



PCAOB Reveals What's Next for AS2

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Possible amendments to the Public Company Accounting

Oversight Board 's Auditing Standard No. 2 include rethinking the auditor 's role in assessing management, improved term definitions, and an emphasis on a top-down, risk-based audit approach, revealed Thomas Ray, chief auditor and director of professional standards for the PCAOB.

The PCAOB staff will soon recommend that the board amend AS2, which guides accountants through the audit process of a company's internal-controls system. Many companies and accounting-industry pros have blamed the standard for driving auditors to conduct overly aggressive and costly audits.

In May 2005, the PCAOB issued a policy statement with guidance on how to implement the internal-controls provision of the Sarbanes-Oxley Act, known as Section 404. The guidance recommended that auditors should use a top-down approach, starting with company-level controls and risks, and rely on the work of others (to avoid unnecessary, costly testing of controls).

"We've received a lot of feedback that a number of auditors are hesitant to implement the concepts and direction from [the May 2005 guidance] for fear they would violate the standard itself," explained Ray. Amending AS2 is the PCAOB's top priority in the coming year.

The PCAOB also plans to reconsider the auditor's role in evaluating management's assessments of internal controls, continued Ray. Under the current standard, auditors write a report with their opinion on whether the management report is fairly presented and on the effectiveness of the company's internal controls. However, auditors have misinterpreted the standard to mean that they must issue an opinion on how well management assessed internal controls, commented Ray. As a result, the board will reconsider the language in that section of the standard and the auditor's role itself.

In addition, the PCAOB staff expects to clarify definitions of such phrases as "material weakness" and "significant deficiency." Currently, there is confusion about definitions when evaluating the severity of a weakness, noted Ray. For example, he said, the phrase "more than remote likelihood" causes auditors to focus at a low level on minor details. "If we change that to 'reasonable possibility,' it might help people," he mused.

While Ray could not specify when the amendments will be introduced, except to say "soon," he declared: "Don't wait for us to amend AS2 to make your audits more efficient."