

## **SEC Approves PCAOB's Auditing Standards Related to the Auditor's Assessment of, and Response to, Risk in an Audit**

The Securities and Exchange Commission ("SEC") recently issued a final order approving eight new auditing standards proposed by the Public Company Accounting Oversight Board ("PCAOB").<sup>1</sup> These auditing standards, which relate to the auditor's assessment of, and response to, the risks of material misstatements in financial statements, will provide the foundation for considering such risks in the planning and performance of public company audits.<sup>2</sup> The new auditing standards may be summarized as follows:

- Auditing Standard No. 8 discusses the auditor's consideration of audit risk in an audit of financial statements as part of an integrated audit or an audit of financial statements only. This standard describes the components of audit risk and the auditor's responsibilities for reducing risk in order to obtain reasonable assurance that the financial statements are free of material misstatements;
- Auditing Standard No. 9 establishes requirements regarding audit planning;
- Auditing Standard No. 10 establishes requirements for supervision of the audit engagement, including supervising the work of engagement team members;
- Auditing Standard No. 11 describes the auditor's responsibilities for consideration of materiality in planning and performing an audit;
- Auditing Standard No. 12 establishes requirements regarding the process of identifying and assessing risks of material misstatement of the financial statements;
- Auditing Standard No. 13 establishes requirements for responding to the risks of material misstatements in financial statements through the general conduct of the audit and performing audit procedures regarding significant accounts and disclosures;
- Auditing Standard No. 14 establishes requirements regarding the auditor's evaluation of audit results and determination of whether the auditor has obtained sufficient audit evidence. The evaluation process includes evaluation of misstatements identified during the audit, the overall presentation of

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<sup>1</sup> See PCAOB Release No. 34-63606, *Order Approving Proposed Rules on Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards* (December 23, 2010), available at <http://www.sec.gov/rules/pcaob/2010/34-63606.pdf> (the "SEC Order"). See also PCAOB Release No. 34-62919 (September 15, 2010) [75 FR 59332, *Notice of Filing of Proposed Rules on Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards* (September 27, 2010)], available at <http://www.sec.gov/rules/pcaob/2010/34-62919.pdf>.

<sup>2</sup> The auditing standards and related amendments to PCAOB standards may be found in Appendices 1-9 of PCAOB Release No. 2010-004, *Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards* (August 5, 2010), available at [http://pcaobus.org/Rules/Rulemaking/Docket%20026/Release\\_2010-004\\_Risk\\_Assessment.pdf](http://pcaobus.org/Rules/Rulemaking/Docket%20026/Release_2010-004_Risk_Assessment.pdf). Also note that the new auditing standards will supersede six PCAOB interim standards and related amendments, including AU sec. 311, *Planning and Supervision*, AU sec. 312, *Audit Risk and Materiality in Conducting an Audit*, AU sec. 313, *Substantive Tests Prior to the Balance Sheet Date*, AU sec. 319, *Consideration of Internal Control in a Financial Statement Audit*, AU sec. 326, *Evidential Matter*, and AU sec. 431, *Adequacy of Disclosure in Financial Statements*.

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the financial statements (including disclosures) and the potential for management bias in the financial statements; and

- Auditing Standard No. 15 explains what constitutes audit evidence and establishes requirements for designing and performing audit procedures to obtain sufficient evidence to support the opinion expressed in the auditor's report.

In an attempt to promote sophisticated risk assessment in audits and minimize the risk that auditors will fail to detect material misstatements, the new auditing standards will enhance the requirements for planning and executing audits, including integrating fraud considerations throughout the audit. The new standards will become effective for audits of fiscal years beginning on or after December 15, 2010. In response to a commenter's concern about the effective date not allowing sufficient time to adapt to the updated standards, the SEC alluded to, and agreed with, the PCAOB's view when similar concerns were raised in its comment letter process. The PCAOB had taken the position with regard to the timing of effectiveness that the underlying concepts of risk-based auditing were not changed by the standards, and therefore, while there are many incremental requirements in the updated standards, they should not require wholesale changes to audit methodologies.<sup>3</sup>

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or [cgilman@cahill.com](mailto:cgilman@cahill.com); Jon Mark at 212.701.3100 or [jmark@cahill.com](mailto:jmark@cahill.com); John Schuster at 212.701.3323 or [jschuster@cahill.com](mailto:jschuster@cahill.com); or Abigail Darwin at 212.701.3240 or [adarwin@cahill.com](mailto:adarwin@cahill.com).

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<sup>3</sup> The SEC Order at 4.