
- compliance with established laws and regulations.

COSO-ERM (Committee of Sponsoring Organizations of Treadway Commission) is the international model for internal controls and consists of five components:

- Control Environment;
- Risk Assessment;
- Control Activities;
- Information and Communication; and
- Monitoring Activities.

Business Process: A succession of clearly defined activities with at least one initial step and one final step.

Risk: Any and all events arising from uncertainties to which the Company is exposed and which may negatively impact the objectives and value generation.

Head Office:

1088-Jail Road,
Faisalabad-Pakistan
Ph: +92 41 2632 301-5

Mills:

35 Km, Sheikhpura Road,
Faisalabad-Pakistan
Ph :+92 41 4589 183-84
Ph :+92 41 4689 251-52

Lahore Office:

506-D, 5th Floor, City Tower,
6-K, Main Boulevard Gulberg II, Lahore
Ph :+92 42 3578 8655
+92 42 3585 1011-2
+92 42 3575 8484

Karachi Office:

Room # 404-405, 4th Floor
Business Centre, Mumtaz
Hassan Road, Karachi-Pakistan
Ph :+92 21 3241 2814-5
Fax:+92 21 32419817



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Types of Controls: The internal controls of the business processes can be classified as:

- **Preventive:** executed at the beginning of the process - prevents the occurrence of errors or irregularities and minimizes the risks at the source;
- **Detective:** executed throughout the process, detecting errors which are difficult to define or predict.
- **Corrective:** put in place after the detective internal controls discover a problem.

Control Execution Frequency: The control execution frequency defines the number of times a control is executed. The frequency can be classified into: recurring (several times a day), daily, weekly, monthly, quarterly, semi-annual, annual and per event (when there is no specific frequency).

Compensatory Controls: Compensatory controls are intended to mitigate losses or exposure to risks in situations where a particular control activity is not capable of achieving the control objectives of a particular process. Compensatory controls do not replace control activities addressed in business processes. They only minimize the occurrence of errors, fraud or losses that would not be prevented and/or detected in the absence of such controls.

Control Deficiency: Failure to execute a control that individually or together with other failures would clearly result in immaterial distortions in financial statements or immaterial financial loss.

Significant Deficiency: A deficiency of control, or a combination of deficiencies, that results in a possible probability of not preventing or detecting material misstatements in financial statements or material financial loss.

ROLES AND RESPONSIBILITIES

Audit and Risk Management Committee:

Committee is responsible for:

- review and evaluation the adequacy of the internal control assessment plan, including the scopes for process, methodology, strategy and its comprehensiveness;
- taking recognition of the control deficiencies identified within the Company's internal control environment;
- monitoring the implementation of the action plans when applicable; and
- informing the Board of Directors on significant deficiencies and actions taken towards them.

Senior Management:

- periodically monitors the evolution of the internal control assessment according to the reports issued by the Risk Management and Internal Control, Internal Audit and Independent Audit coordination teams;

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- ensures the implementation of actions defined by the coordinators subordinated to them in relation to the implementation/adequacy of internal controls; and
- sponsors improvements to the internal control environment, always seeking a balance among the effectiveness of the processes, controls and costs, as well as the alignment with the Company's strategic objectives.

Risk and Internal Control Coordination:

- assists the business areas in the identification/implementation/adequacy of internal controls, documentation of internal controls;
- identifies the need to implement new controls and/or the need for improvement in existing controls when the absence and/or insufficiency of these result in significant deficiencies;
- manages the self-assessment steps of the internal controls;
- reviews/evaluates the action plans indicated by the business areas in relation to meeting the objectives of internal controls, mitigation of risks and implementation deadlines;
- monitors the independent assessments of internal controls performed by the Internal Audit and Independent Auditors;
- is subordinate to the Financial Division.

Coordinators and Teams responsible for internal controls:

- self-assess the processes under their responsibility during a period pre-determined by the Risk and Internal Control Coordination;
- ensure the execution of existing internal controls according to architecture and frequency, implement new internal controls and improvements to existing internal controls; and
- report any changes in the internal controls structures through changes in business (processes, people, systems) in a timely manner.

Internal Audit:

- independently evaluates the efficiency and effectiveness of internal controls;
- recommends the implementation of new internal controls and/or improvements in existing internal controls, when the absence and/or insufficiency of these result in significant deficiencies;
- reports deficiencies in internal controls to Senior Management and the Audit and Risk Management Committee;
- follows the recommendations of the independent auditors; and
- monitors the implementation of action plans for identified internal control deficiencies.

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Strategic Risk Management, Risk and Internal Control Coordination, and Internal Audit:

- interact with the business areas for the annual planning efforts in order to guarantee accuracy, efficiency and effectiveness of the activities;
- share the assessment results carried out by each business area, consolidating the works to be reported to Management, Audit Committee and Risk Management.

INTERNAL CONTROLS DOCUMENTATION

- The documentation of processes, risks and internal controls is carried out through the internal controls matrix, which is structured to guarantee the necessary information that supports the assessments of processes, systems and controls.
- The internal control matrix contains the following structure: process, sub-process, risk factor, control activity, frequency, responsibility, type of control (preventive/detective), nature of control (manual, automatic, manual IT dependent), relevance (key control) and the outcome of the evaluated effectiveness.
- The recordings of the internal control matrix must be updated by the Risk and Internal Control Coordination, according to the information received from the internal control officer, through changes in the business (processes, people and systems) or when change is identified in the self-assessment process of internal controls.

SELF-ASSESSMENT OF INTERNAL CONTROLS

- The internal control's self-assessment is the procedure in which the evaluation of processes and controls must be performed by the internal control officers assigned in the documents of the internal controls matrix.
- The self-assessment is performed either through questionnaires or facilitated sessions to assess the adequacy of internal controls in mitigating risks and promoting compliance with objectives.
- The self-assessment procedure should occur annually according to the schedule defined by the Risk and Internal Control Coordination.
- During the self-assessment process, changes in internal controls architecture, inclusion of new controls and substitution/elimination of controls may be proposed by the respective controllers, provided that it ensures reasonable assurance that all business objectives will be met.
- As an outcome of the self-assessment process, the internal control officers must assign the following status: Implemented (for controls and processes that were implemented and are operating properly as documented in the control matrix) or Not Implemented (for controls that are not operating as described). The internal controls with a Not Implemented status should have a justification in order to be assessed by the Risk and Internal Control Coordination.

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Head Office:
1088-Jail Road,
Faisalabad-Pakistan
Ph: +92 412632 301-5

Mills:
35 Km, Sheikhpura Road,
Faisalabad-Pakistan
Ph :+92 41 4589 183-84
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- The results will be analyzed by the Risk and Internal Control Coordination and informed to the Steering Committee.

INDEPENDENT ASSESSMENT OF INTERNAL CONTROLS

- The assessment of internal controls is performed in two phases: assessment of control design (documentation and walkthrough) and assessment of operational effectiveness (control test).
- The assessment of the internal control architecture is performed annually to confirm understanding of transaction flow and process documentation.
- The assessment of the operational effectiveness is performed annually and the selection of internal controls to be tested is performed considering the following criteria:
 - ❖ relevance of the control (key controls must be selected annually);
 - ❖ result of the effectiveness test from the previous year (ineffective controls are selected);
 - ❖ impact on the financial statements (controls listed in the scope of the Independent Auditors' assessment are selected);
 - ❖ past selection of controls in previous years (other controls are selected according to rotation so that they are assessed, at least, every 3 years).
- The Internal Audit carries out internal control tests according to the selection criteria above or according to the planned audit work for the year.
- The scope of internal control tests that have impact on the financial statements is jointly defined with the Internal Audit and Independent Audit in order to guarantee work synergy. The work carried out by the Independent Audit may use information provided by the Internal Audit to identify material misstatement in the financial statements, and the Internal Audit may use the work performed by the Independent Audit to complement the assessment of the company's control environment. This synergy does not eliminate the need for the independent auditor to study and evaluate the entity's accounting system and internal controls as a basis for determining the nature, timing and extent of the application of audit procedures, considering various aspects.
- The internal control testing procedures are documented in the work plan and must present: control information based on the internal control matrix, test procedure (inquiry, observation, inspection, reperformance or analytical procedures), selected samples, test results, completion of control (effective/ineffective), impact measured, responsible for the test and test date.
- The test sampling is randomly defined according to nature (manual, automatic, manual IT dependent) and control frequency.

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- Ineffective internal controls are assessed in relation to their classification as significant deficiency according to extent of impact on the financial statements or operations of the Company.
- The Independent Audit shares the result of the internal control test with the Internal Audit, consolidates the results and issues a recommendation letter to Management on identified improvement opportunities for internal control according to the performed assessment.
- The result of the internal control tests is consolidated by the Internal Audit and presented to Management and the Audit and Risk Management Committee.

ACTION PLAN

- Internal controls assessed as ineffective are discussed with those responsible for the implementation of the controls and the Coordination responsible for defining the action plan for correcting the identified deficiency.
- The Risk and Internal Control Coordination assists in the preparation and follow-up of the implementation of the necessary action plans to implement or improve the internal controls necessary to mitigate risks.
- The status of the agreed action plan is reported to Management and to the Audit and Risk Management Committee.

For Ideal Spinning Mills Ltd.



Director

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