

Overview of New Standards & Key Auditing Changes

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The Auditing Standards Board, the standards-setting body that governs auditors of non-public entities, has passed a sweeping set of new standards that rewrite many of the fundamental principles of a financial statement audit for non-public entities.

Though not as extensive as the rules for public companies, these new standards parallel many of the key aspects of the Sarbanes-Oxley legislation that public companies have had to comply with in recent years.

These new rules are intended to enhance the auditors' application of the audit risk model and require a more

in-depth understanding and documentation of an entity's overall operations, business objectives and strategies, and the risks associated with achieving those objectives.

Additionally, the new standards require auditors to perform a more thorough evaluation of, and testing related to, the entity's key internal processes and related internal controls. As a result of these increased demands, auditors will likely begin their reconfigured audit approach and development of audit strategies well in advance of their clients' fiscal year ends.

The accompanying table titled "Overview of New Standards & Key Auditing Changes" summarizes the requirements under

New Pronouncement	Overview of Requirements	Key Changes
SAS No. 104 – Due Professional Care in the Performance of Work	Requires the auditor to plan and perform the audit to obtain sufficient appropriate audit evidence in an attempt to reduce overall audit risk to a low level.	Auditors can no longer assess risk at a high level and then automatically turn to substantive procedures to conduct the audit without appropriate documentation and testing of the entity level controls and key processes within an organization.
SAS No. 105 – Generally Accepted Auditing Standards	Expands the scope of the audit primarily to recognize that audit procedures are performed to obtain the understanding on which the auditor's risk assessments are based.	Generic audit work programs will no longer be appropriate for most engagements.
SAS No. 106 – Audit Evidence	Provides the auditor with expanded guidance, concepts, and definitions for audit evidence and relevant assertions; discusses qualitative aspects related to sufficiency and appropriateness of audit evidence; and describes various additional audit procedures and discusses why they should be performed.	Greatly reduces the auditor's ability to rely upon representations from management. Increases auditor's responsibility to observe and test information supporting management representations.
SAS No. 107 – Audit Risk and Materiality in Conducting an Audit	Provides the auditor with guidance on how to consider audit risk and materiality when performing an audit of financial statements.	Similar to SAS No. 104, auditors can no longer automatically turn to a substantive based audit; they must assess control risk and test the effectiveness of internal controls, where appropriate.
SAS No. 108 – Planning and Supervision	Establishes standards and provides guidance applicable to auditor planning and supervision. Planning should begin with engagement acceptance and continue throughout the audit. An overall audit strategy should be developed encompassing nature, timing, and extent of testing, with an understanding of the entity environment, including its internal control.	This will require an increase in auditors' planning and documentation time prior to your actual year end, essentially requiring auditors to be on-site for interim work before the company's year end.

New Pronouncement	Overview of Requirements	Key Changes
SAS No. 109 – Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement	<p>Pertains to the auditor obtaining sufficient understanding of the entity and its environment, including its internal control, and the assessment of risk as it relates to the financial statements. Provides that the auditor should: 1) Assess risk procedures and sources of information about the entity and its environment, including internal control; 2) Understand the entity and its environment, including its internal control; 3) Assess the risks of material misstatement; and 4) Provide adequate documentation to support conclusions.</p> <p>The auditor should consider the following aspects in the overall assessment: 1) Industry, regulatory, and other external factors; 2) Nature of the entity; 3) Objectives and strategies and the related business risks that may result in a material misstatement; 4) Measurement and review of the entity's financial performance; and 5) Internal control, which includes the selection and application of accounting policies.</p>	<p>Auditors should perform increased inquiries of management and others within the entity, analytical procedures, and/or observation and inspection.</p> <p>Auditors are also required to have an internal brainstorming session to discuss the risk of financial statement misstatements.</p> <p>In addition, auditors must evaluate the design of internal controls and determine whether these controls have been implemented, which will require more planning time and related testing of controls.</p>
SAS No. 110 – Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained	<p>Design and perform audit procedures so the nature, timing, and extent are responsive to the assessed risks of material misstatement at the relevant assertion level. Provides a clear linkage between the auditor's procedures and the overall risk assessments.</p>	<p>Essentially, results in each financial statement audit requiring tailored audit programs and procedures, specific to each client.</p>
SAS No. 111 – Audit Sampling	<p>Provides the auditor with amended and enhanced guidance surrounding audit sampling and auditor judgment in planning a sample for tests of details.</p>	<p>Will likely increase the amount of testing performed on audit engagements.</p>
SAS No. 114 – Auditor's Communication with Those Charged with Governance	<p>This encompasses "person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity," including overseeing the financial reporting process...and encompasses the term board of directors or audit committee. Relates to all of entity's governance bodies, including trustees, partners, board of directors. Addresses information to be obtained from those governance bodies. Also clarifies auditor responsibilities, including scope and timing of audit, communication of significant audit findings, and the communication process.</p>	<p>Supersedes SAS No. 61 and addresses all specified matters to be addressed to individuals charged with an entity's governance.</p>

All of the above standards are effective for audits of financial statements for periods beginning on or after December 15, 2006.

the new auditing standards and the key changes anticipated with each.

In conclusion, the new standards represent the most significant change to the auditing profession to occur in the last 30 years.

Although audit time and fees associated are expected to increase as a result of these standards, it is also believed that the new standards will benefit all stakeholders in the financial reporting process — those who prepare financial information, those of us who provide assurance on the reliability of that

information, and those who ultimately use the information to make sound business decisions.

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