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GAAP Reporter

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Introduction

Dear Reader,

Grant Thornton in India presents 'GAAP Reporter', a quarterly bulletin that summarises significant accounting, auditing and related updates. This publication has been compiled to meet the needs of dynamic Indian businesses and focuses on key developments in India and across the globe.

To access the source of information, you can click the hyperlink text, wherever applicable; for complete details, please refer the original pronouncements.

We would be pleased to receive your feedback. Please write to us at contact@in.gt.com with your comments, questions or suggestions.

This edition covers updates for the quarter ended September 2015. All abbreviations used in the publication are explained at the end of the publication.

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ICAI Guidance Note on "Audit of Internal Financial Controls over Financial Reporting"

Section 143(3)(i) of the Companies Act, 2013 (the "Act") requires the statutory auditor to state in his audit report whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.. In order to assist the members to understand and perform the various aspects of this reporting responsibility, the AASB of ICAI has released the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting.

The Guidance Note covers aspects such as scope of reporting on internal financial controls under the Act, essential components of internal controls, technical guidance on audit of Internal Financial Controls, Implementation guidance on audit of Internal Financial Controls. The Appendices to the Guidance Note include Illustrative Engagement Letter, Illustrative Management Representation Letter, Illustrative Reports on Internal Financial Controls, Illustrative Risks of Material Misstatement, and Related Control Objectives and Control Activities.

Click here for more details.

The QRB of ICAI issues review findings

The QRB has issued 'A Report on Audit Quality Review Findings (2012-15)'.

This report summarises findings in relation to compliance with accounting and auditing standards in addition to compliance with relevant laws and regulations.

Click here for more details.

Extension of date for filing of Income tax returns and tax audit reports to 31 October 2015

The CBDT, in exercise of its powers conferred under Section 119 of the Income Tax Act, 1961, has extended the due date of e-filing of returns of income and audit reports under section 44AB from 30 September 2015 to 31 October 2015.

Click here for more details.

India -Other Updates

ICSI issues responses to Queries received on Secretarial Standards on Board Meetings (SS-1) and General Meetings (SS-2)

The ICSI has issued a publication on responses to queries received on SS-1 and SS-2. The handbook is a compilation of the queries received by the ICSI and their responses based on the interpretation of provisions.

Click here for ICSI Publication on SS-1

Click here for ICSI Publication on SS-2

Relaxation of additional fees and extension of last date of filing of Forms MGT -7 (Annual Return) and AOC -4 (Financial Statement) under the Companies Act, 2013

The MCA has released a circular intimating the availability of the electronic version of the Forms MGT -7, AOC-4 and AOC-4 XBRL for filing, by 30 September 2015 and extension of date for filing these forms up to 31 October 2015, without additional fees.

A separate form for filing of consolidated financial statements, 'AOC-4 CFS', will be available to companies which are not required to file their financial statements in XBRL format but are required to file their consolidated financial statements. Such companies would be able to file these forms, without additional fees, up to 30 November 2015.

Click here for more details.

Clarification with regard to circulation and filing of financial statement under relevant provisions of the Companies Act, 2013

The MCA has clarified certain issues in relation to circulation and filing of financial statements. Key amendments are as follows:

- A company holding a general meeting after giving a shorter notice may also circulate financial statements at such shorter notice;
- In case of a foreign subsidiary which is not required to get its financial statements audited in accordance with the legal requirements in the country of incorporation, the Indian parent may place/file such un-audited accounts to comply with requirements of Section 136(1) and 137(1). The aforesaid section requires every company having a subsidiary or subsidiaries to place on its website, if any, separate audited accounts in respect of each of its subsidiary. Further, a company is required to attach along with its financial statements the accounts of its subsidiary(ies) which have been incorporated outside India and which have not established their place of business in India. However, these financial statements of such foreign subsidiaries would be required to be translated in English, if the original accounts are not in English. Further, the format of these accounts should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/filed along with such accounts

Click here for more details.

Companies (Management and Administration) Amendment Rules, 2015

The MCA has issued the Companies (Management and Administration) Amendment Rules 2015 to state that special notice can be signed by the members holding shares with an aggregate paid up value of not less than Rs 5 lakhs

Further, Form MGT 7 for Annual return has been substituted with new form through amendment Rules.

The MCA has also inserted the requirement to add PAN of the company in Form MGT-7, together with the existing requirements.

Click here for Amendment Rules.

Click here for notification relating to requirement for inclusion of PAN.

Amendments relating to disclosure requirements in Schedule III of Companies Act, 2013

The MCA has issued a notification to expand the disclosures relating to trade payables. The companies are now required to disclose trade payables to micro enterprises and small enterprises separately from other trade payables. Further, Company is required to disclose certain additional details including principal amount and interest due thereon remaining unpaid at the end of each accounting year, amount of interest paid by the buyer and amount of interest due and payable for the period of delay in making payment relating to trade payables to micro enterprises and small enterprises.

The notification is effective from 4 September 2015

Click here for more details.

MCA exempts specified Government companies from certain disclosure requirements

The MCA has issued notification to exempt government companies manufacturing defence equipments, including space research, from disclosing certain information relating to inventories and expenditure and earnings in foreign currency in the financial statements subject to compliance with specified conditions, including compliance with prescribed accounting standards and directors' consent to avail the exemption.

The notification shall be applicable in respect of financial statements prepared in respect of financial years ending on or after 31 March 2016.

The MCA has also provided exemption from specified matters to be included in board's report such as conservation of energy, technology absorption, foreign exchange earnings and outgo.

Click here for more details.

Companies (Accounts) Second Amendment Rules, 2015

The MCA has made certain amendments in the Rules relating to preparation of financial statements, which are as follows

- Defined the term 'Indian Accounting Standards' which will be the standards as referred in annexure to the Companies (Indian Accounting Standards) Rules, 2015.
- Clarified that financial statements shall be prepared as per the requirements of Schedule III and also comply with Accounting Standards or Indian Accounting Standards, as applicable. It also states that the items contained in the financial statements shall be prepared in accordance with the definitions and other requirements specified in the Accounting Standards or the Indian Accounting Standards, as the case may be.

Such amendment removes conflict in the use of definition as per AS/Ind AS or the Companies Act, 2013.

- The amended rules state that every company shall file the financial statements with the registrar together with Form AOC-4 and the consolidated financial statements, if any, with Form AOC-4 CFS. Further, the amended rule clarifies that the company which are required to prepare consolidated financial statements, are required to file the same with registrar with the specified Form.

The notification shall come into force from the date of its publication in the official gazette.

Click here for more details.

Companies (Filing of documents and forms in XBRL) Rules, 2015

The MCA has issued Companies (Filing of documents and forms in XBRL) Rules, 2015 which shall come into force from the date of their publication in the official gazette. The MCA has notified the class of companies which are required to file their financial statements and other documents with the registrar in e-form AOC-4 XBRL for the financial years commencing on or after 1 April 2014. Further, a company which is required to file cost audit report and other documents to Central Government, shall file such report and other documents in XBRL form for financial years commencing on or after 1 April 2014

Click here for more details.

Companies (Acceptance of Deposits) Second Amendment Rules, 2015

The MCA has issued amendment rules and added new exempted category of deposits. The Amendment Rules state that the amount received by private companies, from relatives of directors, will not be treated as deposits. The above exemption would be applicable if relative of director of private company furnishes to the company at the time of giving the money a declaration in writing to the effect that, such money is not out of borrowed funds or deposits and details of such deposits from directors and their relatives are given in the Board's report. The Amendment Rules has also replaced the term "paid-up share capital and free reserves" with "paid-up share capital, free reserves and securities premium account".

Click here for more details.

Guidance Note on SEBI (Prohibition of Insider Trading) Regulations, 2015

SEBI had notified SEBI (Prohibition of Insider Trading) Regulations, 2015 ("the Regulations") dated 15th January, 2015. The regulations were effective from 15 May 2015.

In August 2015, SEBI has issued a Guidance note clarifying that the exercise of ESOPs by employees shall not be considered "trading" except for the purposes of disclosure requirements. However, the other provisions of the regulations shall apply to the sale of shares so acquired.

The guidance note also clarifies questions relating to contra trades in derivatives and with respect to buyback of shares, open offers, rights issues, follow-on public offerings, etc. by listed companies. It also deals with issues relating to pledge and other miscellaneous matters.

Click here for for more details.

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

SEBI has issued a notification dated 2 September 2015 to issue SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Regulations). The aforesaid regulations provides ease of reference by consolidating into one single document the requirements applicable to various types of securities listed on the stock exchange.

On 13 October 2015, SEBI has issued a circular to provide a layout of simplified listing agreement, to be executed within six months from the date of notification of the Regulations.

The Regulations includes:

- principles governing disclosures and obligations of listing entities.
- common obligations of listed entities
- obligations of listed entities which has listed its specified securities
- duties and obligations of the recognized stock exchange(s)

The regulations will come into force on the ninetieth day from the date of their publication in the Official Gazette. However,the following two provisions are applicable with immediate effect:

- Passing of ordinary resolution instead of special resolution in case of all material related party transactions subject to related parties abstaining from voting on such resolutions and
- Re-classification of promoters as public shareholders under various circumstances

Additionally, SEBI has issued a circular dated 9 September 2015, which provides guidance indicating details to be provided while disclosing information pursuant to Regulation 30, Disclosure of events and information.

Such information requirements would be classified into two categories:

- Information deemed to be material including acquisition, split or consolidation of shares, buyback of securities, revision in ratings assigned from a credit rating agency to any debt instrument, change in directors/key managerial personnel/ auditor/compliance officer and one time settlement with bank
- Information on which the listed entity may apply materiality including commencement or postponement of commercial production or operations, change in nature of business and effects of change in regulatory framework applicable to the listed entity

Click here for SEBI Regulations.

Click here for SEBI Circular

Click here for layout of simplified listing agreement

SEBI (Share based employee benefits) (Amendment) Regulations, 2015

SEBI had amended the regulations issued on 28 October 2014 vide notification dated 18 September 2015 which includes the following:.

- Change in the definition of 'employee' to exclude employee of associate companies
- Listed companies with employee benefit trusts existing as on the date of notification of the regulations would have to reclassify the shareholding of trust as 'non-promoter and non-public' category and ensure compliance with the requirement of minimum public shareholding within three years
- The time period for exercise of voting rights by employee benefit trusts, existing as on the date of notification of regulations has been increased to three years

The regulations shall come into force on the date of their publication in the Official Gazette

Click here for more details.

Prior approval of RBI required in case of acquisition/ transfer of control of NBFC

The RBI has revised Non-banking financial Companies (Approval of acquisition or transfer of control) Directions, 2014 by notification dated 9 July 2015 which mandates its prior approval for:

- Any takeover or acquisition of control of an NBFC;
- Any change in the shareholding pattern of an NBFC including progressive increases over time, which would result in acquisition/ transfer of shareholding of 26 per cent or more of the paid up equity capital of the NBFC;
- Any change in the management of the NBFC which would result in change in more than 30 per cent of the directors, excluding independent directors

The notification also provides directions for application for prior approval and requirement of prior public notice about change in control or management.

Click here for more details.

RBI roadmap to implement Ind AS

RBI has recommended to the MCA a roadmap for the implementation of Ind AS by banks and non-banking financial companies from 2018-19 onwards. RBI has constituted a Working Group for its implementation.

The Report of the Working Group will be placed on the RBI website by end of October 2015 for public comments.

Click here for more details.

Issue of shares under Employees Stock Options Scheme and/or sweat equity shares to persons resident outside India

RBI has issued a circular dated 16 July 2015 that permits Indian companies to issue shares under Employees Stock Options Scheme and/or sweat equity shares to its employees/ directors or employees/directors of its holding company or joint venture or wholly owned overseas subsidiary/ subsidiaries who are resident outside India subject to conditions stated therein.

Such conditions include:

- The issue of shares are in compliance with the sectoral cap applicable to the said company;
- If such issue of shares is under the approval route, it shall require prior approval of the FIPB of Government of India.

It also requires certain information in relation to the issue to be filed in a prescribed form.

Click here for more details.

Institute of Cost Accountants of India issues Guidance Notes

The Institute of Cost Accountants of India has released Guidance Note on the following:

- Internal Audit of Engineering Industry
- Internal Audit of Plantation Industry

Click here for Guidance Note on Internal Audit of Engineering Industry

Click here for Guidance Note on Internal Audit of Plantation Industry

MCA notifies Cost Auditing Standards

The MCA has granted approval to the following Cost auditing standards under section 148 (3) of the Companies Act, 2013:

- Cost Auditing Standard-101 on Planning an audit of Cost Statements;
- Cost Auditing Standard-102 on Cost Audit Documentation;
- Cost Auditing Standard-103 on Overall objectives of the independent cost auditor; and
- Cost Auditing Standard-104 on Knowledge of business, its processes and the business environment.

These standards are effective from 11 September 2015.

Click here for more details.

International -Auditing & Accounting Updates

IAASB revises ISAs to more explicitly address disclosures

The IAASB has revised ISAs to more explicitly address disclosures in the financial statements. The revisions, (i) enhance the requirements in various ISAs to drive changes in the auditor's approach and improve consistency in practice to more specifically address disclosures, in particular qualitative disclosures and (ii) clarify the auditor's work effort in relation to disclosures by providing additional guidance to assist auditors in better applying the requirements relating to disclosures.

The IAASB staff has also developed guidance highlighting matters that may be of relevance for auditors when addressing disclosures as part of an audit of financial statements.

The revised ISAs would be effective for audits of financial statements for period ending on or after 15 December, 2016.

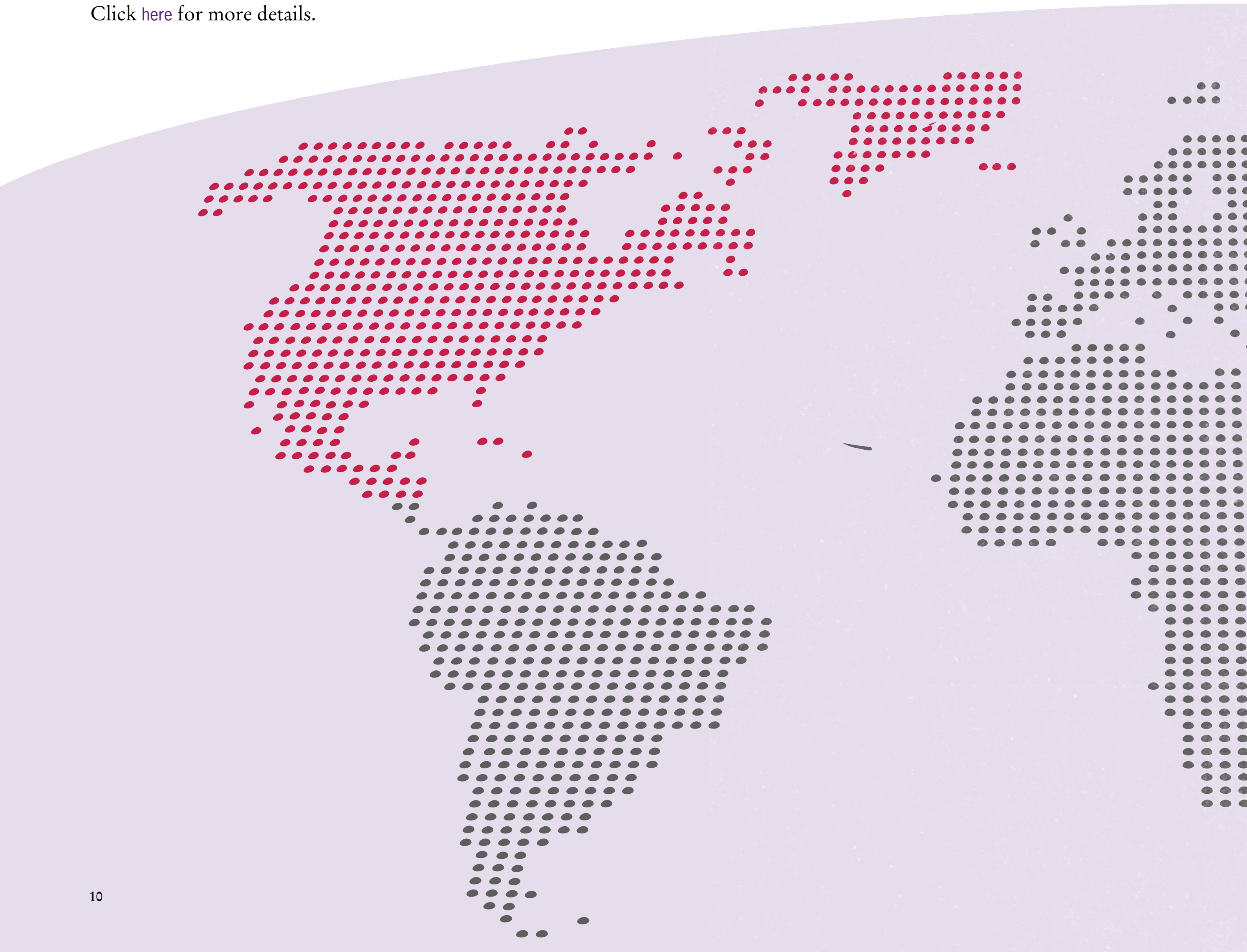
Click here for more details.

IASB confirms One-year Deferral of Revenue Standard

IASB has confirmed a one-year deferral of the effective date of the revenue standard, IFRS 15- Revenue from Contracts with Customers. The standard is now effective from annual periods beginning on or after 1 January 2018.

Earlier application continues to be permitted.

Click here for more details.



America - Auditing Updates

Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Auditing Standards and Rules

The SEC has approved the PCAOB proposal to reorganize the auditing standards and make related changes to PCAOB rules and attestation, quality control, and ethics and independence standards.

The amendments to PCAOB standards and rules include changes, withdrawing certain interim auditing standards that the Board believes are no longer necessary, eliminating inoperative language in auditing standards, references, and interpretations, and eliminating inoperative references to AICPA standards or rules.

The proposal would reorganize the PCAOB's standards into the following categories:

- General auditing standards (AS 1000s).
- Audit procedures (AS 2000s).
- Auditor reporting (AS 3000s).
- Matters related to filings under federal securities laws (AS 4000s).
- Other matters associated with audits (AS 6000s).

These Proposed Rules to implement the reorganisation of PCAOB Auditing standards would be effective as of December 31, 2016. However, auditors and others are not precluded from using and referencing the standards as reorganized pursuant to the Proposed Rules before the effective date because the amendments do not substantively change the standards' requirements.

Click here for more details.

America - Accounting Updates

FASB simplifies accounting for inventory

The FASB has issued ASU 2015-11 Inventory (Subtopic 330) 'Simplifying the Measurement of Inventory', to amend the guidance on measurement of inventory. The update provides for measurement of inventory at lower of cost and Net Realizable Value (NRV), where NRV shall be the market selling price less reasonably predictable costs of completion, disposal, and transportation.

The ASU replaces the earlier guidance to measure inventory at lower of cost and market, where market was defined as replacement cost, provided it is not above NRV (i.e., the ceiling) or below NRV less an "approximately normal profit margin" (i.e., the floor)

This update does not apply to inventory measured either using last in first out method or the retail inventory method

For public business entities: The ASU becomes effective for fiscal years beginning after 15 December 2016 and interim periods within those fiscal years.

For all other entities: The ASU becomes effective for financial statements issued for fiscal years beginning after 15 December 2016 and interim periods within fiscal years beginning after 15 December 2017.

The amendments are to be applied prospectively. Earlier adoption is permitted as of the beginning of an interim or annual reporting period.

Click here for more details.

FASB simplifies accounting of employee benefit plans

The FASB has issued ASU 2015-12, divided in 3 parts, to reduce the complexity in accounting of employee benefit plans.

Part I Plan Accounting - (Topic 962 and 965) 'Fully Benefit Responsive Investment Contracts', is issued to simplify the presentation and disclosure requirements of fully responsive investment contracts. The update requires, fully benefit responsive investment contracts to be disclosed and presented at contract value only. The update eliminates the requirement to disclose the fair value and reconciliation between contract value and fair value.

Part II Plan Accounting - (Topic 960, 962 and 965); 'Plan Investment Disclosures' simplifies the presentation and disclosure requirements. The update eliminates the requirements to:

- disclose individual investments that represent 5% or more of net assets available for benefits and
- disaggregate the net appreciation or depreciation for investments by general type.

Part III Plan Accounting - (Topic 960, 962 and 965) 'Measurement Date Practical Expedient', provides practical expedient on the measurement basis to be used for valuation of employee benefit plans. The amendment allows the entity to measure investment related accounts at a month end date which is closest to financial year end, if the financial year end does not coincide with a month end. In such a case if any significant event occurs between the month end and financial year end, the same shall be disclosed.

For all entities: The ASU becomes effective for financial statements issued for fiscal years beginning after 15 December 2015.

Earlier adoption is permitted. Requirements for Part I and Part II are to be applied retrospectively, while requirements of Part 3 shall be applicable on a prospective basis.

Click here for more details.

FASB provides application guidance for accounting of certain electricity contracts

The FASB has issued ASU 2015-13 Derivatives and Hedging (Topic 815) 'Application of the Normal Purchases and Normal Sales Scope Exception to Certain Electricity Contracts within Nodal Energy Markets' to provide specific guidance for contracts for sale or purchase of electricity on a forward basis with nodal energy markets. A nodal energy market is an interconnected electricity grid operated by an independent system operator with established price points at each node or hub location.

The standard clarifies that marginal pricing system (wherein electricity is sold at each grid point) doesn't result in net settlement of contract of purchase or sale of electricity. Hence, the contract still meets the physical delivery criterion and is eligible for normal purchase and normal sale exception to derivative accounting principles laid down in the standard.

The amendment shall be effective immediately and will be applied prospectively

Click here for more details.

FASB defers effective date for the new revenue standard

The FASB has issued ASU 2015-14 Revenue from Contracts with Customers (Topic 606) 'Deferral of the Effective Date', to defer the effective date of the new revenue standard by one year for both public and other entities.

For public business entities: The new revenue standard now becomes effective for fiscal years beginning after 15 December 2017 and interim periods within those fiscal years.

For all other entities: The new revenue standard becomes effective for fiscal years beginning after 15 December 2018 and interim periods within annual reporting periods beginning after 15 December 2019.

Earlier adoption is permitted for all entities for period beginning after 15 December 2016 and interim period within those fiscal years. Entities other than public business entities are permitted to apply the new revenue standard in the interim periods within the year of initial application or one year subsequent to the year of initial application.

Click here for more details.

FASB adds SEC announcement on recognition and measurement of debt issuance cost associated with Line-of-Credit Arrangements

The FASB has issued ASU 2015-15 Interest—Imputation of Interest (Subtopic 835-30) 'Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements'.

The update clarifies that debt issuance costs incurred in relation to line of credit arrangements can be presented as a deferred charge (i.e. an asset) and need not be presented as a direct deduction from the carrying amount of the debt liability. The update further clarifies that such debt issuance costs can be amortised over the period of the term of the line of credit arrangement.

Click here for more details.

FASB simplifies the accounting for measurement period adjustments in business combinations

The FASB has issued ASU 2015-16 'Business Combinations (Topic 805): 'Simplifying the Accounting for Measurement-Period Adjustments' to simplify the accounting of adjustments made to provisional amounts recognised in Business Combinations. .Under the ASU, the acquirer shall record the adjustments in the reporting period in which they were identified. Accordingly, the adjustments should not be made retrospectively

This update requires entities to present separately in income statement or in notes, the amount recorded in current period earnings, by line item, which would have been recorded in previous period if the adjustment would have been made as of the acquisition date.

For public business entities: The ASU becomes effective for fiscal years beginning after 15 December 2015 and interim periods within those fiscal years.

For all other entities: The ASU becomes effective for financial statements issued for fiscal years beginning after 15 December 2016 and interim periods within fiscal years beginning after 15 December 2017.

Earlier adoption is permitted. Adjustments to provisional amounts, occurring after the effective date, should be made prospectively.

Click here for more details.

Hot Topic

Reporting on Internal Financial Controls ('IFC')

The Companies Act 2013 (the 'Act') puts new responsibilities for the companies to establish and maintain internal financial controls, and as well as for the companies' auditors to report on the adequacy and operating effectiveness of such internal financial controls.

While we are generally familiar with the terms 'internal control' and 'internal control systems' used in the context of financial statements in India, the concept of, and the new requirements for 'internal financial controls' introduced by the Act is somewhat different.

Definition of internal financial controls

The Act provides that the term 'internal financial controls' 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'. However, this definition is very broad and appears to cover propriety as well as operational controls, in addition to financial controls.

Directors' responsibility

It is noteworthy that the said definition has been provided with reference to directors' responsibility. The Act provides that the Directors' Responsibility Statement 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. The Act also requires the audit committees to evaluate internal financial controls and the risk management systems. In addition, 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 internal financial controls with reference to the financial statements.

Auditor's responsibility

The Act requires that the audit report shall state in respect of all companies, whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.

In September 2015, ICAI issued the Guidance Note on *Audit of Internal Financial Controls Over Financial Reporting* (the 'Guidance Note')

The Guidance Note covers aspects such as scope of reporting on internal financial controls under the Companies Act 2013, essential components of internal controls, technical guidance on audit of Internal Financial Controls, implementation guidance on audit of Internal Financial Controls.

The Guidance Note clarifies that the Act specifies the auditor's reporting on internal financial controls only in the context of audit of financial statements, and thus, consistent with the practice prevailing internationally, the term 'internal financial controls' stated in Section 143(3)(i) would relate to 'internal financial controls over financial reporting'.

Key highlights of the Guidance Note

IFC reporting on interim financial statements

The Guidance Note clarifies that reporting on internal financial controls will not be applicable with respect to interim financial statements, such as quarterly or half-yearly financial statement, as reporting requirement is for financial statements prepared under the Act and for audit reports issued under Section 143 of the Act, unless such reporting is required under any other law or regulation.

IFC reporting on consolidated financial statements ('CFS')

The Guidance Note has clarified by stating that reporting on the adequacy and operating effectiveness of IFC would apply even in the case of CFS, for the respective components included in the CFS only if it is a company under the Companies Act 2013 and illustrative audit report for different circumstances in case of Consolidated Financial Statements is given in the Guidance Note. The Guidance Note provides that the auditors can rely on the work of other auditor's and include reference of such reliance in its Auditor's Report while reporting on internal financial controls over financial reporting, similar to reporting on the financial statements.

Criteria to be considered for developing, establishing and reporting on IFC

The Guidance Note provides that the internal financial controls over financial reporting shall mean 'a process designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with generally accepted accounting principles'. The Guidance Note does not prescribe a particular framework, instead the Guidance Note states that a benchmark system of internal control, based on suitable criteria, is essential to enable the management and auditors to assess and state the adequacy and compliance of the system of internal controls. Further, the Guidance Note refers to Appendix 1 of *Standards on Auditing (SA) 315, Identifying and Assessing the Risk of Material Misstatement through Understanding an Entity and Its Environment* which provides necessary criteria for internal financial controls over financial reporting for companies

Auditors' consideration

The auditor's reporting on the adequacy and operating effectiveness of company's internal financial control systems has to be as at the balance sheet date. Although, the extent of testing at or near the balance sheet date may be higher, the auditor should test the internal financial controls during the financial year under audit.

The audit of internal financial controls over financial reporting should be combined with the audit of the financial statements. In a combined audit of internal financial controls over financial reporting and the financial statements, the auditor should design his or her testing of controls to accomplish the objectives of both audits simultaneously.

The auditor may choose to issue combined report (i.e., one report containing both, an opinion on the financial statements and an opinion on internal financial controls over financial reporting), or separate reports on those. The date of the audit report on internal financial control over financial reporting should be the same as that of the date of the audit report on the financial statements where separate reports are issued.

For expressing an opinion, the auditor must plan and perform the audit to obtain appropriate evidence that is sufficient to obtain reasonable assurance about whether the material weaknesses exist as of the balance sheet date. A significant deficiency or material weakness in internal financial control over financial reporting may exist even when financial statements are not materially misstated.

Materiality considerations for the purpose of audit of internal financial controls over financial reporting and financial statements should be same. The auditor should use a top-down approach to the audit of internal financial controls. This approach begins at the financial statements level and assertions that presents a reasonable possibility of material misstatement to the financial statements. The auditor then selects for testing those controls that sufficiently address the assessed risk of misstatement to each relevant assertion.

The auditor should focus more on the areas of highest risk. And hence, it is not necessary to test controls that, even if, deficient, would not present a reasonable possibility of material misstatement to the financial statements. The auditor should test the design effectiveness of controls as this will enable him to conclude if the company has adequate internal financial controls over financial reporting. And to enable himself to comment on effectiveness of the internal financial controls, the auditor performs walkthroughs which includes mix of inquiry of appropriate personnel, observation of the company's operations, and inspection of relevant documentation.

The guidance note also provides guidance related to the frequency of the performance of control that may be considered when planning the extent of tests of operating effectiveness of manual controls for which control deviations are not expected to be found. The auditor may determine the appropriate number of control occurrences to test based on the following minimum sample size for the frequency of the control activity dependant on whether assessment has been made on a lower or higher risk of failure of the control.

Frequency of control activity	Minimum sample size Risk of failure	
	Lower	Higher
Annual	1	1
Quarterly (including period – end, i.e., +1)	1+1	1+1
Monthly	2	3
Weekly	5	8
Daily	15	25
Recurring manual control (multiple times per day)	25	40

Note: Although +1 is used to indicate that the period–end control is tested, this does not mean that for more frequent control operations the year-end operation cannot be tested.

Auditors are not required to report on the management's assessment of effectiveness on internal financial controls. As a result, reporting by auditors will be an independent assessment on the adequacy and effectiveness of the company's internal financial controls. Further an auditor is required to communicate significant deficiency and material weakness in internal financial controls system with those charged with governance.

Summing up

The requirements of reporting on internal financial controls would apply to audits of standalone and consolidated annual financial statements of the periods beginning on or after 1 April 2015.

While there is no guidance for companies from the MCA, in line with the requirement under ICAI guidance note, the Companies may consider referring the guidance for the auditors (to the extent applicable in carrying out internal financial controls assessment on behalf of the company's management) while implementing internal financial controls to avoid any inconsistency in the approach.

Abbrevations used in this publication

AASB - Auditing and Assurance Standards Board

AICPA – American Institute of Certified Public Accountants

ASU - Accounting Standards Update

CBDT – Central Board of Direct Taxes

ESOP – Employee Stock Option Plan

FASB – Financial Accounting Standards Board

FIPB - Foreign Investment Promotion Board

IAASB - International Auditing and Assurance Standards Board

IASB – International Accounting Standards Board

ICAI – Institute of Chartered Accountants of India

ICSI – Institute of Company Secretaries of India

Ind AS – Indian Accounting Standards

ISA – International Standards on Auditing

MCA – Ministry of Corporate Affairs

NBFC – Non Banking Financial Company

PCAOB – Public Company Accounting Oversight Board (United States)

QRB – Quality Review Board

RBI – Reserve Bank of India

SEBI – Securities and Exchange Board of India

SEC – Securities and Exchange Commission

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