

2007 AICPA National Banks & Savings Institutions Conference

Internal Control Assessments

Daniel W. Trigg

Partner, McGladrey & Pullen, LLP

November 28, 2007



McGladrey & Pullen
Certified Public Accountants

PCAOB Auditing Standard No. 5 (AS-5)

AS-5 designed to achieve 4 objectives:

- Focus internal control on the most important matters
- Eliminate procedures that were not considered necessary to achieve the intended benefits
- Make the process fit the client
 - One size doesn't fit all
- Simplify the standard



McGladrey & Pullen
Certified Public Accountants

Differences from AS - 2

- Only one evaluation new required under AS – 5
 - In AS – 2, an evaluation of managements assessment and another evaluation of the effectiveness of internal control over financial reporting.

Differences from AS - 2

- New definitions of significant deficiencies and material weakness
 - Significant deficiencies changed to “less than a material weakness, yet important enough to merit attention by those responsible for financial reporting”
 - In defining material weakness, “more than a reasonable likelihood” replaced with “a reasonable possibility”

Differences from AS - 2

- Walkthroughs
 - AS – 2 required a walkthrough to be performed for each major class of transaction, including routine and non-routine transactions
 - AS – 5 provides for:
 - Performance of procedures to achieve objective of understanding likely sources of misstatements
 - Ability to use the direct assistance of others
 - Walkthroughs are frequently the most effective method to achieve the objective

Differences from AS - 2

- Role of Risk Assessment
 - Relationship of the degree of risk and the amount of auditor attention
 - Auditor should focus on areas of highest risk

Differences from AS - 2

- Scaling the audit
 - Applies to entities of all sizes
 - Incorporates scaling concepts throughout the standard
 - PCAOB will be issuing guidance on auditing internal control on smaller companies

Differences from AS - 2

- Scaling the audit
 - Using the work of others
 - AS – 5 encourages the use of the work of others to a greater extent
 - Eliminates the principal evidence provision
 - Expands the work of others from internal auditors to other company personnel and third parties working under the direction of management or audit committee

Differences from AS - 2

- Using a top-down approach
 - Focus on the most important controls to test
 - Removed requirements to identify major classes of transactions and significant processes
 - Allow for auditor judgment
 - Requirement is the same: to test those controls that address the risk of material assessment to each relevant assessment

Differences from AS - 2

- Relationship of risk to evidence
 - Allows auditors to vary evidence obtained regarding the effectiveness of individual controls selected for testing based on risk associated with the individual control

Differences from AS - 2

- Benchmarking of automated controls
 - Allows the auditor to conclude that automated application controls continue to be effective without repeating the prior year's testing of controls have been found to be effective and nothing has changed when it was last tested by the auditor

2007 AICPA National Banks & Savings Institutions Conference

Section 404 for Non-Accelerated Filers

Wynne E. Baker
KraftCPAs PLLC
November 28, 2007

Non-Accelerated Filers

- Market capitalization held by non-affiliates less than \$75 million
- Management is required to file a report on internal control over financial reporting for a fiscal year ending on or after December 15, 2007
- Auditor's attestation report is not required until a fiscal year ending on or after December 15, 2008

Integration of External Audit and Attestation

- PCAOB now makes it clear that the auditor must integrate the audit of management's assessment with the audit of the financial statements

Use of COSO Internal Control Framework

- AS 5 does not mandate COSO for smaller companies
- Management must select and document a framework
- Management and the auditor must agree on a framework for reporting and testing

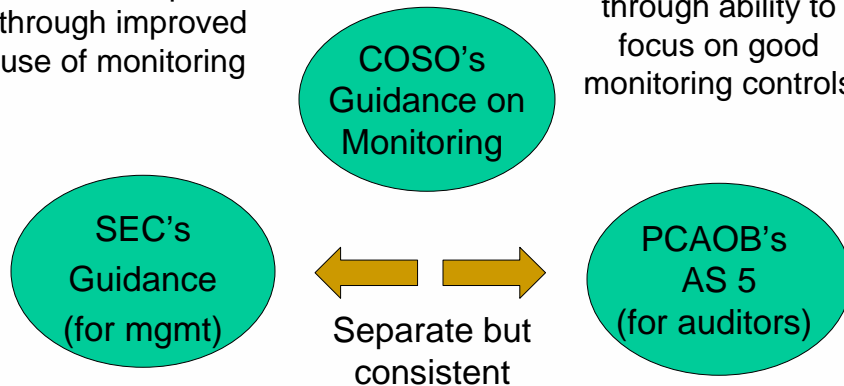
Internal Control Issues for Smaller Banks

- Tone at the top – fewer members of senior management and not as knowledgeable as audit committee
- Fraud risk is higher – less segregation of duties
- Controls not as well defined
 - Personnel not as well qualified
 - Trustworthiness of key executives

Three legs to the “404-improvement” stool

Value to companies
through improved
use of monitoring

Value to auditors
through ability to
focus on good
monitoring controls



SEC's Guidance

Encourages a focus on “entity-level” controls:

- **Indirect** – those that have an indirect effect on control system effectiveness (e.g., tone at the top)
- **Monitoring** – those that monitor the effectiveness of other controls (see the COSO monitoring guidance)
- **Precise** – those that operate at a level of precision that would adequately prevent or detect misstatements on a timely basis

ATTEST STANDARD 501 – Impact of PCAOB Audit Standard 5

AICPA Banking Conference
2007

AT 501 Amendment Process

- Exposure draft issued shortly after SOX
- Exposure draft was never finalized waiting on AS 2
- The revised AT 501 was re-exposed along with SAS 112
- AT 501 was not issued waiting on AS 5
- AT 501 is being revised and will be issued in 2008 after re-exposure
- AS 5 and the exposure draft of AT 501 have many similar concepts
- AT 501 should be issued in 2008 with an effective date of December 2008

Attest Standards

- AT 101 is a umbrella standard covering all attest standards
- Underlying concepts of Subject Matter and or Assertions

ATTEST verse AS5

- Both are giving assurance i.e. an opinion
- Attest standards rely on the criteria for guidance to management and the auditor
- AT 501 engagements must be done at same time as audit but do not have to be preformed by the same auditor
- Separate report

Types of AT 501 Engagements

- Engagements to examine the design and operating effectiveness of an entity's internal control
- Engagements to examine the design and operating effectiveness of a portion of an entity's internal control
- Engagements to examine only the suitability of design of an entity's internal control (no assertion is made about the operating effectiveness of internal control)
- Engagements to examine the design and operating effectiveness of an entity's internal control based on criteria established by a regulatory agency
- The committee is considering separating some of these engagements into a separate attest standard

Objective of an AT 501 engagement

- Opinion on effectiveness over ICFR -design only OR
- Opinion on effectiveness over ICFR – design and operation
- Opinion on financial statements would have be issued at same time.

Deficiencies Defined

- May be the same as AS 5 - waiting on international standards

Managements Framework

- Based on COSO or other criteria
- No specific requirements in standard
- Dirty Assertions are not acceptable

General Controls including IT General Controls

- Pervasive
- Hard to document and measure
- What has management done to measure and document
- General Controls document

Common elements with AS 5

- Walkthroughs
- Significant accounts
- Pervasive controls concepts
- Material weakness indicators
- Using work of others
- Multi locations
- Audit committees

SEC Guidance

- Management is responsible for maintaining evidential matter, including documentation, to provide reasonable support for its assessment.

What is “Reasonable”

- Reasonable assurance and reasonable detail is defined as “such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs”
- Not a single conclusion or method, but a range

Two Broad Principles

- Management should evaluate whether it has implemented controls that adequately address the risk of material misstatement
- Management evaluation of evidence about the operation of its controls should be based on its assessment of risk

Evaluation process

- Identify financial reporting risks
- Identify controls that adequately address risks
- Consider entity level controls
- Consider ITGC's
- Evidential matter to support assessment
 - Documentation of design and entity level controls is an integral part of the support

Evaluation Process

- Evidence of operating effectiveness
 - Operating as designed
 - Person possesses authority and competence
- Higher risk = more evidence
- Implementing procedures to evaluate evidence

Questions?

Michael T. Umscheid, CPA
Managing Partner
757-573-4830
757-228-7878
mumscheid@harbingeplc.com

**ATTEST STANDARD 501 – Impact of PCAOB
Audit Standard 5**

AICPA Banking Conference
2007



McGladrey & Pullen
Certified Public Accountants

**ATTEST STANDARD 501 – Impact of PCAOB
Audit Standard 5**

AICPA Banking Conference
2007



McGladrey & Pullen
Certified Public Accountants