

Report Modifications	C1–C15
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Introduction

1. This standard establishes requirements and provides direction that applies when an auditor is engaged to perform an audit of *management's assessment*¹ of the effectiveness of *internal control over financial reporting* ("the audit of internal control over financial reporting") that is integrated with an audit of the financial statements.²

2. Effective internal control over financial reporting provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes.³ If one or more *material weaknesses* exist, the company's internal control over financial reporting cannot be considered effective.⁴

3. The auditor's objective in an audit of internal control over financial reporting is to express an opinion on the effectiveness of the company's internal control over financial reporting. Because a company's internal control cannot be considered effective if one or more material weaknesses exist, to form a basis for expressing an opinion, the auditor must plan and perform the audit to obtain competent evidence that is sufficient to obtain reasonable assurance⁵ about whether material weaknesses exist as of the date specified in management's assessment. A material weakness in internal control over financial reporting may exist even when financial statements are not materially misstated.

4. The general standards⁶ are applicable to an audit of internal control over financial reporting. Those standards require technical training and proficiency as an auditor, independence, and the exercise of due professional care, including professional skepticism. This standard establishes

¹ Terms defined in Appendix A, *Definitions*, are set in boldface type (*italics* in the **Federal Register** printing) the first time they appear.

² This auditing standard supersedes Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements*, and is the standard on attestation engagements referred to in Section 404(b) of the Act. It also is the standard referred to in Section 103(a)(2)(A)(iii) of the Act.

³ See Securities Exchange Act Rules 13a–15(f) and 15d–15(f), 17 CFR §§ 240.13a–15(f) and 240.15d–15(f); Paragraph A5.

⁴ See Item 308 of Regulation S–K, 17 CFR 229.308.

⁵ See AU sec. 230, *Due Professional Care in the Performance of Work*, for further discussion of the concept of reasonable assurance in an audit.

⁶ See AU sec. 150, *Generally Accepted Auditing Standards*.

the fieldwork and reporting standards applicable to an audit of internal control over financial reporting.

5. The auditor should use the same suitable, recognized control framework to perform his or her audit of internal control over financial reporting as management uses for its annual evaluation of the effectiveness of the company's internal control over financial reporting.⁷

Integrating the Audits

6. The audit of internal control over financial reporting should be integrated with the audit of the financial statements. The objectives of the audits are not identical, however, and the auditor must plan and perform the work to achieve the objectives of both audits.

7. In an integrated audit of internal control 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—

- To obtain sufficient evidence to support the auditor's opinion on internal control over financial reporting as of year-end, and
- To obtain sufficient evidence to support the auditor's control risk assessments for purposes of the audit of financial statements.

8. Obtaining sufficient evidence to support control risk assessments as low for purposes of the financial statement audit ordinarily allows the auditor to reduce the amount of audit work that otherwise would have been necessary to opine on the financial statements. (See Appendix B for additional direction on integration.)

Note: In some circumstances, particularly in some audits of smaller and less complex companies, the auditor might choose not to assess control risk as low for purposes of the audit of the financial statements. In such circumstances, the auditor's tests of the operating effectiveness of controls would be performed principally for the purpose of

⁷ See Securities Exchange Act Rules 13a–15(c) and 15d–15(c), 17 CFR 240.13a–15(c) and 240.15d–15(c). SEC rules require management to base its evaluation of the effectiveness of the company's internal control over financial reporting on a suitable, recognized control framework (also known as control criteria) established by a body or group that followed due-process procedures, including the broad distribution of the framework for public comment. For example, the report of the Committee of Sponsoring Organizations of the Treadway Commission (known as the COSO report) provides such a framework, as does the report published by the Financial Reporting Council, *Internal Control Revised Guidance for Directors on the Combined Code*, October 2005 (known as the Turnbull Report).

supporting his or her opinion on whether the company's internal control over financial reporting is effective as of year-end. The results of the auditor's financial statement auditing procedures also should inform his or her risk assessments in determining the testing necessary to conclude on the effectiveness of a control.

Planning the Audit

9. The auditor should properly plan the audit of internal control over financial reporting and properly supervise any assistants. When planning an integrated audit, the auditor should evaluate whether the following matters are important to the company's financial statements and internal control over financial reporting and, if so, how they will affect the auditor's procedures—

- Knowledge of the company's internal control over financial reporting obtained during other engagements performed by the auditor;
- Matters affecting the industry in which the company operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes;
- Matters relating to the company's business, including its organization, operating characteristics, and capital structure;
- The extent of recent changes, if any, in the company, its operations, or its internal control over financial reporting;
- The auditor's preliminary judgments about materiality, risk, and other factors relating to the determination of material weaknesses;
- Control deficiencies previously communicated to the audit committee⁸ or management;
- Legal or regulatory matters of which the company is aware;
- The type and extent of available evidence related to the effectiveness of the company's internal control over financial reporting;
- Preliminary judgments about the effectiveness of internal control over financial reporting;
- Public information about the company relevant to the evaluation of the likelihood of material financial statement misstatements and the effectiveness of the company's internal control over financial reporting;
- Knowledge about risks related to the company evaluated as part of the auditor's client acceptance and retention evaluation; and

⁸ If no audit committee exists, all references to the audit committee in this standard apply to the entire board of directors of the company. See 15 U.S.C. 78c(a)58 and 7201(a)(3).

