



## RISK ASSESSMENT AUDIT STANDARDS: Are You Ready?

*As a well-governed entity you always assessed and managed the risk of material financial statement misstatement, but new auditing standards now require your auditor to evaluate the effectiveness of your controls. Are you ready for this enhanced scrutiny?*

In 2006, in an unprecedented move the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) approved eight new Statements on Auditing Standards (SASs) - SAS No. 104 through SAS No. 111 - collectively referred to as the Risk Assessment Standards. These standards, effective for audits of financial statements for periods beginning on or after December 15, 2006, establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement (whether caused by fraud or error) in a non-issuer financial statement audit; design and performance of tailored audit procedures to address assessed risks; materiality; and audit evidence.

Overall the new SASs impact the audit process as follows:

- *Expand the quality and depth of the auditor's required understanding of the entity and its environment, including its internal control* - The purpose of the required understanding is to enhance the auditor's ability to identify and assess risks that may lead to material misstatements in the financial statements.
- *Requires the auditor to assess the risks of material misstatements at the financial statement level and at the relevant assertion level* - In addition, the new SASs require the auditor to identify "significant risks" that require special audit consideration, and risks for which substantive procedures alone will not reduce audit risk to an appropriate level.
- *Eliminates the "default to maximum" for control risk, which should encourage testing of controls* - Auditors will no longer be able to assess control risk "at the maximum" without a documented basis supporting that assessment. The ASB believes this will encourage the testing of design and operating effectiveness of controls in all audits.
- *Emphasizes importance of the entity's risk assessment process* - The new SASs emphasize that when the auditor identifies potential risks of material misstatements in the financial statements that the entity's risk assessment processes failed to detect, it is important for the auditor to consider the why the process failed and whether the process is appropriate in the circumstance.

■ *Strengthens the linkage between assessed risks and the auditor's responses to those risks.*

■ *Clarifies the auditor's ability to rely on audit evidence gathered in prior audits* - Except for controls related to significant risks, the auditor who plans to rely on controls that have not changed since they were last tested should perform tests of the operating effectiveness of those controls at least once every three years.

■ *Strengthens guidance for testing disclosures* - The new SASs include expanded guidance to specifically address the importance of considering the "completeness" of disclosures and their understandability.

■ *Clarifies and expands guidance on evaluating audit findings* - When evaluating audit findings, auditors should now consider the effect of uncorrected misstatements related to prior periods on the current-period financial statements.

■ *Expands documentation requirements* Because the ASB believes that documentation requirements can drive behavior, the new SASs require the auditor to document, among other things, the following items:

- Results of the risk assessments both at the financial statement level and the assertion levels;
- The linkage of auditor responses with the assessed risks;
- The nature, timing, and extent of audit procedures performed; and
- Results of the audit procedures.

## **What does this mean for non-public entities?**

- Increased external audit focus on controls over financial reporting
- Reporting of significant deficiencies and material weaknesses to management/Board
- Need to establish a robust risk assessment process and document controls.

## **Veris can assist with the following:**

- Document controls over financial reporting
- Review controls and perform a gap analysis to the COSO Framework
- Execute test plans to verify that controls are operating effectively
- Evaluate deficiencies and implement remediation plans.

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