

PKF PERSPECTIVES

NEW RISK ASSESSMENT AUDITING STANDARDS

Will Enhance Audit Approach and Methodology

On February 22, 2006, the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) announced the approval of eight new Statements on Auditing Standards (SASs) relating to risk assessment. These Statements will be effective for the audits of financial statements for periods beginning on or after December 15, 2006, although earlier adoption is permitted.

The standards are applicable to privately-held (non-issuer) entities and are intended to improve the effectiveness of audit engagements. They will be available from the AICPA on or around March 8, 2006.

The new SASs are numbered 104 through 111 and are comprised of the following:

- ~ SAS No. 104, Amendment to Statement on Auditing Standards No. 1, Codification of Auditing Standards and Procedures - Due Professional Care in the Performance of Work.
- ~ SAS No. 105, Amendment to Statement on Auditing Standards No. 95 - Generally Accepted Auditing Standards.
- ~ SAS No. 106, Audit Evidence.
- ~ SAS No. 107, Audit Risk and Materiality in Conducting an Audit.
- ~ SAS No. 108, Planning and Supervision.
- ~ SAS No. 109, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.
- ~ SAS No. 110, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained.
- ~ SAS No. 111, Amendment to Statement on Auditing Standards No. 39 - Audit Sampling.

These statements are expected to provide guidance and improve the auditor's assessment of the risks of material misstatement, caused by error or fraud, in a financial statement audit. The AICPA states that the primary objective of these SASs is to enhance the auditor's appli-

cation of the audit risk model by obtaining:

- More in-depth understanding of the entity and its environment, including its internal control, to identify the risks of material misstatement in the financial statements and what the entity is doing to mitigate them.
- More rigorous assessment of the risks of material misstatement of the financial statements based on that understanding.
- Improved linkage between the assessed risks and the nature, timing, and extent of audit procedures performed in response to those risks.

What the New Standards Mean for Auditors and Their Clients

In order to comply with the new standards, auditors must tailor their audit approach to each client so that it is responsive to assessed risks and focuses on those areas where risk of misstatement is greatest.

Auditors will be spending more time with the CEO, CFO and other financial decision-makers in obtaining an understanding of the business and its risks in reporting accurate financial statements. It is believed that the more open the client is about how internal accounting decisions are made, the better the auditor's understanding of the strengths and weaknesses of the organization and the more efficient and effective the audit will be.

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