

Comparison of the PCAOB’s Auditing Standards No. 5 and No. 2

(Certain key differences are highlighted by underlining)

<u>Topic</u>	<u>AS No. 5</u>	<u>AS No. 2</u>
Objective of ICFR Audit	Express an opinion on the effectiveness of ICFR, which necessitates planning and performing the audit to obtain “reasonable assurance” about whether material weaknesses exist as of the date of management’s assessment. Para. 3	Parallel provision in Para. 4
Planning the ICFR Audit		
Integration of ICFR Audit with Audit of Financial Statements	The audit of ICFR should be integrated with the audit of the financial statements. The objectives of the audits are not identical, however, and the auditor must plan and perform the work to achieve the objectives of both audits. Para. 6	Parallel provision in Para. 145
Materiality Considerations in Planning the Audit of ICFR	The auditor should use the same materiality considerations that the auditor would use in planning the audit of the company’s annual financial statements. Cites AU Section 312, <i>Audit Risk and Materiality in Conducting an Audit</i> , for an additional explanation of materiality. Para. 20	The auditor should apply the concept of materiality in an audit of ICFR at both the financial-statement level <u>and at the individual account-balance level</u> . The same conceptual definition of materiality that applies to financial reporting applies to information on ICFR, <u>including the relevance of both quantitative and qualitative considerations</u> . Cites AU Section 312, <i>Audit Risk and Materiality in Conducting an Audit</i> , for an additional explanation of materiality. Paras. 22 and 23
Evidence Required	The auditor must plan and perform the audit of ICFR to obtain competent evidence that is sufficient to obtain reasonable assurance about whether material weaknesses exist as of the date of management’s assessment. Para. 3	Comparable provision, stated with greater clarity, in Para. 27: The auditor must obtain sufficient competent evidence about the design and operating effectiveness of controls over all relevant financial statement assertions related to all significant accounts and disclosures in the financial statements. The auditor must plan and perform the audit to obtain reasonable assurance that deficiencies that, individually or in the aggregate, would represent material weaknesses are

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		identified.
Matters to Evaluate in Planning Audit of ICFR	<p>The auditor should evaluate whether the following matters are important to the company's financial statements and ICFR and, if so, how they will affect the auditor's procedures:</p> <ul style="list-style-type: none"> - knowledge of the company's ICFR during other engagements performed by the auditor; - matters affecting the industry in which the company operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes; - matters relating to the company's business, including its organization, operating characteristics, and capital structure; - the extent of recent changes, if any, in the company, its operations, or its ICFR; - the auditor's preliminary judgments about materiality, risk and other factors relating to the determination of material weaknesses; - control deficiencies previously communicated to the audit committee or management; - legal or regulatory matters of which the company is aware; - the type and extent of available evidence related to the effectiveness of the company's ICFR; - preliminary judgments about the effectiveness of ICFR; - public information about the company relevant to the evaluation of the likelihood of material financial statement misstatements and the effectiveness of the company's ICFR; - knowledge about risks related to the company evaluated as part of the auditor's client acceptance and retention evaluation; 	Essentially the same matters listed in Para. 39.

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	<p>- the relative complexity of the company's operations.</p> <p>Para. 9</p>	
Role of Risk Assessment	<p>Risk assessment underlies the entire ICFR audit process, including the determination of the significant accounts and disclosures and relevant assertions, the selection of controls to test, and the determination of the evidence necessary for a given control.</p> <p>Para. 10</p> <p>A direct relationship exists between the degree of risk that a material weakness could exist in a particular area of the company's ICFR and the amount of audit attention that should be devoted to the area.</p> <p>The auditor should focus more of its attention on the areas of highest risk.</p> <p>Para. 11</p>	No comparable provisions.
Scaling the Audit	<p>The size and complexity of the company, its business processes, and business units, may affect the way in which the company achieves many of its control objectives. The size and complexity of the company also might affect the risks of misstatement and the controls necessary to address those risks.</p> <p>Para. 13</p>	No comparable provision.
Addressing the Fraud Risk in Planning and Performing Audit of ICFR	<p>The auditor should take into account the results of its fraud risk assessment.</p> <p>As part of the auditor's identification and testing of entity-level controls, and selecting other controls to test, the auditor should evaluate whether the company's controls sufficiently address identified risks of material misstatement due to fraud and controls intended to address the risk of management override of other controls.</p> <p>Para. 14</p> <p>If the auditor identifies deficiencies in controls designed to prevent or detect fraud</p>	<p>The auditor should evaluate all controls specifically intended to address the risks of fraud that have a least a reasonably possible likelihood of having a material effect on the company's financial statements.</p> <p>Para. 24</p> <p>Parallel provision in Para. 26.</p>

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	<p>during the audit of ICFR, the auditor should take into account those deficiencies when developing the auditor's response to risks of material misstatement during the financial statement audit, per AU Section 316.44 and .45</p>	
<p>Using the Work of Others</p>	<p>The auditor should evaluate the extent to which the auditor will use the work of others to reduce the work the auditor might otherwise perform itself.</p> <p>Para. 16</p> <p>The auditor may use the work performed by, <u>or receive direct assistance from</u>, internal auditors, company personnel (in addition to internal auditors) and third parties working under the direction of management or the audit committee.</p> <p>Para. 17</p> <p>The auditor should assess the competence and objectivity of the persons whose work the auditor plans to use to determine the extent to which the auditor may use their work. The higher degree of competence and objectivity, the greater use the auditor may make of the work.</p> <p>Para. 18</p> <p>The extent to which the auditor may use the work of others also depends on the risk associated with the control being tested. As the risk associated with the control increases, the need for the auditor to perform its own work on the control increases.</p> <p>Para. 19</p>	<p>The auditor must perform enough of the testing itself <u>so that the auditor's own work provides the principal evidence for the auditor's opinion.</u></p> <p>Para. 108</p> <p>The auditor may use the work of others to alter the nature, timing or extent of the work the auditor otherwise would have performed. The work of others includes relevant work performed by internal auditors, company personnel (in addition to internal auditors) and third parties working under the direction of management or the audit committee.</p> <p>Para. 108</p> <p>The auditor should evaluate whether to use the work performed by others. The auditor should evaluate <u>the nature of the controls subjected to the work of others</u>, the competence and objectivity of the individuals who performed the work, <u>and test some of the work performed by others to evaluate the quality and effectiveness of their work.</u> The higher the degree of competence and objectivity, the greater use the auditor may make of the work.</p> <p>Paras. 109, 117</p> <p>Comparable provision, stated with greater clarity in Para. 112: The auditor should evaluate the following factors when evaluating the nature of the controls subjected to the work of others. As these factors increase in significance, the need for the auditor to perform its own work on those controls increases.</p> <p>- the materiality of the accounts and disclosures that the control addresses and the risk of material misstatement:</p>

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		<ul style="list-style-type: none"> - the degree of judgment required to evaluate the operating effectiveness of the control; - the pervasiveness of the control; - the level of judgment or estimation required in the account or disclosure; - the potential for management override of the control.
Manner of Conducting ICFR Audit		
Use a Top-Down Approach	<p>The auditor should use a top-down approach to the audit of ICFR to select the controls to test.</p> <p>A top-down approach begins at the financial-statement level and with the auditor’s understanding of the overall risks to ICFR. The auditor then focuses on entity-level controls and works down to significant accounts and disclosures and their relevant assertions. This approach directs the auditor’s attention to accounts, disclosures and assertions that present a reasonable possibility of material misstatement to the financial statements and related disclosures.</p> <p>Para. 21</p>	<p>Without using the term “top-down”, As No. 2 articulates essentially the same methodology:</p> <p>It may be appropriate for the auditor to test and evaluate the design effectiveness of entity-level controls first, because the results of that work might affect the way the auditor evaluates the other aspects of ICFR.</p> <p>The auditor should identify significant accounts and disclosures, first at the financial-statement level and then at the account or disclosure-component level. Determining specific controls to test begins by identifying significant accounts and disclosures within the financial statements.</p> <p>Paras. 52, 60</p>
Testing Entity-Level Controls	<p>The auditor must test entity-level controls that are important to the auditor’s conclusion about whether the company has effective ICFR.</p> <p>The auditor’s evaluation of entity-level controls can result in increasing or decreasing the testing that the auditor otherwise would have performed on other controls.</p> <p>Para. 22</p>	<p>Comparable provision in Para. 52, though phrased in a less prescriptive manner:</p> <p>Controls that exist at the entity-level often have a pervasive impact on controls at the process, transaction or application level. For that reason, as a practical consideration, it may be appropriate for the auditor to test and evaluate the design effectiveness of entity-level controls first, because the results of that work might affect the way the auditor evaluates the other aspects of ICFR.</p>

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Testing of Other (i.e., other than entity-level) Controls	<p>Testing of certain entity-level controls might (i) affect the other controls the auditor selects for testing, and the nature, timing and extent of procedures the auditor performs on other controls, (ii) allow the auditor to reduce the testing of other controls, or (iii) eliminate the need to test additional controls relating to the particular risk.</p> <p>Para. 23</p>	<p>Testing entity-level controls is not sufficient for the purpose of expressing an opinion on the effectiveness of a company's ICFR.</p> <p>Para. 54</p>
Evaluate Control Environment	<p>The auditor must evaluate the control environment at the company. This entails assessing whether:</p> <ul style="list-style-type: none"> - management's philosophy and operating style promote effective ICFR - sound integrity and ethical values, particularly of top management, are developed and understood; and - the board or audit committee understands and exercises oversight responsibility over financial reporting and internal control. <p>Para. 25</p>	<p>Parallel provision in Para. 113.</p>
Evaluate Period-End Financial Reporting Process	<p>The auditor must evaluate the period-end financial reporting process.</p> <p>Para. 26</p> <p>As part of evaluating the period-end financial reporting process, the auditor should assess:</p> <ul style="list-style-type: none"> - inputs, procedures performed and outputs of the processes the company uses to produce its annual and quarterly financial 	<p>Para. 78 reflects a comparable provision, stated in a less prescriptive manner:</p> <p>The period-end financial reporting process is always a significant process because of its importance to financial reporting and to the auditor's opinions on ICFR and the financial statements. The auditor's understanding of the company's period-end financial reporting process and how it interrelates with the company's other significant processes assists the auditor in identifying and testing controls that are most relevant to the financial statement risks.</p> <p>Parallel provision in Para. 77.</p>

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	<p>statements;</p> <ul style="list-style-type: none"> - the extent of information technology involvement in the period-end financial reporting process; - who participates from management; - the locations involved in the period-end financial reporting process; - the types of adjusting and consolidating entries; - the nature and extent of the oversight of the process by management, the board of directors and the audit committee. <p>Para. 26</p>	
<p>Identifying Significant Accounts and Disclosures and their Related Assertions</p>	<p>The auditor should identify significant accounts and disclosures and their relevant assertions.</p> <p>Para. 28</p> <p>Risk factors relevant to the identification of significant accounts and disclosures and their relevant assertions include:</p> <ul style="list-style-type: none"> - size and composition of the account; - susceptibility to misstatement due to errors or fraud; - volume of activity, complexity, and homogeneity of the individual transactions processed through the account or reflected in the disclosure; - nature of the account or disclosure; - accounting and reporting complexities associated with the account or disclosure; - exposure to losses in the account; - possibility of significant contingent liabilities arising from the activities reflected in the account or disclosure; - existence of related party transactions in 	<p>The auditor should identify significant accounts and disclosures, <u>first at the financial-statement level and then at the account or disclosure-component level.</u></p> <p>Para. 60</p> <p>Parallel provision in Para. 65.</p>

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	<p>the account; and</p> <ul style="list-style-type: none"> - changes from the prior period in account or disclosure characteristics. <p>Para. 29</p>	
<p>Understand Likely Sources of Misstatement</p>	<p>To understand the likely sources of potential misstatements, and as part of selecting the controls to test, the auditor should achieve the following objectives:</p> <ul style="list-style-type: none"> - understand the flow of transactions related to the relevant assertions, including how these transactions are initiated, authorized, processed and recorded; - verify that the auditor has identified the points within the company's processes at which a misstatement – including a misstatement due to fraud – could arise that, individually or in combination with other misstatements, would be material; - identify the controls that management has implemented to address these potential misstatements; and - identify the controls that management has implemented over the prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could result in a material misstatement of the financial statements. <p>Para. 34</p>	<p>Parallel provision in Para. 74, <u>applicable to each significant process.</u></p>
<p>Performing Walkthroughs</p>	<p>Performing walkthroughs will frequently be the most effective way of achieving the objectives in Paragraph 34.</p> <p>Paras. 37 and 38</p>	<p><u>The auditor should perform at least one walkthrough for each major class of transactions.</u></p> <p>Paras. 79- 82</p>
<p>Selecting Controls to Test</p>	<p>The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion.</p> <p>Para. 39</p>	<p>Parallel provision in Para. 83.</p>
<p>Testing Controls</p>		
<p>Testing Design</p>	<p>The auditor should test the design</p>	<p>Parallel provision in Para. 88.</p>

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Effectiveness	<p>effectiveness of controls by determining whether the company's controls, if they are operated as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the company's control objectives and can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements.</p> <p>Para. 42</p>	
Testing Operating Effectiveness	<p>The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively.</p> <p>Para. 44</p>	Parallel provision in Para. 92.
Relationship of Risk to Evidence to be Obtained	<p>For each control selected for testing, the evidence necessary to persuade the auditor that the control is effective depends on the risk associated with the control. The risk associated with a control consists of the risk that the control might not be effective and, if not effective, the risk that a material weakness would result. As the risk associated with the control being tested increases, the evidence that the auditor should obtain also increases.</p> <p>Para. 46</p> <p>Factors that affect the risk associated with a control include:</p> <ul style="list-style-type: none"> - the nature and materiality of misstatements that the control is intended to prevent or detect; - the inherent risk associated with the related account(s) and assertion(s); - whether there have been changes in the volume or nature of transactions that might adversely affect control design or operating effectiveness; - whether the account has a history of 	<p>No directly comparable provision in AS No. 2.</p> <p>Para. 105 has a similar orientation and cites similar factors.</p>

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	<p>errors;</p> <ul style="list-style-type: none"> - the effectiveness of entity-level controls; - the nature of the control and the frequency with which it operates; - the degree to which the control relies on the effectiveness of other controls; - the competence of the personnel who perform the control or monitor its performance and whether there have been changes in key personnel who perform the control or monitor its performance; - whether the control relies on performance by an individual or is automated; - the complexity of the control and the significance of the judgments that must be made in connection with its operation. <p>Para. 47</p>	
Nature of Tests of Controls	<p>The nature of the tests of effectiveness that will provide competent evidence depends, to a large degree, on the nature of the control to be tested.</p> <p>Para. 51</p> <p>Inquiry alone does not provide sufficient evidence to support a conclusion about the effectiveness of a control.</p> <p>Note to Para. 50</p>	<p>Comparable provision in Para. 97.</p> <p>Parallel provision in Para. 96.</p>
Timing of Tests of Controls	<p>Testing controls over a greater period of time provides more evidence of the effectiveness of controls than testing over a shorter period of time.</p> <p>Testing performed closer to the date of management's assessment provides more evidence than testing performed earlier in the year.</p> <p>Para. 52</p>	<p>The auditor must perform tests of controls over a period of time that is adequate to determine whether, as of the date specified in management's report, the controls necessary for achieving the objectives of the control criteria are operating effectively. The period of time over which the auditor performs tests of controls varies with the nature of the controls being tested and with the frequency with which specific controls operate and specific policies are applied.</p> <p>Para. 98</p>

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Subsequent Years' Audits of ICFR	<p>In subsequent years' audits, the auditor should incorporate knowledge obtained during past ICFR audits the auditor performed into the decision-making process for determining the nature, timing and extent of testing necessary.</p> <p>Para. 57</p> <p>The auditor should vary the nature, timing and extent of testing of controls from year to year to introduce unpredictability into the testing and respond to changes in circumstances.</p> <p>Para. 61</p>	<p><u>Each year</u> the auditor must obtain sufficient evidence about whether the company's ICFR is operating effectively. This means that <u>each year</u> the auditor must obtain evidence about the effectiveness of controls for all relevant assertions related to all significant accounts and disclosures in the financial statements.</p> <p>Parallel provision in Para. 104.</p>
Evaluating Identified Deficiencies		
Determining whether a Control Deficiency is a Material Weakness	<p>The auditor must evaluate the severity of each control deficiency that comes to the auditor's attention to determine whether the deficiencies, individually or in combination, are material weaknesses as of the date of management's assessment.</p> <p>Para. 62</p> <p>The severity of a deficiency depends on:</p> <ul style="list-style-type: none"> - whether there is a reasonable possibility that the company's controls will fail to prevent or detect a misstatement of an account balance or disclosure; and - the magnitude of the potential misstatement resulting from the deficiency or deficiencies. <p>Para. 63</p>	<p>The auditor must evaluate identified control deficiencies and determine whether the deficiencies, individually or in combination, <u>are significant deficiencies or</u> material weaknesses. The evaluation of the significance of a deficiency should include both quantitative and qualitative factors.</p> <p>Para. 130</p> <p>Parallel provision in Para. 131.</p>
Risk Factors that Affect Whether there is a Reasonable Possibility that a Deficiency will Result in a Misstatement of an Account Balance or Disclosure	<p>Factors include:</p> <ul style="list-style-type: none"> - the nature of the financial statement accounts, disclosures and assertions involved; - the susceptibility of the related asset or liability to loss or fraud; 	<p>Parallel provision in Para. 133.</p>

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	<ul style="list-style-type: none"> - the subjectivity, complexity or extent of judgment required to determine the amount involved; - the interaction of relationship of the control with other controls, including whether they are interdependent or redundant; - the interaction of the deficiencies; and - the possible future consequences of the deficiency. <p>Para. 65</p>	
Factors that Affect the Magnitude of the Potential Misstatement that may result from a Control Deficiency	<ul style="list-style-type: none"> -The financial statement amounts or total of transactions exposed to the deficiency; and - The volume of activity in the account balance or class of transactions exposed to the deficiency that has occurred in the current period or is expected in future periods. <p>Para. 66</p>	Parallel provision in Para. 135.
Indicators of Material Weaknesses in ICFR	<ul style="list-style-type: none"> - Identification of fraud on the part of senior management; - Restatement of previously issued financial statements to reflect the correction of a material misstatement; - Identification by the auditor of a material misstatement of financial statements in the current period in circumstances that indicate that the misstatement would not have been detected by the company's ICFR; and - Ineffective oversight of the company's external financial reporting and ICFR by the company's audit committee. <p>Para. 69</p>	Parallel provision in Para. 140, with the bulleted items referred to as "strong" indicators. AS No. 5 deletes the word "strong."
Forming an Opinion	The auditor should form an opinion on the effectiveness of ICFR by evaluating evidence obtained from all sources, including the auditor's testing of controls, misstatements detected during the financial statement audit, and any identified control deficiencies.	When forming an opinion on ICFR, the auditor should evaluate all evidence obtained from all sources, including: <ul style="list-style-type: none"> - the adequacy of the assessment performed by management and the results of the auditor's evaluation of the design

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	Para. 71	<p>and tests of operating effectiveness of controls;</p> <ul style="list-style-type: none"> - the negative results of substantive procedures performed during the financial statement audit; and - any identified control deficiencies. <p>Para. 127</p>