Excerpts from Auditing Standard No. 2
PCAOB interpretation of Sarbanes-Oxley

Nuggets of advice for corporate management

Management is precluded from concluding that the company's internal control over financial reporting is effective if there are one or more material weaknesses. In addition, management is required to disclose all material weaknesses that exist as of the end of the most recent fiscal year.

To be effective, internal controls must be designed properly, and all the controls necessary to provide reasonable assurance about the fairness of a company's financial statements should be in place and performed by appropriately qualified people who have the authority to implement them.

Requirements for external auditors

Auditing Standard No. 2 (AS#2) requires the auditor to obtain evidence about the operating effectiveness of controls related to all relevant financial statement assertions for all significant accounts and disclosures in the financial statements.

The auditor must obtain an understanding of, and evaluate, management's process for assessing the effectiveness of the company's internal control over financial reporting. When obtaining the understanding, the auditor should determine whether management has addressed the following elements: … Including information technology general controls, on which other controls are dependent.

AS#2 specifically addresses and emphasizes the importance of controls over possible fraud and requires the auditor to test controls specifically intended to prevent or detect fraud that is reasonably possible to result in material misstatement of the financial statements.

> The auditor should evaluate all controls specifically intended to address the risks of fraud that have at least a reasonably possible likelihood of having a material effect on the company's financial statements. …. Such controls include, but are not limited to, the … company's risk assessment processes ….

AS#2 directs the auditor to confirm his or her understanding by performing procedures that include … reviewing documents that are used in, and that result from, the application of the controls.

AS#2 requires the auditor to review all reports issued during the year by internal audit … that address internal controls over financial reporting and evaluate any internal control deficiencies identified in those reports. Additionally, the auditor may use the results of testing by others to alter the nature, timing, and extent of his or her tests of controls.

Information technology general controls are part of the control activities component of internal control; therefore, the nature of the controls might permit the auditor to use the work of others. ….

Controls to detect attempts to override controls that prevent unauthorized journal entries from being posted may have a highly pervasive effect, may involve a high degree of judgment in evaluating their operating effectiveness, many involve a subjective evaluation, and may have a reasonable possibility for management override. Therefore, the auditor could determine that, based on the nature of these controls over systems access, he or she would need to perform more of the tests of those controls himself or herself. Further, because of the nature of the controls, the auditor should use the work of others only if the degree of competence and objectivity of the individuals performing the tests is high.

The extent to which the auditor may use the work of others depends of the degree of competence and objectivity of the individuals performing the work. The higher the degree of competence and objectivity, the greater use the auditor may make of the work ….. Factors concerning the competence of the individuals performing the tests of controls include: …. Quality of the documentation of their work, including any reports or recommendations issued.

The entire content of the final AS#2 standard

The full text of the standard can be found here on the PCAOB web site: **go-see-it** Brace yourself for a 211 page .pdf download.

The PCAOB web site home page is: www.pcaobus.org

Page 2 of 2

Return to Sarbanes-Oxley Standards from PCAOB page
Return to Sarbanes-Oxley Act page