Reporting on Internal Financial Controls

February 17, 2015

Agenda

- Understanding Internal Financial Controls
- Who all are responsible
- Consequences of Non-Compliance
- Comparison of regulations
- Key matters for consideration
- Global scenario
- Way forward
- Reporting considerations

Understanding **Internal Financial Controls (IFC)**

Understanding Internal Financial Controls

"IFC" means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

IFC means the policies and procedures adopted by the company for:

- ensuring the **orderly and efficient conduct of its business**,
- including **adherence to company's policies**,
- **the safeguarding of its assets**,

+

- the **prevention and detection of frauds and errors**

+

- the **accuracy and completeness of the accounting records**, **and**
- **the timely preparation** of reliable financial information

Operating controls	Fraud Prevention	Internal Financial Controls over Financial Reporting ('ICFR')
Check if all documents (including background checks) are available as per checklist	Can we create an employee record without relevant documents?	All salaries to the new employees are processed

Internal financial controls system includes policies and procedures for ensuring efficiency and effectiveness of business and ensuring accuracy of accounting records.

Definition of internal control as per SA- 315

Internal control is the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations.

Comparable definition – COSO : Internal Control

‘Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance’

ICFR + **Operational controls** + **Compliance**

=

Internal Controls

Internal Financial Controls over Financial Reporting

As per Guidance Note*, ICFR is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

A company's ICFR 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 authorisations of management and directors of the company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

** The Guidance Note on ICFR has been withdrawn by the ICAI. References made herein are based on the Guidance Note as earlier issued by ICAI for discussion purposes only*

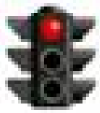
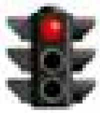
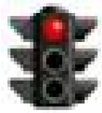
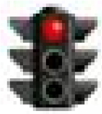
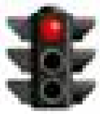
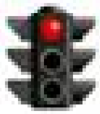
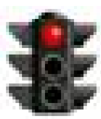
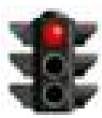
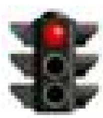
The above definition is in line with definition given under SEC Rules in respect of ICFR.

Who all are responsible?

The Companies Act 2013 – Who All Are Responsible?

Section 134	**Director's Responsibility Statement**	▶ In the case of a listed company, the Directors' Responsibility states that directors, have laid down IFC to be followed by the company and that such controls are adequate and operating effectively.
Rule 8	**Directors**	▶ The Board of Directors of all companies to state the details in respect of adequacy of IFC with reference to the financial statements
Section 143	**Auditor Report**	▶ The auditor's report should also state whether the company has adequate IFC system in place and the operating effectiveness of such controls
Section 177	**Audit Committee**	▶ Audit committee may call for comments of auditors about internal control systems before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company
Sch IV	**Independent Directors**	▶ The independent directors should satisfy themselves on the integrity of financial information and ensure that financial controls and systems of risk management are robust and defensible.

The Companies Act 2013 – Who All Are Responsible? (contd.)

Requirement (as per previous slide)	Public Listed	Public Limited			Others
		Paid-up share capital>= INR 10 Cr	Turnover >= INR 100 Cr	Loans, Borrowing in aggregate >= INR 50 Cr	
1 Director's Responsibility Statement (134)					
2 Auditor Report (143)					
3 Audit Committee (177)					
4 Independent Directors (Schedule IV)					
5 Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 – BOD report – Financial Statements only					

Consequences of Non- Compliance

The Companies Act 2013 – Consequence of Non-Compliance

Section 134 : Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both

2(59) "officer" includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act

Comparison of regulations

Role	Companies Act, 1956	Companies Act, 2013	Clause 49
Board of Directors	Sec 217 – The Directors' Responsibility statement to state that, the directors had taken proper and sufficient care: - for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and - for preventing and detecting fraud and other irregularities;	Additional requirement: Listed Companies: Sec 134 - The Directors' Responsibility statement to state that, directors had laid down IFC to be followed by the company and that such IFC are adequate and operating effectively. Other Companies*: Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 requires the board report of all companies to state the details in respect of adequacy of IFC with reference to the "financial statements" only. Sch IV - The independent directors should satisfy themselves on the integrity of financial information and ensure that financial controls and systems of risk management are robust and defensible.	As a part of directors' report , the Management Discussion and Analysis report ('MDNA') should include discussion on Internal control systems and their adequacy. Though there is no change in the structure of MDNA, the reporting on this clause has to be made considering the new definition under the Act.

* (1) As a result of the above rules, Board of Directors of all Companies are responsible in respect of IFC.
(2) As per Guidance note, even though no specific responsibility statement is made in respect of Unlisted Companies for IFC (i.e. from operating controls+ fraud prevention perspective), still the responsibility of ensuring adequacy and operating effectiveness of the IFC remains with the management and the persons charged with governance in the company.

Comparison of regulations

Role	Companies Act, 1956	Companies Act, 2013	Clause 49
Audit Committee	Sec 292A(7) - The Audit Committee - should have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and - review the half-yearly and annual financial statements before submission to the Board and - also ensure compliance of internal control systems.	Additional requirement: Sec 177(5) - Audit committee may call for comments of auditors about internal control systems before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company. Sec 177(4)(vii) - evaluation of IFC and risk management systems.	The Audit Committee to review matters required to be included in the Director's Responsibility Statement . Evaluate IFC and risk management systems. (new under Revised Clause 49) Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems. Review Management letters / letters of internal control weaknesses issued by the statutory auditors. Review Internal audit reports relating to internal control weaknesses. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.

Comparison of regulations

Role	Companies Act, 1956	Companies Act, 2013	Clause 49
Auditor's Responsibility	Under CARO, the reporting on internal controls was limited to the adequacy of controls over purchase of inventory and fixed assets and sale of goods and services. As such, CARO did not require reporting on all controls relating to financial reporting and also did not require reporting on the "adequacy and operating effectiveness" of such controls.	Section 143 - The auditor's report should also state whether the company has adequate IFC system in place and the operating effectiveness of such controls. As per the Guidance Note, a separate audit report is required to be issued by the auditor as annexure to the main audit report covering items such as: - Management's responsibility on IFC - Identification of Framework - Auditor's responsibility on ICFR - Inherent Limitations of ICFR - Auditors opinion on ICFR, etc. Further, in case of modified opinion, the auditor should determine the effect of modified opinion on ICFR for providing opinion on the financial statements.	If appointed, issue a certificate regarding regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company.

Key matters for consideration

Key matters for consideration

Whether directors are required to comment on Operating controls + Fraud Prevention + ICFR?

Listed Companies: Based on the reading of law, since the specific definition of IFC is prescribed under the Act for Listed Companies, the directors are required to comment on all the 3 components of IFC.

Other Companies: Under Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014, the board report of all companies to state the details in respect of adequacy of IFC with reference to the "financial statements" only.

However, Guidance Note states that, even though no specific responsibility statement is made in respect of Unlisted Companies for IFC (i.e. from operating controls+ fraud prevention perspective), still the responsibility of ensuring adequacy and operating effectiveness of the IFC remains with the management and the persons charged with governance in the company.

Clause 49 requires certification by the CEO/CFO stating that they accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of intern 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 operations of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify those deficiencies.

Key matters for consideration

As per section 143 , the auditor’s report should also state whether the company has adequate IFC system in place and the operating effectiveness of such controls. In this regard, whether auditors are responsible for reporting on operating controls?

As per Guidance note, the auditor needs to obtain reasonable assurance to state whether an adequate internal controls system was maintained and whether such IFC system operated effectively in the company in all material respects with respect to financial reporting only.

Accordingly, the term ‘Internal Financial Control – IFC’ wherever used in this Guidance Note in the context of the responsibility of the auditor for reporting on such controls under Section 143(3)(i) of the Act, per se implies and relates to internal financial controls over financial reporting i.e. ICFR.(applicable to both listed and unlisted entities).

In India, auditors are not required to report on the management’s assertion of effectiveness on internal financial controls. Reporting under the Act will be an independent assessment and assertion by the auditor on the adequacy and effectiveness of the entity’s system of internal financial controls.

Key matters for consideration

What is the specific date for reporting on the adequacy and operating effectiveness of IFC systems over financial reporting in case of Auditors and Directors?

Auditors: As per Guidance Note, the auditor should report if the company has adequate internal control systems in place and whether they were operating effectively as at the balance sheet date. Hence, if any weakness noted by him has been corrected by the management as at the balance sheet date, then reporting is not required.

Directors: Directors are responsible for ensuring adequacy and operating effectiveness of controls, hence reporting may be required even in cases where the weakness noted by them have been corrected as at the balance sheet date. As there is no clarity in law, MCA could clarify on this matter.

Whether IFC reporting is required in case of interim financial statements?

The reporting on IFC will not be applicable with respect to interim financial statements, such as quarterly or half-yearly financial statements, unless such reporting is required under any other law or regulation.

Reporting on internal control systems is similar to reporting on the commercial operations of the company. Whilst, the testing is carried out on the transactions recorded during the year, the reporting is at the balance sheet date.

Key matters for consideration

What is the auditor’s responsibility for reporting on IFC in case of Consolidated Financial Statements?

As per the Guidance Note, the requirements relating to reporting on IFC are not intended to apply in the case of the consolidated financial statements.

Further, Rule 8 of Companies (Accounts) Rules, 2014 states that the Board’s Report, which includes the Directors’ Responsibility on IFC, is required to be prepared only based on the standalone financial statements and, thus, the responsibility for establishing such controls on the subsidiaries, joint ventures and associates, in any case, may not rest with the Board of the parent company but with the management of the respective component.

However, in case of branch operations, the same is considered as integral part of the standalone financial statements and accordingly reporting on IFC would be required.

In determining the adequacy of ICFR, whether materiality needs to be considered or not?

In planning the audit of ICFR, the auditor should use the same materiality considerations as he or she would use in planning the audit of the company's annual financial statements as provided in SA 320 “Materiality in Planning and Performing an Audit”.

Key matters for consideration

Internal Control Vs. Enterprise Risk Management (‘ERM’)?

Internal control is an integral part of enterprise risk management.

The following are some of the key differences between internal controls over financial reporting and ERM:

- ERM is applied in strategy setting while IFC operate more at the process level.
- ERM is applied across the enterprise, at every level and unit, and includes taking an entity level portfolio view of risk while IFCs are applied for the processes which contribute to financial reporting.

Section 134(3)(n) - Board report to include a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the board may threaten the existence of the company.

The existence of an appropriate system of IFC does not in itself provide an assurance to the board of directors that the company has developed and implemented an appropriate risk management policy or vice versa.

IFC in case of Joint audits?

The professional responsibilities which the auditors undertake in case of Joint Audit for reporting on IFCs to be considered in line with present guidance available under SA 299 “Responsibility of Joint Auditors”.

Global Scenario

IFC - SOX Vs. Companies Act, 2013

Particulars	Section 404 – SOX	Companies Act, 2013
Applicability	All companies, including Indian Companies, which are listed on US stock exchanges are required to comply.	Applies to all Indian Companies.
Coverage	ICFR	IFC=Operating controls+ Fraud Prevention+ICFR
Issued on*	Consolidated Financial Statements – Requires Annual assessment and Quarterly review for change	Standalone Financial Statements – Annual basis
Report**	Sec 404 requires management to file "Internal Controls Report". This report must contain : ▶ statement of management's responsibility for establishing and maintaining adequate ICFR. ▶ A statement identifying the framework used by management to evaluate the effectiveness of the company's ICFR. ▶ Management's assessment of the effectiveness of the ICFR. ▶ A statement that its auditor has issued an attestation report on management's evaluation of the company's ICFR.	Directors' Responsibility Statement to state that directors, have laid down IFC to be followed by the company and that such controls are adequate and operating effectively. Further, a Separate Audit report is issued by the auditor as annexure to the main audit report covering items such as: - Management's responsibility on IFC - Identification of Framework - Auditor's responsibility on ICFR - Inherent Limitations of ICFR - Auditors opinion on ICFR, etc. Further, in case of modified opinion, the auditor should determine the effect of modified opinion on ICFR for providing opinion on the financial statements.

* Under SOX, ICFR is assessed at group level for adequacy i.e. the processes are spread across entities, where as under the Act, the adequacy of the processes are required at entity level.

** (a) Under SOX, Management is responsible for ICFR whereas under the Act, Directors are responsible for IFC.
(b) Since SOX is applicable on consolidated financial statements, the sample can be selected from the entire population of the group, whereas IFC is applicable only on standalone financial statements, accordingly the population would be restricted to the entity.

IFC provisions - India and Global comparison

	India	USA	UK
Scope	Operating Controls+Fraud Prevention+ ICFR	ICFR	All material controls, including financial, operational and compliance controls
Framework	Not defined	COSO	The UK Corporate Governance Code
Guidance	ICAI Guidance issued in November 2014*	AS-5	UK Combined Code/Turnbull guidance
Control assessment	Yes – CEO/CFO, Board	Yes	Yes
Auditor attestation	Yes – ICFR	Yes – ICFR	Yes
Rigour of implementation	Past precedent – Low Now expected to be High	High	High

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Way Forward

Framework to be adopted for ensuring compliance with IFC

In India, which framework has to be adopted for compliance with IFC?

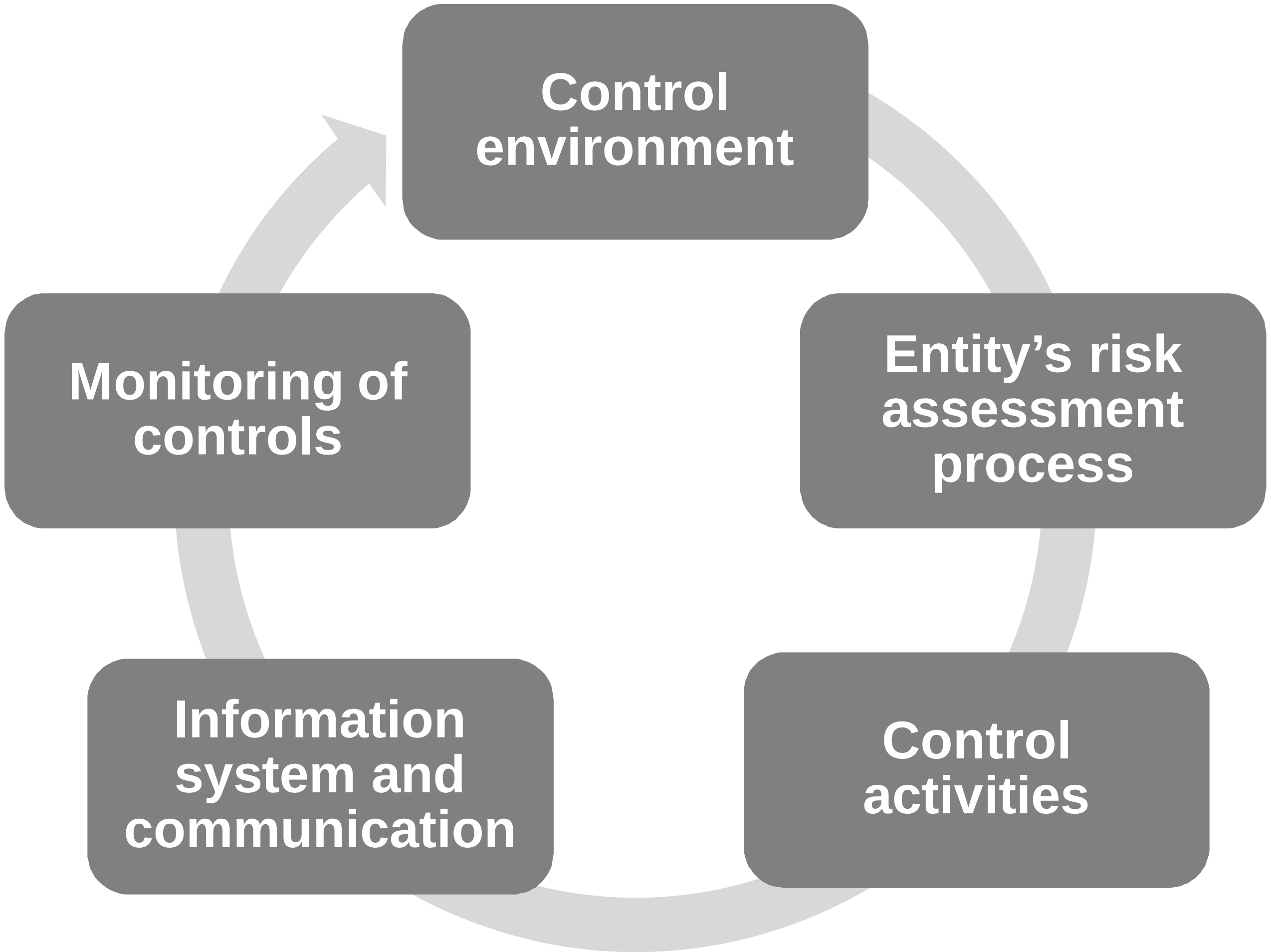
Under the Act, no framework has been prescribed. As per the Guidance Note, any of the following frameworks can be used in India:

- Internal Control - Integrated Framework issued by Committee of the Sponsoring Organisations of the Treadway Commission (COSO Framework).
- Guidance on Assessing Control published by the Canadian Institute of Chartered Accountants (CoCo).
- "Internal Control: Guidance for Directors on the Combined Code", published by the Institute of Chartered Accountants in England & Wales (known as the Turnbull Report)
- SA 315 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", could also provide the necessary framework for companies. (currently under revision by the ICAI).

COSO framework has become the most widely used internal control framework in the U.S. and has been adopted by numerous countries and businesses around the world.

Considering the fact that the control environment may vary from one framework to another, the auditor would need to consider the framework selected by the Company for the purpose of reporting on ICFR.

Components of Internal Control as per SA 315



Principles embedded in the framework

Principles-based approach: Principles represent the fundamental concepts associated with the components of internal control. It is generally expected that all principles will, to some extent, be *present and functioning* for a organization to have effective internal control. When a principle is not being met, some form of internal control deficiency exists.

1. Control Environment	▪ Demonstrates commitment to integrity and ethical values ▪ BOD demonstrates independence from management & exercises oversight of the development & performance of internal control ▪ Management, with board oversight, establishes structure, authority and responsibility ▪ The organization demonstrates commitment to competence ▪ The organization establishes accountability
2. Risk Assessment	▪ Specifies relevant objectives with sufficient clarity to enable identification of risks ▪ Identifies and assesses risk ▪ Considers the potential for fraud in assessing risk ▪ Identifies and assesses significant change that could impact system of internal control
3. Control Activities	▪ Selects and develops control activities to mitigate risks ▪ Selects and develops general controls over technology ▪ Deploys controls activities through policies and procedures
4. Information & Communication	▪ Obtains or generates relevant, quality information ▪ Communicates internally w.r.t functioning of internal controls ▪ Communicates externally w.r.t functioning of internal controls
5. Monitoring	▪ Selects, develops and performs ongoing and separate evaluations ▪ Evaluation of deficiencies and taking corrective actions

Points to focus - Examples

Environment	Principle	Points to focus
Control Environment	The organization demonstrates a commitment to attract, develop and retain competent individuals in alignment with objectives.	▶ Establishes Policies and Practices ▶ Segregation of Duties ▶ Evaluates Competence and Addresses Shortcomings ▶ Attracts, Develops, and Retains Individuals Takes Corrective Action ▶ Plans and Prepares for Succession
Risk Assessment	The organization considers the potential for fraud in assessing risks to the achievement of objectives.	▶ Considers Various Types of Fraud ▶ Assesses Incentive and Pressures ▶ Assesses Opportunities ▶ Assesses Attitudes and Rationalizations *Identification of business risk relevant to the preparation of Financial Statements in accordance with the entity's applicable financial reporting framework, assess the likelihood of their occurrence, and decide upon actions to respond to and manage them and the results thereof.*
Control Activity	The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.	▶ Establishes Policies and Procedures to Support Deployment of Management's Directives ▶ Establishes Responsibility and Accountability for Executing Policies and Procedures ▶ Performs in a Timely Manner ▶ Takes Corrective Action ▶ Performs Using Competent Personnel ▶ Reassesses Policies and Procedures Performance Reviews Information Processing Physical Controls
Information & Communication	The organization communicates with external parties regarding matters affecting the functioning of internal control.	▶ Communicates to External Parties ▶ Enables Inbound Communications ▶ Communicates with the Board of Directors ▶ Provides Separate Communication Lines ▶ Selects Relevant Method of Communication
Monitoring	Evaluation of deficiencies and taking corrective actions	▶ Perform ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning ▶ Communicate internal control deficiencies in a timely manner and take corrective actions

IFC – How Should You Proceed : Key Components

Culture & enabling structure

Define 'Tone at the Top' - Ensures alignment with objectives

- Business and long range planning
- Organisation structure and SOD
- Delegation of authority
- Compensation and rewards

Internal control system

facilitates oversight and supporting of the Board's agenda

- Policies and procedures
- Budgeting and reporting
- IT/ERP controls
- Risk management
- Code of conduct & vigil mechanism
- FCPA/ Anti bribery controls
- Fraud program
- Transaction controls

Monitoring & assurance

Direct and indirect monitoring and control activities

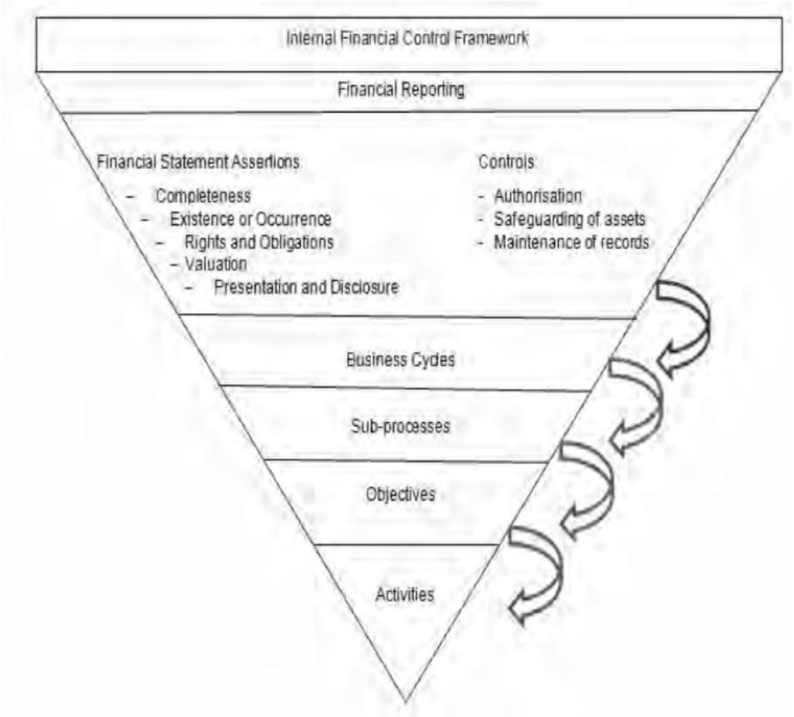
- Management Information Systems
- Internal Audit/ Special reviews
- External Audit
- Control Self Assessment (CSA)

UK (FRC) COSO Framework Companies Act

Top-down approach

- The Guidance note recommends the use of a top-down approach to the audit of IFC over FR
- A top-down approach begins at the financial statement level with the auditor's understanding of the overall risks to IFC over FR. The auditor then focusses on entity-level controls and works down to significant accounts and disclosures and their relevant assertions

Top-Down Approach to Internal Financial Controls Over Financial Reporting



Entity Level Controls

Entity Level Controls include:

- Controls related to the Control Environment
- Controls over management override
- The company’s risk assessment process
- Centralized processing and controls, including Shared Service environments
- Controls to monitor results of operations
- Controls to monitor other controls, including activities of the internal audit function, the audit committee and self-assessment programs
- Controls over the period-end financial reporting process
- Controls over the recording of unusual transactions; and
- Policies that address significant business control and risk management practices.

Identifying significant accounts and disclosures

The auditor should identify significant accounts and disclosures and their relevant assertions. Relevant assertions are those financial statement assertions that have a reasonable possibility of containing a misstatement that would cause the financial statements to be materially misstated. The financial statement assertions include:

- Existence or occurrence
- Completeness
- Valuation or allocation
- Rights and obligations
- Assertions relating to presentation and disclosure

Identifying significant accounts - example

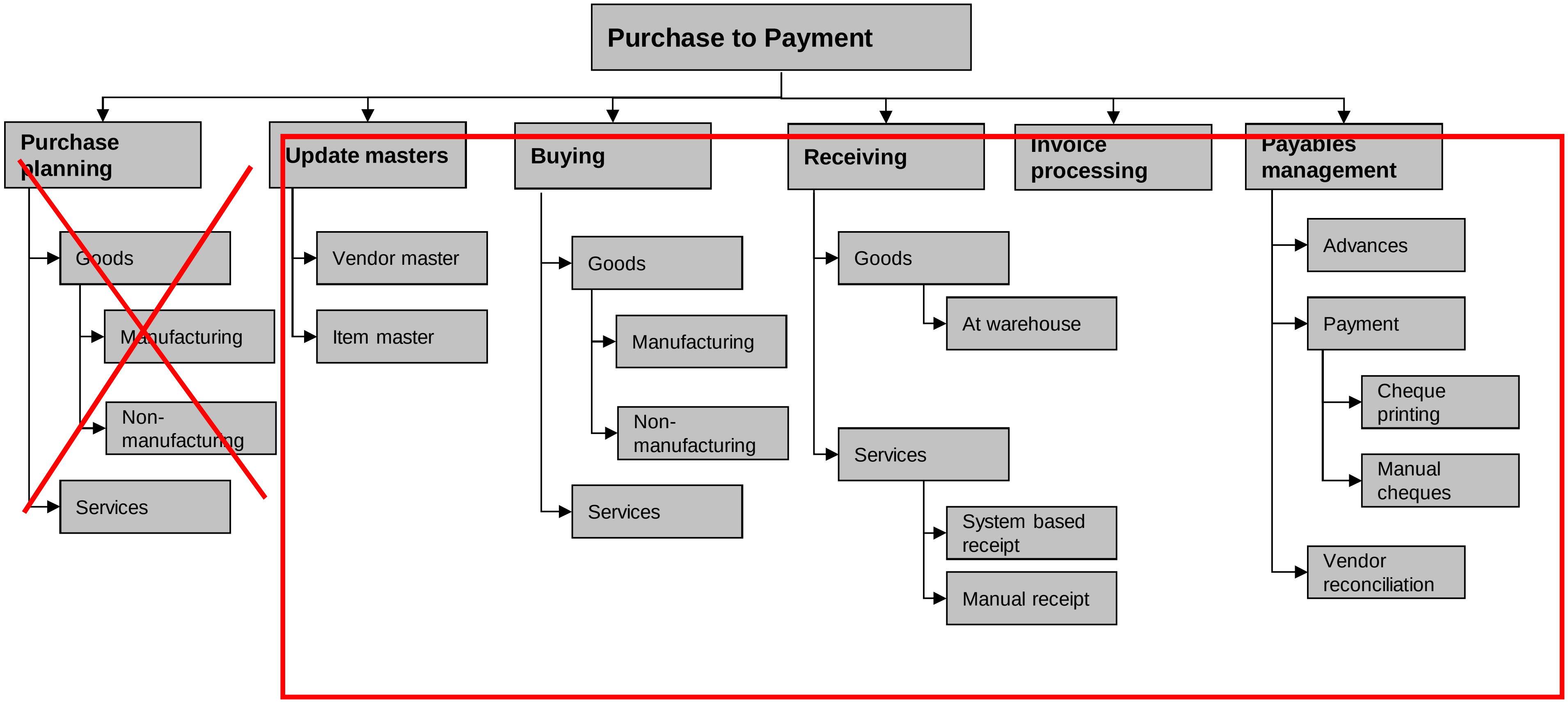
Accounts	Amount	Significant account
Cash & cash equivalents		
Cash in hand	600,000	✓ Susceptibility to fraud/error
Cash at bank	980,123,000	✓ Materiality
Accounts Receivable		
Accounts receivable	502,405,110	✓ Materiality
Accrued revenue	55,550,400	✓ Susceptibility to fraud/error
Allowance for bad debt	(1,940,305)	✓ Subjectivity in estimation
Inventories		
Raw-materials	59,204,240	✓ Materiality
Work-in-progress	49,042,040	✓ Materiality + Subjectivity
Finished goods	189,204,000	✓ Materiality
Goods-in-transit	45,603,000	✓ Susceptibility to fraud & error
Provision for obsolescence	(34,104,049)	✓ Subjectivity in estimation
Other current assets		
Current portion of deferred taxes	78,802,840	✓ Subjectivity in estimation
Prepaid expenses	5,607,000	✗ Not a significant account
Employee receivables	43,789,900	✓ Susceptibility to fraud/error
Advances to vendors	8,794,000	✓ Susceptibility to fraud/error

Mapping accounts and processes - example

Accounts	PTP	Production	Sales	Payroll	Accounting	Taxation	Treasury
Cash & cash equivalents							
Cash in hand	✓		✓	✓	✓		✓
Cash at bank	✓		✓	✓	✓	✓	✓
Accounts Receivable							
Accounts receivable			✓		✓		
Accrued revenue			✓		✓		
Allowance for bad debt			✓		✓		
Inventories							
Raw-materials	✓	✓			✓		
Work-in-progress		✓			✓		
Finished goods		✓			✓		
Goods-in-transit	✓	✓			✓		
Provision for obsolescence					✓		
Other current assets							
Current portion of deferred taxes					✓	✓	
Prepaid expenses	✓				✓		
Employee receivables				✓	✓		
Advances to vendors	✓				✓		

For each process identify activities that impact financial reporting

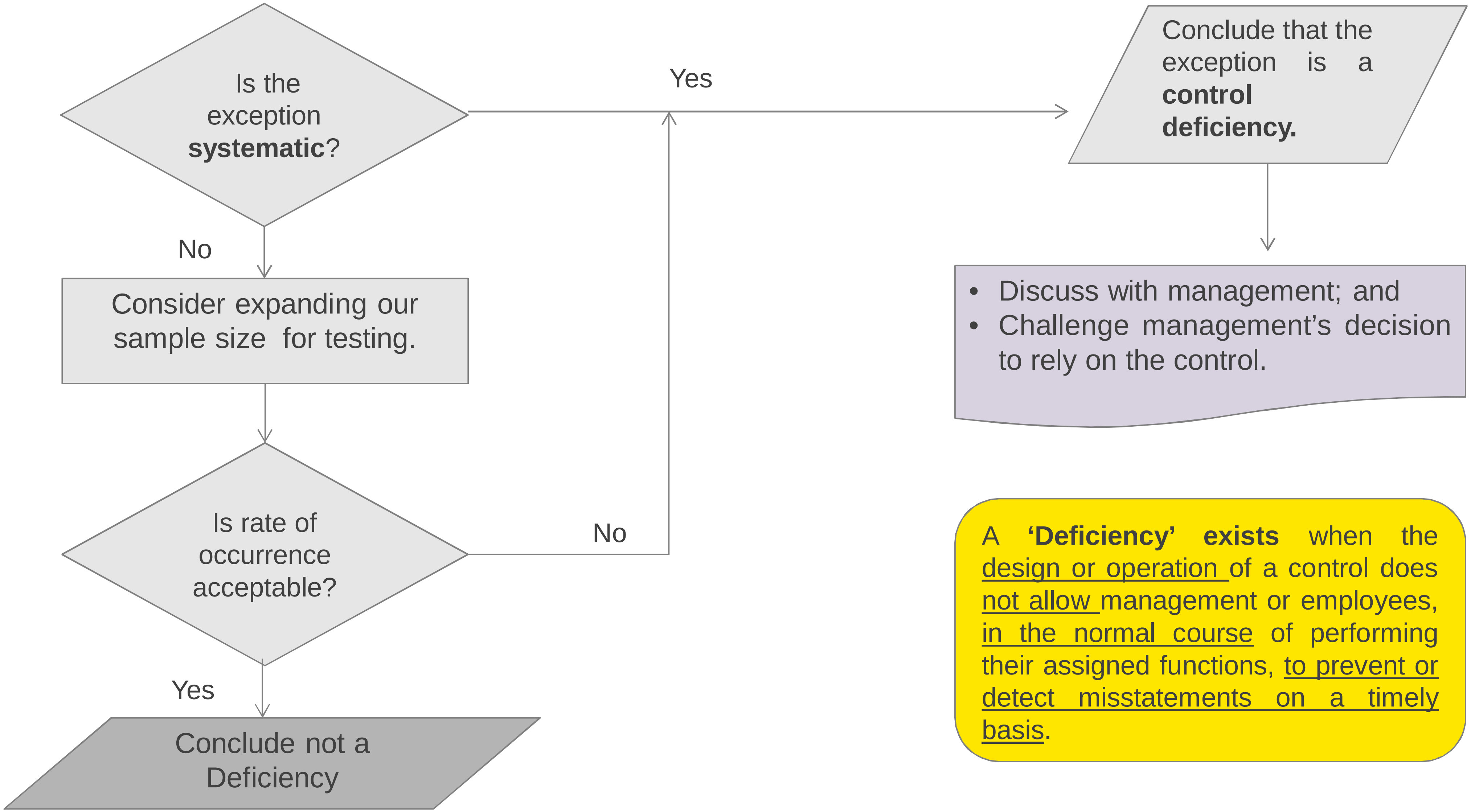
- Break down a process into all sub-activities
- For each sub-activity, assess its impact on financial reporting



Reporting considerations

Reporting - Control Exception Vs. Control Deficiency

- **Address control exceptions**



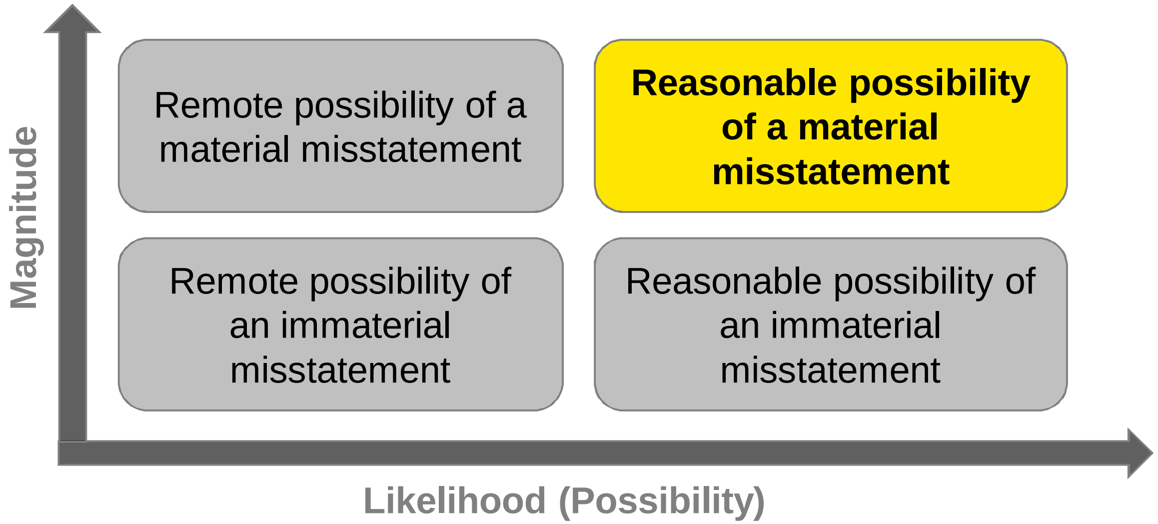
A **'Deficiency' exists** when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

Reporting – Evaluating Control Deficiency (Contd.)

- The severity of a deficiency depends on:
  - Whether there is a reasonable possibility that the entity's controls will fail to prevent or detect a misstatement of an account balance or disclosure; and
  - The magnitude of the potential misstatement resulting from the deficiency or deficiencies.

- Evaluate the severity of each control deficiency that comes to attention to determine whether the deficiencies, individually or in combination, as of the balance sheet date are,
  - significant deficiencies; or
  - material weaknesses.
- A ‘significant deficiency’ is a deficiency, or a combination of deficiencies, in ICFR that is important enough to merit attention of those charged with governance since there is a reasonable possibility that a misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.
- A ‘material weakness’ is a deficiency, or a combination of deficiencies, in ICFR, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Reporting – Evaluating Control Deficiency (Contd.)



- If there are deficiencies that, individually or in combination, result in one or more material weaknesses, must evaluate the need to express a modified opinion. -- Qualified or Adverse opinion.
- The PCAOB Auditing Standard No.5 “*An Audit of Internal Control Over Financial Reporting*” does not provide for issuing a Qualified opinion.

Note: As per Guidance note, if a material weakness is identified with respect to customer acceptance, credit evaluation and establishing credit limits for customers resulting in a risk of revenue recognition where potential uncertainty exists for ultimate realisation of the sale proceeds, the auditor may modify the opinion on IFC in that respect. However, in an audit of financial statements, the auditor when performing substantive procedures obtains evidence of confirmation of customer balances and also observes that all debtors as at the balance sheet date have been subsequently realised by the date of the audit, the audit opinion on the financial statements should not be qualified, though the internal control deficiency exists.

Indicators of Material Weakness

- Identification of fraud, whether or not material, on the part of the senior management.
- Errors observed in previously issued financial statements in the current financial year
- Identification by the auditor of a material misstatement of financial statements in the current period in circumstances that indicate that the misstatement would not have been detected by the company's internal financial controls over financial reporting
- Ineffective oversight of the company's external financial reporting and IFC by the company's audit committee.

Auditor should determine level of detail and degree of assurance that would satisfy prudent officials in the conduct of their own affairs that they have reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in conformity with GAAP. Materiality should be considered by auditor while treating severity of deficiency or a combination of deficiencies.

Subsequent Events

Changes in IFC over financial reporting or other factors that might significantly affect IFC over financial reporting might occur subsequent to the date as of which internal financial controls over financial reporting is being audited but before the date of Auditors report. Such events are called Subsequent events.

Following reports can be examined to keep a check on subsequent events:

- Internal audit report issued during the subsequent period
- Regulatory agency reports on the Company's IFC over Financial Reporting.
- Information on IFC on Financial Reporting through other engagements

Obtaining Written Representations

Company's ICFR written representation should include management's statement/acknowledgment of :

- responsibility for establishing and maintaining adequate ICFR effectively;
- performing an evaluation & assessment of the adequacy and effectiveness of ICFR and specifying control criteria;
- accepting that auditor's procedures performed during the audits of ICFR has not been used as a basis for management's assessment of adequacy and effectiveness of ICFR.
- describing about fraud resulting in material misstatement to the company's financial statement and any other fraud that doesn't result in material misstatement but involves senior management who has significant role in ICFR if any;
- concluding about the adequacy and effectiveness of the company's ICFR based on the control criteria as of the balance sheet date;
- stating whether control deficiencies identified and communicated to the audit committee during previous engagements pursuant to paragraph 137 and 139 have been resolved and details of any subsequent events identified.

Forming an Opinion

- Auditor should form an opinion on the adequacy and operating effectiveness of ICFR by evaluating evidence obtained from all sources, including the auditor's TOC, misstatements detected or any identified control deficiencies.
- Auditor should evaluate by reviewing reports issued during the year by internal audit or similar functions.
- After forming an opinion auditor should evaluate the disclosures that the management and BOD is required to make, under the Companies Act, 2013 on IFC.
- If auditor determines that any required elements are incomplete or improperly presented ,auditor should perform procedures according to SA-720.
- Auditor may form an opinion on the adequacy and operating effectiveness of ICFR only when there are no restrictions on the scope of auditor's work. A scope limitation requires the auditor to disclaim an opinion or withdraw from the engagement

Let’s Discuss