

Swiss Auditing Standard:
Confirmation of the existence of the internal control
system
(PS 890)

(Unofficial English Translation – German and French Text is binding only)

The Swiss Auditing Standard PS 890 was approved by the Swiss Institute of Certified Accountants and Tax Consultants on December 17, 2007. It is effective for audits of financial statements which require confirmation of the existence of the internal control systems for periods beginning on or after January 1, 2008. This standard should be read in the context of the introductory remarks which set out the application and authority of Swiss Auditing Standards.

This auditing standard is divided into the two following chapters:

Chapter A. “**General comments**” presents the following aspects, which are necessary to obtain an understanding of the “Confirmation of the existence of the ICS” according to article 728a CO, such as

- Definitions,
- Responsibilities,
- Differentiation between the “Confirmation of the existence of the internal control system” (subsequently referred to in abbreviated form as “ICS”) according to article 728a paragraph 1 CO and “Considering the ICS in determining the nature and extent of the audit procedures” according to article 728 paragraph 2 CO and
- Comments on the design of the ICS.

Chapter B. “**Confirmation of the existence of the ICS**” contains explanations related to the audit procedures, which are necessary so that the auditor can confirm the existence of the ICS as required by Swiss law. In addition, certain specific questions, such as the confirmation of the existence of the ICS in the context of Group financial statements and the related reporting, are addressed.

A. General comments

I. Introduction

- a) The purpose of this auditing standard is to provide guidance regarding the procedures that are necessary for the auditor to conclude that an internal control system as stipulated in article 728a paragraph 1 item 3 CO exists.
- b) Under Swiss Law (article 716a paragraph 1 item 3 as related to article 662a, and article 957ff. CO), the Board of Directors is responsible for the design, implementation and maintenance of a suitable and appropriate ICS. According to article 728a paragraph 1 item 3 CO, the external auditor confirms on an annual basis the existence of the ICS which has been defined by the Board of Directors. As long as the ICS defined by the Board of Directors fulfills the minimum general requirements of an ICS with respect to the size, complexity and the risk profile of the entity, the auditor will be able to confirm to the General Meeting its existence. See article 728a paragraph 1 item 3 CO for additional information. However, a prerequisite for the confirmation of the existence is that this ICS defined by the Board of Directors is documented in written form and is operating in the daily business of the entity. This documentation of the design and implementation of the ICS needs to be examined by the auditor as part of the audit of the annual financial statements. The “confirmation of the existence” of the ICS, as stated in article 728a paragraph 1 item 3 CO, does not, however, include an audit of the ongoing and reliable functioning (“operating effectiveness”) of the ICS. By deleting the word “functioning or operational” in the final text of the law, the Swiss Parliament has deliberately refrained from requiring an audit of the effectiveness and efficiency.
- c) An entity should have implemented an ICS that continuously operates as designed in all sectors of the entity. The auditor must, however, according to article 728a paragraph 1 item 3 CO, merely audit and confirm its existence relating to financial reporting.
- d) The auditor’s approach in evaluating the ICS for audit planning purposes (article 728a paragraph 2 CO) differs from the one for the confirmation of the existence of the ICS in the sense of article 728a paragraph 1 item 3 CO. However, the audit work to be performed in these two areas complements each other and will be combined in an integrated audit approach.

As part of the process of the audit of the financial statements, the auditor will gain an adequate understanding of the ICS in order to plan the audit and to develop an effective audit strategy. In planning the audit of the existence of the ICS, the auditor will therefore take into consideration the audit procedures performed in connection with the financial statement audit in order to determine, based on the understanding gained, whether additional audit procedures are necessary in order to confirm the existence of the ICS.

To the extent that audit procedures in respect of the ICS have already been performed in connection with the audit of the financial statements, these do not need to be re-performed for the audit of the existence of the ICS. On the other hand, the performance and results of the work for confirming the existence of the ICS can also be used in planning and performing the financial statement audit.

- e) This auditing standard has to be applied to all audits which require the confirmation of the existence of the ICS as per article 728a paragraph 1 item 3 CO.

II. Definitions

- a) In this auditing standard, the term “internal control system” is not used in its commonly perceived way, but is limited with respect to its content. The ICS, as mentioned in this auditing standard, comprises only those activities and control measures taken by an entity that assure the maintenance of proper accounting records and financial reporting. It is generally understood that the ICS normally comprises the control components “control environment, risk assessment procedures of the entity, information systems relevant to the financial reporting / communication, the control activities and the monitoring of the controls”. Particularly in smaller entities, these control components are often differently developed or can also be grouped together. According to the Swiss law, the Board of Directors of the entity is responsible for the design of the ICS and also for the design of the respective components, whereby other structures for its components can also be used.
- b) This auditing standard uses the terms “Board of Directors” and “Management”. Where the reference is to both bodies, the term “Senior Management” is used. Where the reference is made to other legal forms than the limited company, which is the form primarily addressed here, the applicable terms for the governing and managing bodies are to be used analogously.
- c) “Risk”, as mentioned in this auditing standard, is the risk of material misstatement of the financial statements. This risk represents only a part of the overall business risks.
- d) “Entity level controls” are higher level controls. Higher level means that the controls cover a number of processes simultaneously and thus cannot be allocated to one process.

Direct and indirect controls exist at the entity level. “Direct controls” are measures which are performed by Management itself or are instructed by Management. “Indirect controls” comprise the code of conduct, the mission statement, and the emphasis on integrity, ethical values and competence within the entity.

- e) “Process level controls” are designed to cover the risks of material errors within individual processes, which could arise on the initiation, registration, processing and recording of business transactions. These can be either manual controls or automated IT application controls.
- f) “IT general controls” build the basis for the proper functioning of automated IT application controls. IT general controls address, for instance, risks in the areas of access rights, data quality, data security or system changes (hardware and software) and maintenance.
- g) “Walk-throughs” are testing procedures which follow an individual business transaction from start to completion, including the related documentation of the performance of the respective key controls. Walk-through tests are used particularly for the evaluation of the implementation of the ICS. However, the operating effectiveness of the ICS cannot be audited with a single walk-through.

- h) “Key controls” are designed to prevent or detect misstatements in the financial statements, which are material to the entity. The audit of the existence of an ICS in the sense of article 728a paragraph 1 item 3 CO does not include a systematic audit of all controls, but is limited to the periodical audit of the existence of key controls.
- i) A “control deficiency” is a failure in the design or implementation of a control. This is the case when a necessary control does not exist, when a control cannot achieve the objective of the ICS because of flaws in the control design, or when, although appropriately designed, it has not been, or has not been implemented as designed.
- j) A “weakness” exists when one or more control deficiencies lead to the situation that a material error (caused by fraud or malfunctioning) cannot be prevented or detected and could lead to a material misstatement in the financial statements.
- k) “Documentation”, as stated in this auditing standard, encompasses both the documentation of the design of the ICS as well as the documentation of its implementation. The documentation prepared by Senior Management, in order to be acceptable for the auditor according to this auditing standard, needs to cover the design of the ICS as well as the implementation of the required key controls at the entity and process levels, and should be prepared in a written and comprehensive form.

III. Duties and responsibilities regarding the ICS

Duties and responsibilities of the Board of Directors

- a) The Board of Directors is responsible for the design, implementation and maintenance of a suitable and appropriate ICS.
- b) This duty of the Board of Directors results from his duty to design the accounting system of the entity in such a way that the requirements of generally accepted accounting principles and financial reporting requirements are met (article 716a paragraph 1 item 3 as related to article 662a, and article 957 ff. CO).
- c) The Board of Directors ensures that suitable and appropriate control measures are implemented to prevent, detect or correct material errors in financial reporting.

In particular, the following lies within the responsibility of the Board of Directors:

- decisions regarding the design of the ICS, taking into consideration its suitability and ongoing operational monitoring;
- ensuring that the control measures to be taken by Management to implement the ICS are implemented, and
- ensuring that the effectiveness of the ICS is subject to adequate monitoring.

Duties and responsibilities of Management

- d) Management is responsible for the implementation and maintenance of the strategies and business policies defined by the Board of Directors and is therefore usually responsible for the implementation of the ICS, to the extent that this task is not assumed directly by the Board of Directors.
- e) Management is generally responsible for:
- the development of suitable processes for the identification, evaluation and monitoring of the risks;
 - the maintenance and documentation of the organizational structure that defines responsibilities, competencies and flows of information;
 - the definition of key controls and their monitoring, as well as ensuring that corrective actions are taken;
 - ensuring that delegated duties are fulfilled.

Duties and responsibilities of the Auditor

- f) In defining the nature and extent of audit procedures in connection with the financial statement audit, the auditor takes into account the ICS in order to determine which areas of the financial statements are planned to be audited by means of substantive audit procedures and which by means of tests of controls (article 728a paragraph 2 CO).
- g) According to article 728a paragraph 1 item 3 CO, the auditor confirms whether the ICS designed by the Board of Directors for the financial reporting exists. The auditor issues a written summary report to the general meeting (article 728b paragraph 2 CO) and further issues a comprehensive report to the Board of Directors, which also includes the auditor's comments regarding the ICS (article 728b paragraph 1 CO).

IV. Components of the ICS

- a) The design and implementation of an ICS depends on the size, the business risks and the complexity of the respective entity. Less formalized resources and simplified processes can be adequate to achieve ICS objectives in smaller entities.
- b) As widely understood in practice, an ICS may generally be divided into the following control components:
- The control environment
 - The entity's risk assessment process
 - The information systems, related business processes relevant to financial reporting, and communication
 - Control activities
 - Monitoring of controls

This auditing standard with respect to the confirmation of the existence of the ICS does not determine how and in which form these control components have to be implemented. The design of the ICS lies within the responsibility of the Board of Directors of the entity. Within the scope of this responsibility of the Board of Directors for the design of the ICS, other structures and components may also be possible.

Control environment

- c) The control environment comprises governance and management functions of the entity's Senior Management as well as its attitude, awareness and actions concerning the ICS and its importance within the entity.
- d) The control environment defines the spirit of an organization, influencing the control awareness of its people. It provides the basis of an effective ICS.
- e) The control environment of an entity is mainly influenced by the following elements and how they are incorporated into the processes of the entity:
 - Communication and enforcement of integrity and ethical values;
 - Commitment to competence of the staff;
 - Participation by those charged with governance;
 - Management philosophy and operating style;
 - Organizational structure;
 - Assignment of authority and responsibilities;
 - Human resource policies and practices.

The entity's risk assessment process

- f) The entity's risk assessment process forms the basis for how Senior Management determines the risks to be managed by the ICS. According to article 663b item 12 CO, the notes to the financial statements must now contain information related to the performance of a risk assessment. Once the process is adapted to the specific situation (including characteristics, size and complexity of the entity), it helps the auditor to identify the risks of material misstatement in the financial statements. In assessing the risks, the entity identifies its important business risks, estimates their significance and the likelihood of their occurrence and decides on measures to manage them.

The information systems, related business processes and communication

- g) The information systems relevant to financial reporting (including the accounting system) consist of the procedures and records established to initiate, record, process and report business transactions of the entity which are relevant to the financial statements. They further serve as evidence for the related assets and liabilities, the equity, the income statement and the disclosures in the notes to the financial statements.

- h) Open channels of communication within the entity can help to ensure that once exceptions or other irregularities occur, they are promptly reported and the necessary actions are taken.

Control activities

- i) Control activities are the policies and procedures that help ensure that management directives are carried out, e.g. that necessary actions are taken to address risks. Independently of whether the control activities are included in IT systems or manual systems, they have different objectives and are applied at different organizational and functional levels.
- j) Examples of specific control activities are those relating to the following aspects:
- Authorization
 - Performance reviews
 - Information processing
 - Physical controls
 - Segregation of duties
- k) In evaluating the control activities, Management considers whether and how, a specific control activity, individually or in combination with others, is appropriate to prevent or detect material misstatements in accounting and financial reporting.
- l) The use of IT affects the character of the control activities. Senior Management responds appropriately to these risks by establishing effective IT general controls and IT application controls. Controls over IT systems can be regarded as effective when they maintain the integrity and the security of the data processed by such systems.

Monitoring of controls

- m) By monitoring the ICS, Senior Management gains assurance that the requirements of the ICS have been observed. When doing this, Senior Management also recognizes whether modifications to the ICS, originating from factual changes (e.g. changes in the organization or in the processes) are necessary.
- n) The monitoring of the controls in an ICS takes place at the appropriate level and is put in place and supervised by Senior Management. Senior Management has various means available to achieve this. Monitoring can, for example, be performed by persons in the same department (provided that they are not involved in the process being monitored), by persons in other departments, by Internal Audit (if available) or by Senior Management itself.

V. Limitations of the ICS

- a) The objective of financial statements being free from material misstatements, regardless of the quality of the ICS of an entity, cannot be achieved with absolute assurance, but only with reasonable assurance. The limitations inherent in every ICS are, for example,
- the human element in judgmental decisions, which can turn out to be erroneous;
 - break-downs, which can occur in the ICS as a consequence of human failures, e.g. mistakes due to carelessness or errors;
 - deliberate violations of the rules of the ICS by staff at all levels. Such violations can occur at the operating level or at the supervisory level.
- b) In smaller entities and due to limited personnel resources, certain elements of the ICS often cannot be established, or can only be established partially, (e. g. organizational measures such as segregation of duties). On the other hand, there is often the possibility that the entrepreneur or general manager, with his comprehensive knowledge, can compensate for possible control deficiencies, in order to achieve an ICS that corresponds to the size, complexity and risk profile of the entity.

VI. Differentiation between the consideration of the ICS in the audit of the financial statements versus the confirmation of the existence of the ICS

- a) Auditing standards for the audit of financial statements require that the auditor gains a sufficient understanding of the financial reporting process and the ICS in order to plan the audit of the financial statements and to develop an effective audit strategy. This should ensure that the risk of material misstatements in the financial statements is reduced to an acceptable level.
- b) These standards for the audit of financial statements basically allow two different methods for gaining audit evidence: tests of controls and substantive tests. In testing controls, the auditor evaluates the quality and reliability of the key controls and thus gains audit evidence on the reliability of the system. On the other hand, substantive testing relates to individual positions in the financial statements and their accounting disclosure (existence, valuation or transaction).
- c) In areas where the auditor obtains appropriate audit evidence primarily through substantive testing, the auditor has to undertake additional audit procedures for the confirmation of the existence of the ICS according to article 728a paragraph 1 item 3 CO.
- d) In the financial statement audit, the consideration and testing of the ICS supports the audit. This “means-to-an-end” function is also indicated in article 728a paragraph 2 CO, which differs from the confirmation of the existence of the ICS as stated in the article 728a paragraph 1 item 3 CO, where the ICS represents a new audit subject matter by itself.

Considering the ICS in the audit of the financial statements

- e) Considering the ICS in the audit of the financial statements aids in determining the appropriate audit strategy. This aims to achieve the audit objective in the most economical manner. The audit objective is to issue an opinion as to the conformity of the financial statements with the law and, where applicable, with a set of accounting standards. According to this concept, the inclusion of the ICS in the audit of the financial statements is aimed at evaluating the risk of material misstatements in the financial statements, which are attributable to an inadequate or non-existent ICS.
- f) The inclusion of the ICS in the planning serves to answer the question whether, and to what extent, tests of controls and/or substantive tests should be performed in order to achieve the objective of the audit. The consideration of the ICS in the planning of the audit of the financial statements does not provide audit assurance as to the existence of the ICS as such. Whenever the auditor wants to rely on tests of controls instead of, or in addition to substantive tests, the auditor shall perform further testing. This helps to verify the ongoing and proper functioning, as well as the effectiveness of the controls in these areas. It is however permitted and in simpler circumstances not un-common to perform the audit of the financial statements primarily with substantive tests. In this context, reference is made to the relevant standards for the audit of the financial statements.
- g) The results of the tests of controls performed as part of the audit of the financial statements can and should also be used for the audit of the existence of the ICS. If the auditor relies on tests of controls in certain areas, no further audit procedures are generally necessary in these specific areas to confirm the existence of the ICS.
- h) To what extent reliance can be placed on the ICS in the audit of the financial statements and to determine the extent of tests of controls, reference is made to the relevant standards for the audit of the financial statements.

Confirmation of the existence of the ICS

- i) The new regulatory requirement for a confirmation of the existence of the ICS according to article 728a paragraph 1 item 3 CO is a separate subject matter required by Swiss law.
- j) The understanding of the ICS, which is gained in order to determine the audit strategy, is not sufficient for the auditor of the financial statements to form a separate opinion to confirm the existence of the ICS.
- k) Contrary to the audit of the financial statements, the auditor must gain sufficient audit assurance in order to be able to conclude on the existence of the ICS with respect to the financial reporting as a whole. This means that for the separate confirmation of the existence of the ICS at the entity level and at the process and IT application levels, those parts of the ICS must also be included in the examination which, in the case of the audit of the financial statements, are covered exclusively by substantive audit tests. In addition, the scope of the audit of the existence of the ICS is generally broader (i.e. covers a variety of audit areas), but is less in-depth (individual transactions limited to walk-through tests) than would be the case in the audit of the financial statements where reliance on internal controls is placed. When the auditor relies on tests of controls in an area and has tested these controls, further audit tests to confirm the existence of the ICS are usually not necessary.

- l) The confirmation of the existence requires the consideration of the ICS as it relates to the financial reporting as a whole, even if the confirmation of the existence is not a comprehensive examination of the ICS (areas of emphasis are set based on the materiality and risk assessment, annual rotation of certain controls testing, and no examination of the operating effectiveness).
- m) The consideration of the ICS in connection with a standard audit of financial statements is not separately referred to in the audit report presented to the General Meeting of the owners. However, in the separate confirmation of the existence of the ICS under Swiss law, the auditor of the financial statements must form a separate conclusion considering the effects of the results of his work on the ICS. The law requires that the auditor of the financial statements confirms to the General Meeting that an ICS exists and, in addition, he communicates his findings regarding the ICS in a separate comprehensive report to the Board of Directors.

VII. Requirements for the confirmation of the ICS existence

- a) General prerequisites for the existence of the ICS are that:
 - the ICS is in place and can be examined (i.e. is documented);
 - the ICS is tailored to the business risks and the business activities;
 - the ICS is known to the staff members responsible;
 - the defined ICS is being applied;
 - adequate control awareness exists within the entity.
- b) The requirement that an ICS is implemented and applied is an essential condition for its existence and therefore also a prerequisite for the examination of its existence. The existence of the ICS can only be audited when its significant elements are documented. The extent and degree of detail of the documentation is subject to judgment; it must, however, appropriately consider the size, complexity and the risk profile of the entity.
- c) The ICS is to be documented in a manner that significant processes can be verified. At the entity level, the documentation must provide information on:
 - what the Board of Directors wants to achieve with the ICS;
 - how Senior Management implements the ICS;
 - how the risks of material misstatement in the accounting records and in the financial reporting are addressed; and
 - how the ICS should prevent or detect such risks.
- d) Furthermore, the significant risks and the manual and/or automatic key controls designed to address them, as well as the operating of the key controls, are to be documented at the process level. The evidence of the operation contains information such as for example the person performing the control, the findings and the corrective measures initiated.
- e) The documentation of significant risks and the respective key controls is to be adapted to changed circumstances as necessary.

- f) Controls in the IT area become increasingly important the more the financial statement preparation and financial reporting processes rely on IT systems and the higher the risk is, that errors could arise from the development and utilization of IT systems.

B. Confirmation of the existence of the ICS

Planning the confirmation and determining the extent of audit procedures

1. In a first phase, the auditor will evaluate the ICS in order to define an effective and efficient audit strategy for the audit of the financial statements. If a controls approach is selected, i.e. reliance is placed on internal controls in selected areas, appropriate audit procedures are carried out to confirm the existence of the ICS in these areas. Additional audit procedures in accordance with this auditing standard are carried out in those areas where no tests of controls have been performed in order to be able to confirm the existence of the ICS in accordance with article 728a paragraph 1 item 3 CO. The above procedures represent an integrated audit approach. To the extent tests of controls have already been performed in connection with the audit of the financial statements, these do not need to be re-performed to confirm the existence of the ICS.
2. The auditor examines the existence of entity level controls, as well as process level controls and IT general controls.
3. The auditor examines the existence of the key controls at the entity level, since these are usually considered to be significant. Entity level controls generally address risks related to the integrity, ethical values and behavior of Senior Management and also consider authority limits within the entity. As a consequence, entity level controls influence several processes.
4. At the process level, controls within individual processes should be designed to address the risks of a material misstatement in the accounting records and the financial statements, starting at the initiation, then continuing to the registration, processing and recording and ending in the financial reporting of business transactions. Apart from these processes which are directly linked to accounting, this also applies to key controls in other processes, for example, in the purchasing or sales areas. The processes that are selected depend on the business model of the entity.
5. The selection of the key controls at the process level to be examined depends on the nature, size, complexity and risk profile of the entity being audited and on the key controls defined by the Board of Directors of the entity. Selection criteria are, for example, the significance of the process to the preparation of the financial statements or whether key controls tend to be present rather at the entity, process or IT application level.
6. IT general controls are the foundation for the proper functioning of the IT applications. The following areas should be addressed in the ICS:
 - Program development;
 - Program and database changes;

- Access to programs and data;
 - IT operations.
7. When determining the extent of the audit procedures, the auditor should proceed by keeping the potential risks in mind and should place special audit emphasis on those areas with the highest risk of failure related to the financial statements. The decision, which audit procedures should be performed at the entity level, which at the process level, which at the IT application level and which with respect to the IT general controls, is subject to the auditors professional judgment. The extent of audit procedures should take into account the size, complexity, and the risk profile of the entity.
 8. The auditor can also rely on compliance checks performed or established by Senior Management, without directly verifying the performance of these controls. This requires that the performance of these checks done upon request of Senior Management is documented.

Audit approach with respect to the control components

9. In order to be able to examine the existence of the selected key controls, the auditor will determine in his program the audit procedures to be performed.
10. The auditor examines, on one side, whether an ICS as designed by the Board of Directors exists and whether the defined processes and key controls are adequately documented, allowing verification of the existence of the ICS. This work also includes analysis as to whether the documented system is in general suitable to fulfill its purpose as designed. The documentation of the implementation of adequate key controls with respect to the individual control components by Senior Management forms the basis for such work. An element of the audit of the existence of an ICS is therefore the auditor's investigation as to whether he can, on the basis of the documentation of the design of the ICS of Senior Management, determine whether the intended ICS has been implemented within the entity.
11. The confirmation of the existence of an ICS under Swiss law does not require the extension of the work to confirm the ongoing and correct functioning of the ICS (operational effectiveness).

Audit procedures to be applied

12. The auditor can chose among the following possible audit procedures for the confirmation whether an ICS exists:
 - Review of the design documentation;
 - Inquiries;
 - Observation;
 - Verification;
 - Walk-through.
13. With these procedures the auditor can gain information on all the control components at the entity level, the process level and the IT application level.

14. The auditor cannot obtain adequate assurance as to the implementation and, thus, existence of an ICS solely through a review of the documentation with respect to the design. Therefore, only in exceptional cases, will the auditor be able to only rely on the examination of the documentation regarding the design of the ICS. This could, for example, be the case when the auditor can, in a simple environment and based on his knowledge of the entity, assume that the documented ICS is also in fact implemented. However, the auditor normally will have to perform further audit procedures, beyond the review of the documentation with respect to the design, in order to confirm that the ICS has been implemented. In doing so, he will base his work on the entity's documentation regarding the implementation and the operational monitoring of the ICS.
15. An "inquiry" solely does usually not give adequate assurance on the existence of the ICS on its own. The same principles apply as with the review of the documentation with respect to the design.
16. An "observation" provides additional assurance compared to inquiries or a review of the documentation regarding the design. The observation can be used in order to gain an impression of the extent the ICS is implemented.
17. A "verification" can be undertaken in connection with manual controls, such as, for example, re-performing of exceptions observed and can, like the observation, be used in order to gain an impression as to what extent the ICS is implemented.
18. A "walk-through test" is an efficient audit procedure to gain evidence of the existence of the ICS. With this test, an individual business transaction is followed through the system from start to end and the documentation of the performance of the designed key controls is checked.
19. The application of audit procedures, or the combination of audit procedures is subject to the auditor's professional judgment. The selected audit procedures and the associated audit activities must give the auditor adequate assurance to be able to issue a separate confirmation of the existence of the ICS.
20. If an Internal Audit function exists, it is common practice, that the internal audit function is integrated in the audit process of the external audit and thus also in the audit of the existence of the ICS. The auditor has to conclude to what extent the work of third parties, such as, for example, internal audit, may be included in his work. When the auditor can place reliance on the work of third parties, this can influence the extent of procedures to be performed.

Audit procedures with respect to the control components

Control environment

21. In the control environment, the controls are primarily at the entity level.
22. When examining the existence of controls or control activities in the control environment, the auditor will mainly rely on the review of the documentation, inquiries and verification. These procedures serve both to examine the appropriateness of the control measures that

determine the character of the control environment as well as the implementation of these measures.

23. Audit procedures determined at the process level can also be applied to the control environment. These audit procedures are normally limited to the review of the documentation, inquiries and observation.

Risk assessment

24. When examining the existence of the risk assessment at the entity level, the auditor will mainly rely on the review of the documentation, inquiries and verification. In a simple environment, in which the risk assessment process is not very formalized, the auditor will primarily rely on discussions with Senior Management and will gain an impression as to how risks are identified and addressed.

Information systems, related business processes relevant to financial reporting and communication

25. Entity level controls are primarily applicable to information systems that are relevant to the financial reporting and the communication.
26. When examining the information systems relevant to the financial reporting and communication, the auditor will generally rely on the review of the documentation, verification and inquiries. The auditor can obtain an understanding which control measures the entity plans in this area, respectively, how these measures are implemented in order to assure the safe and reliable operation of the data and information processing. In smaller entities with less formalized processes and descriptions in this area, the respective evidence may be obtained principally through inquiries and observation.
27. The auditor's understanding as to how matters relevant to financial reporting are communicated within the entity, includes also the exchange of information between Management and the Board of Directors or, where applicable, the Audit Committee. Also the communication with external bodies, e.g. supervisory authorities, has to be taken into account.

Control activities

28. Control activities usually comprise controls at the process and IT application levels.
29. In examining the control activities at the process level, the auditor will generally rely on the review of the documentation, verification, inquiries, observation and on walk-through tests.
30. Audit procedures with respect to the control activities in the area of IT general controls include the measures and processes which the entity has implemented in order to address the IT risks in an adequate manner. This includes an assessment whether general IT controls permit a reliable and smooth operation of the data processing and assure the integrity of the processed data and the accuracy of the data processing process.

Monitoring the controls

31. Entity level controls are usually used for the monitoring of the controls.

32. The auditor will generally rely on the review of documentation and inquiries when conducting the audit of the controls at the entity level.

Special questions related to the confirmation of the existence of the ICS

Frequency of the audit procedures

33. The auditor has to examine the existence of the entity level controls on an annual basis (including IT general controls).

34. The auditor has to examine the existence of the process level controls regularly if they include material risks to the entity. Where the key controls in significant processes have been audited in one year, reduced audit procedures may in some cases be adequate in the following years. The frequency depends on changes in the business model and the risk profile of the entity. At least, the auditor has to obtain information as to whether there have been any changes in the business model and in the risks of the entity since the last audit.

35. A rotation of the examination of the existence of the key controls is possible. This means that it is not necessary to examine all key controls in all areas each year; but, based on the above considerations, to perform in one year only minimal audit procedures in respect of key controls in certain areas. The decision which key controls should be audited lies within the responsibilities of the auditor who uses his professional judgment to make the selection. It has to be assured that all key controls are audited at least once during a planning cycle (3 years as a rule), which is determined by the auditor and that the planning cycle is aligned with the risk environment.

Timing of the audit

36. The audit planning determines which audit procedures will be performed at what time and to what extent the results of the audit testing in prior years can influence the current audit.

37. The reporting is aligned with the balance sheet date of the financial statements. This does not, however, imply that the audit procedures must take place immediately before the balance sheet date. Determining the timing when audit procedures for the confirmation of the existence of the ICS are carried out lies within the professional judgment of the auditor and can be conducted simultaneously with the audit of the financial statements. The auditor, however, must ensure that fundamental changes in the business model and the ICS between the date of the audit procedures and the balance sheet date are adequately considered.

Audit documentation

38. The auditor has to document the observations which are important and relevant as evidence to support the conclusion on the existence of the ICS. Apart from this, the auditor must document the fact that the audit has been performed in accordance with this auditing

standard. The work papers have to support in an adequate manner an overall understanding of the examination of the existence of the ICS.

39. The auditor has an obligation to maintain documentation about the planning of the work, the nature, the timing and the extent of the procedures performed, the results of these and the conclusions reached based on the evidence obtained. The work papers also document the considerations and conclusions with respect to those matters which require significant judgment. In situations when difficult questions regarding basic principles or judgment arise, the relevant facts, which were known to the auditor at the time of his conclusion, have to be documented in the work papers.
40. Otherwise, the requirements of the Swiss Auditing Standards for the documentation of the financial statement audit apply also to the documentation of the examination of the existence of the ICS.

Reporting

Introduction

41. Swiss law requires two separate written reports of the auditor in connection with the confirmation of the existence of the ICS. On one hand, the auditor must, under article 728a CO item 3, confirm as part of his reporting to the General Meeting that “an internal control system exists”. In addition, article 728b CO requires that the auditor to issue a comprehensive report to the Board of Directors “with observations on the financial reporting, the internal control system and the performance and results of the financial statement audit”.
42. The reporting to the General Meeting should be in a summarized form as a result of the legal requirement that the Board of Directors has to be informed by the auditor regarding the ICS in a separate “comprehensive” report. This report wording is limited to a clear definition of the scope of the engagement and confirms to the shareholders whether an ICS designed by the Board of Directors exists for the entity. On the other hand, the comprehensive report to the Board of Directors should be more detailed on the ICS. The objective of this report is to present to the Board of Directors, from the point of view of the auditor, opportunities for improving the ICS, or to mention certain deficiencies in the implementation, which the auditor has identified during the course of the financial statement audit or the audit of the existence of the ICS.
43. The Board of Directors bears the overall responsibility for designing, implementing and maintaining the ICS, whereas the auditor examines only once a year whether the ICS designed by the Board of Directors and implemented by Management exists. It is customary that the auditor makes suggestions to the Board of Directors for improvements regarding the design, and the implementation of the ICS, based on his experience. These suggestions, together with other observations on the ICS, which are relevant to the Board of Directors, have to be included in the comprehensive report according to article 728b CO.

Reporting to the General Meeting

44. The auditor must report to the General Meeting of the owners as to whether the ICS defined by the Board of Directors has been implemented and thus “exists” as stated in article 728a paragraph 1 item 3 CO. Based on this work, three different opinions are possible:

- the existence of the ICS is confirmed;
- the existence of the ICS is denied;
- the existence of the ICS is confirmed with qualifications.

45. No objective assessment criteria can be determined for the considerations leading to the respective conclusion. The decision lies within the professional judgment of the auditor. However, the following guidance should be considered:

Existence is confirmed

46. The existence of an ICS can also be confirmed when isolated deficiencies or areas for improvements are identified. The confirmation of the existence of the ICS issued to the General Meeting does not necessarily mean that the ICS is working either ideally or effectively. The existence can be confirmed when:

- the considerations of the Board of Directors regarding the design of the ICS are documented;
- this design meets the minimum requirements of an ICS based on the size, complexity and risk profile of the entity;
- the implementation of this ICS is documented in writing; and
- the audit procedures confirm that the key controls defined by the Board of Directors have been implemented.

Existence is denied

47. An adverse opinion is issued in particular cases when, for example, the following is observed:

- the ICS defined by the Board of Directors does not at all address the risks of the entity, taking into account its size, complexity and risk profile;
- written documentation of the ICS does not exist in all significant areas; or
- the ICS defined by the Board of Directors has not been implemented in the daily operations of the entity in all significant areas.

48. The observation of individual deficiencies in the implementation, or key controls not always applied in practice, does not usually lead to an adverse opinion in the report to the General Meeting but will be presented in the comprehensive report to the Board of Directors.

Existence is confirmed with qualifications

49. A qualification with respect to the confirmation of the existence of the ICS is to be considered when the existence of the ICS can, in principle, be confirmed, but in some significant areas, an ICS as discussed in this auditing standard does not exist. Examples:

- The existence of the ICS is documented for the head office and for most of the subsidiary companies or branch offices being material in respect to the ICS. However,

for one material branch office or subsidiary, a documented ICS is missing completely, or the audit work shows that the ICS at this branch office or subsidiary is not implemented in all material respects.

- An ICS exists for the large majority of the processes of the entity which are material with respect to the ICS. However, in the cases of one or more individual significant processes there is no ICS documentation or the results of the audit work show that the designed ICS is not implemented at all.

50. Professional judgment plays an important role in forming this conclusion based on the audit findings for the report to the General Meeting. Ultimately, the overall assessment, which is based on the information gained from the audit work conducted, is absolutely decisive when forming an opinion.

51. When it becomes apparent during the course of the audit that the existence of the ICS cannot be confirmed or can only be confirmed with qualifications, the auditor will communicate this fact to Management in a timely manner in order to allow Management to correct deficiencies before the issuance of the report.

52. An adverse opinion regarding the existence of the ICS does not relieve the auditor from the responsibility of undertaking the necessary additional substantive audit procedures in order to issue an opinion on the conformity of the company's financial statements with the legal requirements or other financial reporting standards or for the purpose of making a qualification with respect to the financial statements.

Comprehensive report to the Board of Directors

53. Article 728b CO requires the auditor to summarize the findings with respect to the ICS to the Board of Directors in a comprehensive written report. The content and size of the comprehensive report with regard to the ICS is based on the size and complexity of the entity, but also its Corporate Governance Model, and the composition of the Board of Directors. The comprehensive report to the Board of Directors might include:

- Presentation of the areas of emphasis of the ICS audit tests in the current year audit and any rotating audit procedures for processes applied;
- Observations and recommendations for improvements relating to the design of the ICS from the point of view of the auditor
- Observations and recommendations for improvements relating to the implementation of the ICS designed by the Board of Directors in the day to day business operations;
- Elimination of weaknesses in the ICS previously observed.

54. A non-existent ICS or the existence of an ICS with qualifications as stated in items 48ff, should not only be addressed in the comprehensive report to the Board of Directors. In such cases, an appropriate qualification in the report to the General Meeting is unavoidable, whereby additional explanations regarding the situation may be appropriate in the report to the Board of Directors.

Confirmation of the existence of the ICS in Group financial statements

ICS in Group financial statements

55. The existence of the ICS in the Group as a whole (group-wide ICS) has to be audited by the Group auditor (principal auditor) as part of the audit of the Group financial statements. With respect to the Group financial reporting, this covers those processes and activities which ensure proper accounting and preparation of the Group financial statements and form the basis of the Group financial reporting.
56. The group-wide ICS contains controls at the Group level (group-wide controls), controls relating to the consolidation process and controls at the individual components of the Group.
57. The Board of Directors of the parent entity of the Group is responsible for the design, implementation and maintenance of an appropriate ICS. The Board of Directors determines in which subsidiary and in which areas an ICS must be implemented. Size, complexity and risk profile of the subsidiary companies in relation to the Group financial statements need to be taken into account. The size criteria relevant for Swiss companies that determine the requirement for the ordinary audit are not applicable to foreign subsidiary companies.

Evidence of the existence of the group-wide ICS

58. The Group auditor must obtain adequate evidence related to the existence of the group-wide ICS. He will refer to the documentation prepared by the Group Management and examines the existence of the ICS based on the audit procedures described in this Standard.

Responsibility of the Group auditor

59. The Group auditor has the sole responsibility for the final assessment and the reporting regarding the existence of the group-wide ICS. This responsibility includes obtaining an overview of the Group structure, the components of the Group, its areas of business activity and of the consolidation process. It is the duty of the Group auditor to audit the existence of the group-wide controls and the controls within the consolidation process. The group auditor will rely on other auditors for the audit of the controls at the components of the group.

Group-wide controls

60. Group-wide controls are those controls, which are defined and carried out by Group Management. These include, where applicable, the activities of Internal Audit. The existence of group-wide controls has to be examined primarily at Group level.

Controls in the consolidation process

61. These include controls over the Group financial reporting, over the consolidation process and over the accounting entries which are made at Group level. IT general controls basically enable the proper functioning of automated IT application controls that are in

place in the consolidation processes. The existence of these controls has to be audited primarily at Group level.

Controls at the components of the Group

62. We refer to the preceding Chapter of this Auditing Standard related to the audit approach with respect to the ICS at the individual components of the group. Given the involvement of other auditors in the audit of material components of the ICS, an assessment of their work must be made as outlined in the respective auditing standards.
63. The findings at the level of the individual components of the group are combined in the final conclusion of the Group auditor with respect to the group-wide ICS. It is therefore necessary that the Group auditor informs the other auditors in his instructions as to the extent of the audit, taking into account this Standard and the reporting requirements.
64. According to these instructions, the other auditors must forward their observations and conclusions with respect to the existence of the ICS to the Group auditor at previously agreed dates.

Selection of the components of the group which are to be examined for the confirmation of the existence of the ICS within the Group

65. The Group auditor determines which components of the group are material and which contain a specific risk. This is done by assessing the financial significance of the components of the Group and, for each component of the group, the risk that material misstatements could arise in the financial reporting. The Group auditor can select further components from the remaining components of the Group in order to achieve appropriate coverage. Considerations are given to the group-wide controls which are relevant for individual components of the group or for groups of components of the group.

Material components of the group

66. In selecting material components of the Group, the group auditor takes into account the risk assessment of the Board of Directors of the Group parent entity. The group auditor considers the material items of the financial statements of the components of the group and considers them in relation to the Group financial statements. He further assesses whether individual components of the entity contain processes which are significant for the Group (for example, the treasury function).
67. A small number of components of the group often have a high financial significance for the Group. For these components, the existence of the ICS is assessed as described in the above chapters of this Auditing Standard.

Components of the entity with specific risks

68. One specific risk can cause a material misstatement in the Group financial statements. For components of the group, which contain a specific risk, the Group auditor examines only the existence of the controls with respect to this specific risk.

New components of the Group

69. Newly acquired components of the group are to be included in the selection of components of the group to be audited for the first time in the year following the acquisition.
70. If the ICS of components of the group is not assessed in the year of the acquisition, and these components of the group are material for the Group financial statements or contain a material risk, the Group auditor must comment on this in his reports.

Consideration of foreign regulations concerning the ICS

71. Where individual companies, or the Group itself, already have audit reports which confirm the existence and/or the effectiveness of the ICS in accordance with this auditing standard, such reports are to be treated as equivalent. These can be reports based on national laws such as SOX 404 or auditing standards such as ISA 315. If components of the group have already such reports, further audit procedures are generally not necessary.

Instructions to other auditors

72. In the instructions, the Group auditor communicates to the other auditors the objectives of the confirmation of the existence of an ICS and the audit procedures to be performed. The instructions must contain explanations on the audit procedures and the reporting. The Group auditor relies on his own professional judgment to determine the level of influence he will exercise on the individual audit procedures.

Audit procedures of other auditors

73. The other auditor must confirm the instructions received from the Group auditor. The other auditor shall bring to the attention of the Group auditor all significant aspects of the ICS of the component of the Group that the Group auditor should additionally take into account. The other auditor performs his work in accordance with the instructions received and reports to the Group auditor.

Timing of the audit procedures

74. The timing of the audit procedures of the other auditor has to be determined in accordance with articles 36ff of this Auditing Standard. The communication between the Group and the components of the Group should be such that significant changes that may occur can be taken into account during the audit.

Reporting to the Group auditor

75. Control deficiencies and weaknesses observed have to be reported in writing to the Group auditor independently of whether these weaknesses have been identified during the course of the agreed ICS audit procedures or during the audit of the financial statements.
76. Based on the reports received, the Group auditor concludes whether further audit procedures or investigations are necessary. Thereafter, the Group auditor makes an overall assessment of the existence of the ICS in the Group.

Influence of the reporting of the other auditors on the reporting of the Group auditor

77. In his examination of the existence of a group-wide ICS and his reporting thereof, the Group auditor takes into consideration the implications:

- of control deficiencies and weaknesses;
- of the inability to confirm the existence of the ICS or of individual key controls;
- of disagreements of opinion with the management of components of the group regarding the existence of the ICS or individual key controls at the components of the group.