

# Overview and Key Provisions of Risk Assessment Standards

Keith Wilson

*Deputy Chief Auditor, Office of the Chief Auditor*

# Risk Assessment Standards Overview

---

- ❑ Covers the entire audit process from initial planning activities to forming the opinions to be expressed in the auditor's report
- ❑ Applies to both integrated audits and audits of financial statements only
- ❑ Is effective for audits of fiscal years beginning on or after December 15, 2010, subject to SEC approval

# Enhancements to Risk Assessments and Responses

---

- ❑ Establishes a process for obtaining evidence to support the auditor's risk assessments
- ❑ Strengthens the requirements linking audit tests to the assessed risks
- ❑ Promotes a more comprehensive evaluation of evidence obtained during the audit
- ❑ Integrates fraud considerations into the core audit process
- ❑ Focuses more audit attention on financial statement disclosures

# Enhancements to Risk Assessments and Responses

---

- ❑ Enhances the requirements for planning the audit and consideration of materiality, including for multi-location engagements
- ❑ Describes more directly the supervisory responsibilities of the engagement partner based upon, among other things, the risks of material misstatement
- ❑ Enhances the requirements regarding obtaining sufficient appropriate evidence

# Auditing Standard No. 8 – Audit Risk

---

- ❑ Describes audit risk and the relationship among the various components of the audit risk
- ❑ Discusses risk of material misstatement
  - At the financial statement level
  - At the assertion level
- ❑ Emphasizes the importance of performing substantive procedures to reduce detection risk to an appropriate low level

# Auditing Standard No. 9 – Audit Planning

- ❑ Describes the auditor's responsibilities for properly planning the audit, including determining the audit strategy and audit plan
- ❑ Requires an evaluation of the importance of certain matters to the company's financial statements and ICFR and their effect on the audit procedures
- ❑ In multi-location engagements, establishes requirements for selecting locations for testing and determining the procedures to be performed based on the risk associated with the location
- ❑ Requires the auditor to determine whether persons with specialized skill and knowledge are needed and, if so, the knowledge of the subject matter that the auditor needs

# Auditing Standard No.10 – Supervision of the Audit Engagement

---

- ❑ Sets forth requirements for supervision of the audit engagement, especially the work of engagement team members
- ❑ Describes responsibilities of the engagement partner and others who assist the engagement partner with supervision
- ❑ Sets forth the nature and extent of supervisory activities necessary for proper supervision
  - For example, the extent of supervision should be commensurate with the risk of material misstatement

# Auditing Standard No.11 – Consideration of Materiality in Planning and Performing an Audit

- Uses the concept of materiality that currently applies under the federal securities laws, which reflects a reasonable investor's perspective
- Requires the auditor to:
  - Establish an appropriate materiality level for the financial statements as a whole
  - Establish lower materiality levels for particular accounts and disclosures when misstatements of lesser amounts are likely to influence the judgment of a reasonable investor
  - Determine tolerable misstatement at the account and disclosure level and, in multi-location engagements, for individual locations
  - Reevaluate materiality level(s) when necessary based on circumstances or additional information



# Auditing Standard No.12 – Identifying and Assessing Risks of Material Misstatement

- ❑ Establishes a process that prompts the auditor to “connect the dots” to identify and appropriately analyze the risks of error or fraud in the financial statements
- ❑ Designed to be scalable based on the size and complexity of the company
- ❑ Requires the auditor to obtain sufficient evidence that provides a reasonable basis for his or her assessments
- ❑ Includes procedures for identifying and assessing fraud risks
- ❑ Includes new requirements related to forming expectations about disclosures and considering risks of omitted, incomplete, or inaccurate disclosures

# Auditing Standard No.12 – Identifying and Assessing Risks of Material Misstatement

- Risk assessment procedures
  - Obtaining an understanding of the company and its environment, including, for example, risks related to executive compensation
  - Obtaining an understanding of ICFR
  - Considering information from client acceptance and retention evaluation, audit planning activities, past audits, and other engagements performed for the company
  - Performing analytical procedures
  - Conducting a discussion among engagement team members regarding risks of material misstatement
  - Inquiring of the audit committee, management, and others within the company about risks of material misstatement

# Auditing Standard No.12 – Identifying and Assessing Risks of Material Misstatement

- Risk assessment involves
  - Assessment of the risks of material misstatement due to error or fraud at the financial statement level and assertion level (including consideration of fraud risk factors)
  - Identification of significant accounts and disclosures and their relevant assertions
  - Identification of significant risks, including fraud risks

# Auditing Standard No.13 – The Auditor's Responses to the Risks of Material Misstatement

---

- Requires the auditors to respond to risks of material misstatement due to error or fraud through
  - Overall responses
  - Responses involving the nature, timing, and extent of audit procedures

# Auditing Standard No.13 – The Auditor's Responses to the Risks of Material Misstatement

- Tests of controls
  - Required only when auditor plans to assess control risk below the maximum, except in certain specified situations
  - More evidence is needed the greater the degree of reliance on controls
  - Must obtain evidence for the entire period of reliance
- Substantive procedures
  - Required for each relevant assertion of each significant account and disclosure, regardless of the assessed level of control risk
  - The higher the risk, the more evidence is needed from substantive procedures

# Auditing Standard No.13 – The Auditor's Responses to the Risks of Material Misstatement

---

- Required responses to significant risks, including fraud risks:
  - Audit procedures that are specifically responsive to the risks
  - Substantive procedures that include tests of details

# Auditing Standard No. 14 – Evaluating Audit Results

---

- Describes the auditor's responsibilities regarding the process of
  - evaluating the results of the audit to form the opinion on the financial statements and
  - determining whether sufficient appropriate audit evidence has been obtained

# Auditing Standard No. 14 – Evaluating Audit Results

- The standard covers evaluation of:
  - The results of analytical procedures performed in the overall review of the financial statements
  - Misstatements accumulated during the audit, including, in particular, uncorrected misstatements
  - The qualitative aspects of the company's accounting practices
  - Conditions identified during the audit that relate to the assessment of fraud risk
  - The presentation of the financial statements, including the disclosures
  - The sufficiency and appropriateness of the audit evidence obtained



# Auditing Standard No. 14 – Evaluating Audit Results

---

- Examples of new or enhanced requirements
  - Special considerations for misstatements related to accounting estimates
  - Expanded discussion of evaluating potential management bias in the amounts and disclosures in the financial statements
  - Additional procedures regarding offsetting adjustments identified by management

# Auditing Standard No. 15 – Audit Evidence

---

- ❑ Describes what constitutes audit evidence and establishes requirements regarding designing and performing audit procedures to obtain sufficient appropriate audit evidence
- ❑ Discusses the concepts of sufficiency, appropriateness, relevance, and reliability of audit evidence
- ❑ Discusses the auditor's responsibilities for selecting items for testing

# Examples of Amendments to Existing PCAOB Standards

- ❑ AS No. 3, Audit Documentation – Among other things, requires a summary of identified risks, the assessment of those risks, and the auditor's responses to those risks, including linkage of the responses to the risks
- ❑ AU sec. 329, Substantive Analytical Procedures – Amended standard discusses only analytical procedures performed as substantive procedures
- ❑ AU sec. 350, Audit Sampling – Along with other conforming changes, expanded the direction regarding determination of sample sizes when non-statistical sampling approaches are used

# Amendments to Existing PCAOB Standards

- AU sec. 336, *Using the Work of Specialists* – Amended to specify that AS No. 10 applies to specialists employed by the firm and to situations in which persons with specialized skills in accounting and auditing participate in the audit
- AU sec. 543, *Part of Audit Performed by Other Independent Auditors* – Amended to specify that AS No. 10 applies to situations not covered by AU sec. 543 in which other accounting firms or other accountants participate in the audit
- AU sec. 316, *Consideration of Fraud in a Financial Statement Audit* – Added a “roadmap” that references other standards containing requirements regarding the auditor’s consideration of fraud
  - Important principles regarding auditor’s responsibility to fraud and more detailed requirements regarding the auditor’s response to fraud risks retained in AU sec. 316

# Effect on Future Standard-Setting

---

- Framework for the audit process, including planning, assessing risks, performing audit procedures in response to risk, and evaluating audit results
- Future standards can apply the principles in framework to specific audit areas