

Enhanced Audit Expectations

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COMPLIANCE WEEK 2014
POWERFUL INSIGHTS, PRACTICAL IDEAS, REAL SOLUTIONS

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The views I express today are mine alone, and do not necessarily reflect the views of the Board, other Board Members, or PCAOB staff.

ICFR Auditing Quiz: Question 1

Which of the following statements is true?

- a) PCAOB recently has changed the standards for auditing internal control;
- b) PCAOB recently has promulgated new rules for audits of internal control; or
- c) PCAOB has not changed the standards or the rules in this area in recent years.

The correct answer is “c.”

ICFR Auditing Quiz: Question 2

Is the following statement true or false?

- PCAOB's inspections approach related to internal control over financial reporting has changed over the years.

The correct answer is "true."

ICFR Audit Standards and Inspections

- **2004** - Auditing Standard No. 2 (AS 2), Audits of Internal Control
- **2006** - The Board announced that inspections would focus on efficiency
- **2007** - The Board adopted AS 5, which superseded AS 2, and used a top-down, risk-based audit approach that focuses on the most important matters. It also eliminated unnecessary audit procedures and was designed to be scalable to the size and complexity of the business.
- **2008** - Inspections of ICFR audits were focused on whether auditors were effectively transitioning to AS 5.
- **2009-2010** – The Board continued to monitor the execution of AS No. 5 and began focusing on whether firms had obtained sufficient audit evidence to support audit opinions on the effectiveness of ICFR.
- **2010** – Reporting of deficiencies in the auditor’s testing of design and/or operating effectiveness of internal controls through comment forms and firms’ inspection reports.

Board Report on ICFR Audit Deficiencies

- *Observations from 2010 Inspections of Domestic Annually Inspected Firms Regarding Deficiencies in Audits of Internal Control Over Financial Reporting*
 - Issued Dec 10, 2012 (PCAOB Release 2012-006)
 - In 46 of the 309 integrated audit engagements (**or 15 percent**), the firm, at the time it issued its audit report, had not obtained sufficient appropriate evidence to support its opinion on the effectiveness of internal control.
 - In 39 of those 46 engagements (**85 percent**) with deficiencies related to the opinion on the effectiveness of internal control, the firm also failed to obtain sufficient appropriate evidence to support its opinion on the financial statements.

Staff Audit Practice Alert No. 11

Audit Practice Alert No. 11, *Considerations for Audits of Internal Control Over Financial Reporting*

- Issued Oct. 24, 2013
- Discusses the application of certain requirements of Auditing Standard No. 5 and other PCAOB standards to audits of internal control:
 - Auditors' risk assessment and the audit of internal control;
 - Selecting controls to test;
 - Testing management review controls;
 - Information technology considerations, including system-generated data and reports;
 - Roll-forward of control testing performed at an interim date;
 - Using the work of others; and
 - Evaluating identified control deficiencies.

Current ICFR ‘Perfect Storm’

- Changes in firms’ audit approaches as a result of PCAOB inspections and the recent guidance in Audit Practice Alert No. 11.
- Implementation of COSO 2013
- Risks associated with taking a checklist approach on the part of issuers and audit firms
- The ICFR audit is more difficult if management’s process is not as effective or well-documented as it should be.
- Need for effective communications between audit firms, issuers, and internal audit.
- Opportunity for a fresh look, and ‘reset’ on ICFR through COSO 2013
- Opportunity really to get it right!