

**Amendment to Interim Auditing Standards – Part of Audit Performed by Other  
Independent Auditors**

June 9, 2004

**AUDITING AND RELATED PROFESSIONAL PRACTICE STANDARDS**

Amendment to Interim Auditing Standards –

***Part of Audit Performed by Other Independent Auditors***



[Effective pursuant to SEC Release No. 34-50253, File No. PCAOB-2004-05 (August 25, 2004)]

**Public Company Accounting Oversight Board  
Bylaws and Rules – Standards – Interim Standards Amendment**

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**AU sec. 543.12 is amended as follows:**

When the principal auditor decides not to make reference to the audit of the other auditor, in addition to satisfying himself as to the matters described in AU sec. 543.10, the principal auditor must obtain, and review and retain, the following information from the other auditor:

- a. An engagement completion document consistent with paragraphs 12 and 13 of PCAOB Auditing Standard No. 3

Note: This engagement completion document should include all cross-referenced, supporting audit documentation.

- b. A list of significant fraud risk factors, the auditor's response, and the results of the auditor's related procedures.
- c. Sufficient information relating to significant findings or issues that are inconsistent with or contradict the auditor's final conclusions, as described in paragraph 8 of PCAOB Auditing Standard No. 3.
- d. Any findings affecting the consolidating or combining of accounts in the consolidated financial statements.
- e. Sufficient information to enable the office issuing the auditor's report to agree or reconcile the financial statement amounts audited by the other firm to the information underlying the consolidated financial statements.
- f. A schedule of audit adjustments, including a description of the nature and cause of each misstatement.
- g. All significant deficiencies and material weaknesses in internal control over financial reporting, including a clear distinction between those two categories.
- h. Letters of representations from management.
- i. All matters to be communicated to the audit committee.

The principal auditor must obtain, and review and retain, such documents prior to the report release date.<sup>1/</sup> In addition, the principal auditor should consider performing one or more of the following procedures:

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<sup>1/</sup> As it relates to the direction in paragraph .19 of AU sec. 324, for the auditor to "give consideration to the guidance in section 543.12," the auditor need not, in this circumstance, obtain the previously enumerated documents.

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- Visit the other auditor and discuss the audit procedures followed and results thereof.
- Review the audit programs of the other auditor. In some cases, it may be appropriate to issue instructions to the other auditor as to the scope of the audit work.
- Review additional audit documentation of the other auditor relating to significant findings or issues in the engagement completion document.

Conforming Amendments To PCAOB Interim Standards Resulting from the  
Adoption of PCAOB Auditing Standard No. 2

September 15, 2004

AUDITING AND RELATED PROFESSIONAL PRACTICE STANDARDS

***CONFORMING AMENDMENTS TO PCAOB INTERIM  
STANDARDS RESULTING FROM THE ADOPTION OF  
PCAOB AUDITING STANDARD NO. 2, "AN AUDIT OF  
INTERNAL CONTROL OVER FINANCIAL REPORTING  
PERFORMED IN CONJUNCTION WITH AN AUDIT OF  
FINANCIAL STATEMENTS"***

**PCAOB**  
Public Company Accounting Oversight Board

[Effective pursuant to SEC Release No. 34-50688, File No. PCAOB-2004-07 (November 17, 2004)]

***Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2, "An Audit Of Internal Control Over Financial Reporting Performed In Conjunction With An Audit Of Financial Statements"***

**Auditing Standards**

AU sec. 310, "Appointment of the Independent Auditor"

Statement on Auditing Standards ("SAS") No. 1, "Codification of Auditing Standards and Procedures," AU sec. 310, "Appointment of the Independent Auditor," as amended by SAS No. 45, "Omnibus Statement on Auditing Standards-1983," SAS No. 83, "Establishing an Understanding With the Client," and SAS No. 89, "Audit Adjustments" (AU sec. 310, "Appointment of the Independent Auditor"), is amended as follows:

- a. The first sentence of paragraph .06 is amended to read as follows:

An understanding with the client generally includes the following matters.

- b. The first bullet point of paragraph .06 is amended to read as follows:

The objective of the audit is:

- Integrated audit of financial statements and internal control over financial reporting: The expression of an opinion on both management's assessment of internal control over financial reporting and on the financial statements.
- Audit of financial statements: The expression of an opinion on the financial statements.

- c. The third bullet point of paragraph .06 is amended to read as follows:

Management is responsible for establishing and maintaining effective internal control over financial reporting. In an integrated audit of financial statements and internal control over financial reporting, an auditor is required to communicate, in writing, to management and the audit committee that the audit of internal control over financial reporting cannot be satisfactorily completed and that he or she is required to disclaim an opinion if management has not:

- Accepted responsibility for the effectiveness of the company's internal control over financial reporting.

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- Evaluated the effectiveness of the company's internal control over financial reporting using suitable control criteria,
  - Supported its evaluation with sufficient evidence, including documentation, and
  - Presented a written assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year.
- d. The seventh bullet point of paragraph .06 is amended to read as follows:

The auditor is responsible for conducting the audit in accordance with the standards of the Public Company Accounting Oversight Board. Those standards require that the auditor:

- Integrated audit of financial statements and internal control over financial reporting: Obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, and whether management's assessment of the effectiveness of the company's internal control over financial reporting is fairly stated in all material respects. Accordingly, there is some risk that a material misstatement of the financial statements or a material weakness in internal control over financial reporting would remain undetected. Although not absolute assurance, reasonable assurance is, nevertheless, a high level of assurance. Also, an integrated audit is not designed to detect error or fraud that is immaterial to the financial statements or deficiencies in internal control over financial reporting that, individually or in combination, are less severe than a material weakness. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.
- Audit of financial statements: Obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Accordingly, there is some risk that a material misstatement would remain undetected. Although not absolute assurance, reasonable assurance is, nevertheless, a high level of assurance. Also, a financial statement audit is not designed to detect error or fraud that is immaterial to the financial statements. If, for any reason, the auditor is unable to complete the audit or is unable to form or has not formed an opinion, he or she may decline to express an opinion or decline to issue a report as a result of the engagement.

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- e. The eighth bullet point of paragraph .06 is amended to read as follows:

An audit includes:

- Integrated audit of financial statements and internal control over financial reporting: Planning and performing the audit to obtain reasonable assurance about whether the company maintained, in all material respects, effective internal control over financial reporting as of the date specified in management's assessment. The auditor is also responsible for obtaining an understanding of internal control sufficient to plan the financial statement audit and to determine the nature, timing, and extent of audit procedures to be performed. The auditor is also responsible for communicating in writing:
  - To the audit committee - all significant deficiencies and material weaknesses identified during the audit.
  - To management - all internal control deficiencies identified during the audit and not previously communicated in writing by the auditor or by others, including internal auditors or others inside or outside the company.
  - To the board of directors – any specific significant deficiency or material weakness identified because the auditor concludes that the audit committee's oversight of the company's external financial reporting and internal control over financial reporting is ineffective.
- Audit of financial statements: Obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing, and extent of audit procedures to be performed. An audit is not designed to provide assurance on internal control or to identify internal control deficiencies. However, the auditor is responsible for communicating in writing:
  - To the audit committee - all significant deficiencies and material weaknesses identified during the audit.
  - To the board of directors – if the auditor becomes aware that the oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee is ineffective, that specific significant deficiency or material weakness.

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AU sec. 311, "Planning and Supervision"

SAS No. 22, "Planning and Supervision," as amended by SAS No. 47, "Audit Risk and Materiality in Conducting an Audit," SAS No. 48, "The Effects of Computer Processing on the Audit of Financial Statements," and SAS No. 77, "Amendments to Statements on Auditing Standards No. 22, 'Planning and Supervision,' No. 59, 'The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern,' No. 62, 'Special Reports'" (AU sec. 311, "Planning and Supervision"), is amended by adding the following note after paragraph 1:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraph 39 of PCAOB Auditing Standard No. 2 regarding planning considerations in addition to the planning considerations set forth in this section.

AU sec. 312, "Audit Risk and Materiality in Conducting an Audit"

SAS No. 47, "Audit Risk and Materiality in Conducting an Audit," as amended by SAS No. 82, "Consideration of Fraud in a Financial Statement Audit," SAS No. 96, "Audit Documentation," and SAS No. 98, "Omnibus Statement on Auditing Standards--2002" (AU sec. 312, "Audit Risk and Materiality in Conducting an Audit"), is amended as follows:

- a. The following note is added after paragraph 3.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 22-23 of PCAOB Auditing Standard No. 2 regarding materiality considerations.

- b. The following note is added after paragraph 5.

Note: An integrated audit of financial statements and internal control over financial reporting is not designed to detect deficiencies in internal control over financial reporting that, individually or in the aggregate, are less severe than a material weakness.

- c. The following note is added after paragraph 7.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 24-26 of PCAOB Auditing Standard No. 2 regarding fraud considerations.

- d. The following note is added after paragraph 12.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 22-23 and 39

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of PCAOB Auditing Standard No. 2 regarding materiality and planning considerations, respectively.

- e. The following note is added after paragraph 18.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to Appendix B, "Additional Performance Requirements and Directions; Extent-of-Testing Examples," of PCAOB Auditing Standard No. 2 for considerations when a company has multiple locations or business units.

- f. The following note is added after paragraph 30.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 147-149 of PCAOB Auditing Standard No. 2 regarding tests of controls.

AU sec. 313, "Substantive Tests Prior to the Balance-Sheet Date"

SAS No. 45, "Omnibus Statement on Auditing Standards--1983" (AU sec. 313, "Substantive Tests Prior to the Balance-Sheet Date"), is amended by adding the following note after paragraph 1:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 98-103 of PCAOB Auditing Standard No. 2 regarding timing of tests of controls.

AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"

SAS No. 99, "Consideration of Fraud in a Financial Statement Audit" (AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"), is amended as follows:

- a. The following note is added after paragraph 1:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 24-26 of PCAOB Auditing Standard No. 2 regarding fraud considerations, in addition to the fraud consideration set forth in this section.

- b. In paragraph 80, the phrase "the auditor should consider whether these risks represent reportable conditions relating to the entity's internal control that should be communicated to senior management and the audit committee" is replaced by "the auditor should consider whether these risks represent significant deficiencies that must be communicated to senior management and the audit committee" and the reference to section 325, "Communication of Internal Control Related Matters Noted in an Audit,"

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paragraph .04 is replaced by the reference to section 325, "Communications About Control Deficiencies in An Audit of Financial Statements," paragraph 4.

AU sec. 319, "Consideration of Internal Control in a Financial Statement Audit"

SAS No. 55, "Consideration of Internal Control in a Financial Statement Audit," as amended by SAS No. 78, "Consideration of Internal Control in a Financial Statement Audit: An Amendment of Statement on Auditing Standards No. 55," and SAS No. 94, "The Effect of Information Technology on the Auditor's Consideration of Internal Control in a Financial Statement Audit" (AU sec. 319, "Consideration of Internal Control in a Financial Statement Audit"), is amended as follows:

- a. In paragraph 2, the term "assertions" is replaced by the term "relevant assertions."
- b. The following sentence is added at the end of paragraph 2:  
  
Regardless of the assessed level of control risk, the auditor should perform substantive procedures for all relevant assertions related to all significant accounts and disclosures in the financial statements.
- c. The following note is added after paragraph 2:  
  
Note: Refer to paragraphs 68-70 of PCAOB Auditing Standard No. 2 for discussion of identifying relevant financial statement assertions.
- d. The following note is added after paragraph 9:  
  
Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to Appendix B, "Additional Performance Requirements and Directions; Extent-of-Testing Examples," of PCAOB Auditing Standard No. 2 for discussion of considerations when a company has multiple locations or business units.
- e. The following note is added after paragraph 42:  
  
Note: For purposes of evaluating the effectiveness of internal control over financial reporting, the auditor's understanding of control activities encompasses a broader range of accounts and disclosures than what is normally obtained in a financial statement audit.
- f. The following note is added after paragraph 65:  
  
Note: When performing an integrated audit of financial statements and internal control over financial reporting, if the auditor assesses control risk

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as other than low for certain assertions or significant accounts, the auditor should document the reasons for that conclusion.

- g. The following note is added after paragraph 83:

Note: In an integrated audit of financial statements and internal control over financial reporting, PCAOB Auditing Standard No. 2 states, in part, that "If, however, the auditor assesses control risk as other than low for certain assertions or significant accounts, the auditor should document the reasons for that conclusion." Accordingly, if control risk is assessed at the maximum level, the auditor should document the basis for that conclusion. Refer to paragraphs 159-161 of PCAOB Auditing Standard No. 2 for additional information regarding documentation requirements.

- h. The following note is added after paragraph 97:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 104-105 of PCAOB Auditing Standard No. 2 for discussion on the extent of tests of controls.

- i. The last sentence of paragraph 107 is replaced with the following sentence:

Consequently, regardless of the assessed level of control risk, the auditor should perform substantive procedures for all relevant assertions related to all significant accounts and disclosures in the financial statements.

AU sec. 322, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements"

SAS No. 65, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements" (AU sec. 322, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements"), is amended as follows:

- a. The following note is added after paragraph 1:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 108-126 of PCAOB Auditing Standard No. 2 for discussion on using the work of others to alter the nature, timing, and extent of the work that otherwise would have been performed to test controls.

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- b. The second sentence of paragraph 16 is replaced with the following sentence:

The auditor assesses control risk for each of the relevant financial statement assertions related to all significant accounts and disclosures in the financial statements and performs tests of controls to support assessments below the maximum.

- c. The following note is added after paragraph 20:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 112-116 of PCAOB Auditing Standard No. 2 regarding evaluating the nature of controls subjected to the work of others.

- d. The following note is added after paragraph 22:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraph 122 of PCAOB Auditing Standard No. 2 regarding assessing the interrelationship of the nature of the controls and the competence and objectivity of those who performed the work.

AU sec. 324, "Service Organizations"

SAS No. 70, "Service Organizations," as amended by SAS No. 78, "Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standard No. 55," SAS No. 88, "Service Organizations and Reporting on Consistency," and SAS No. 98, "Omnibus Statement on Auditing Standards – 2002" (AU sec. 324, "Service Organizations"), is amended as follows:

- a. The following note is added after paragraph 1:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs B18-B29 of Appendix B, "Additional Performance Requirements and Directions; Extent-of-Testing Examples," in PCAOB Auditing Standard No. 2 regarding the use of service organizations.

- b. In paragraph 20, the term "reportable conditions" is replaced by the term "significant deficiencies" and the reference to section 325, "Communication of Internal Control Related Matters Noted in an Audit," is replaced by the reference to section 325, "Communications About Control Deficiencies in An Audit of Financial Statements."

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### AU sec. 325, "Communication of Internal Control Related Matters Noted in an Audit"

SAS No. 60, "Communication of Internal Control Related Matters Noted in an Audit," as amended by SAS No. 78, "Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55," and SAS No. 87, "Restricting the Use of an Auditor's Report" (AU sec. 325, "Communication of Internal Control Related Matters Noted in an Audit"), is superseded.

- In an integrated audit of financial statements and internal control over financial reporting, SAS No. 60, as amended, is superseded by paragraphs 207-214 of PCAOB Auditing Standard No. 2.
- In an audit of financial statements only, SAS No. 60, as amended, is superseded by the following paragraphs.

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### **Communications about Control Deficiencies in An Audit of Financial Statements**

1. In an audit of financial statements, the auditor may identify deficiencies in the company's internal control over financial reporting. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

- A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective is not always met.
- A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

2. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company's

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annual or interim financial statements that is more than inconsequential will not be prevented or detected.

Note: The term "remote likelihood" as used in the definitions of *significant deficiency* and *material weakness* (paragraph 3) has the same meaning as the term "remote" as used in Financial Accounting Standards Board Statement No. 5, *Accounting for Contingencies* ("FAS No. 5"). Paragraph 3 of FAS No. 5 states:

When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. This Statement uses the terms probable, reasonably possible, and remote to identify three areas within that range, as follows:

- a. *Probable*. The future event or events are likely to occur.
- b. *Reasonably possible*. The chance of the future event or events occurring is more than remote but less than likely.
- c. *Remote*. The chance of the future events or events occurring is slight.

Therefore, the likelihood of an event is "more than remote" when it is either reasonably possible or probable.

Note: A misstatement is inconsequential if a reasonable person would conclude, after considering the possibility of further undetected misstatements, that the misstatement, either individually or when aggregated with other misstatements, would clearly be immaterial to the financial statements. If a reasonable person could not reach such a conclusion regarding a particular misstatement, that misstatement is *more than inconsequential*.

3. A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Note: In evaluating whether a control deficiency exists and whether control deficiencies, either individually or in combination with other control deficiencies, are significant deficiencies or material weaknesses, the auditor should consider the definitions in

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paragraphs 1, 2 and 3, and the directions in paragraphs 130 through 137 of PCAOB Auditing Standard No. 2. As explained in paragraph 23 of PCAOB Auditing Standard No. 2, the evaluation of the materiality of the control deficiency should include both quantitative and qualitative considerations. Qualitative factors that might be important in this evaluation include the nature of the financial statement accounts and assertions involved and the reasonably possible future consequences of the deficiency. Furthermore, in determining whether a control deficiency, or combination of deficiencies, is a significant deficiency or a material weakness, the auditor should evaluate the effect of compensating controls and whether such compensating controls are effective.

4. The auditor must communicate in writing to management and the audit committee all significant deficiencies and material weaknesses identified during the audit. The written communication should be made prior to the issuance of the auditor's report on the financial statements. The auditor's communication should distinguish clearly between those matters considered significant deficiencies and those considered material weaknesses, as defined in paragraphs 2 and 3.

Note: If no such committee exists with respect to the company, all references to the audit committee in this standard apply to the entire board of directors of the company.<sup>1/</sup> The auditor should be aware that companies whose securities are not listed on a national securities exchange or an automated inter-dealer quotation system of a national securities association (such as the New York Stock Exchange, American Stock Exchange, or NASDAQ) may not be required to have independent directors for their audit committees. In this case, the auditor should not consider the lack of independent directors or an audit committee at these companies indicative, by themselves, of a control deficiency. Likewise, the independence requirements of Securities Exchange Act Rule 10A-3<sup>2/</sup> are not applicable to the listing of non-equity securities of a consolidated or at least 50 percent beneficially owned subsidiary of a listed issuer that is subject to the requirements of Securities Exchange Act Rule 10A-3(c)(2).<sup>3/</sup> Therefore, the auditor should interpret references to the audit committee in this standard, as applied to a subsidiary registrant, as being consistent with the provisions of Securities

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<sup>1/</sup> See 15 U.S.C. 78c(a)58 and 15 U.S.C. 7201(a)(3).

<sup>2/</sup> See 17 C.F.R. 240.10A-3.

<sup>3/</sup> See 17 C.F.R. 240.10A-3(c)(2).

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Exchange Act Rule 10A-3(c)(2).<sup>4/</sup> Furthermore, for subsidiary registrants, communications required by this standard to be directed to the audit committee should be made to the same committee or equivalent body that pre-approves the retention of the auditor by or on behalf of the subsidiary registrant pursuant to Rule 2-01(c)(7) of Regulation S-X<sup>5/</sup> (which might be, for example, the audit committee of the subsidiary registrant, the full board of the subsidiary registrant, or the audit committee of the subsidiary registrant's parent). In all cases, the auditor should interpret the terms "board of directors" and "audit committee" in this standard as being consistent with provisions for the use of those terms as defined in relevant SEC rules.

5. If oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee is ineffective, that circumstance should be regarded as at least a significant deficiency and as a strong indicator that a material weakness in internal control over financial reporting exists. Although there is not an explicit requirement to evaluate the effectiveness of the audit committee's oversight in an audit of only the financial statements, if the auditor becomes aware that the oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee is ineffective, the auditor must communicate that specific significant deficiency or material weakness in writing to the board of directors.

6. These written communications should include:
- a. The definitions of significant deficiencies and material weaknesses and should clearly distinguish to which category the deficiencies being communicated relate.
  - b. A statement that the objective of the audit was to report on the financial statements and not to provide assurance on internal control.
  - c. A statement that the communication is intended solely for the information and use of the board of directors, audit committee, management, and others within the organization. When there are requirements established by governmental

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<sup>4/</sup> See 17 C.F.R. 240.10A-3(c)(2).

<sup>5/</sup> See 17 C.F.R. 210.2-01(c)(7).

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authorities to furnish such written communications, specific reference to such regulatory authorities may be made.

7. The auditor might identify matters in addition to those required to be communicated by this standard. Such matters include control deficiencies identified by the auditor that are neither significant deficiencies nor material weaknesses and matters the company may request the auditor to be alert to that go beyond those contemplated by this standard. The auditor may report such matters to management, the audit committee, or others, as appropriate.

8. The auditor should not report in writing that no significant deficiencies were discovered during an audit of financial statements because of the potential that the limited degree of assurance associated with such a report will be misunderstood.

9. When timely communication is important, the auditor should communicate the preceding matters during the course of the audit rather than at the end of the engagement. The decision about whether to issue an interim communication should be determined based on the relative significance of the matters noted and the urgency of corrective follow-up action required.

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In an audit of financial statements only, auditing interpretation 1 to AU sec. 325, "Reporting on the Existence of Material Weaknesses," continues to apply except that the term "reportable condition" means "significant deficiency," as defined in paragraph 9 of PCAOB Auditing Standard No. 2.

### AU sec. 326, "Evidential Matter"

SAS No. 31, "Evidential Matter," as amended by SAS No. 48, "The Effects of Computer Processing on the Audit of Financial Statements," and SAS No. 80, "Amendment to Statement on Auditing Standards No. 31, 'Evidential Matter'" (AU sec. 326, "Evidential Matter"), is amended by adding the following sentences at the end of paragraph 19:

Additionally, the auditor's substantive procedures must include reconciling the financial statements to the accounting records. The auditor's substantive procedures also should include examining material adjustments made during the course of preparing the financial statements.

### AU sec. 329, "Analytical Procedures"

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SAS No. 56, "Analytical Procedures," as amended by SAS No. 96, "Audit Documentation" (AU sec. 329, "Analytical Procedures"), is amended as follows:

- a. The following sentence is added to the end of paragraph 9:

For significant risks of material misstatement, it is unlikely that audit evidence obtained from substantive analytical procedures alone will be sufficient.

- b. The following sentences are added to the end of paragraph 10:

When designing substantive analytical procedures, the auditor also should evaluate the risk of management override of controls. As part of this process, the auditor should evaluate whether such an override might have allowed adjustments outside of the normal period-end financial reporting process to have been made to the financial statements. Such adjustments might have resulted in artificial changes to the financial statement relationships being analyzed, causing the auditor to draw erroneous conclusions. For this reason, substantive analytical procedures alone are not well suited to detecting fraud.

- c. The following sentence is added to the beginning of paragraph 16:

Before using the results obtained from substantive analytical procedures, the auditor should either test the design and operating effectiveness of controls over financial information used in the substantive analytical procedures or perform other procedures to support the completeness and accuracy of the underlying information.

AU sec. 332, "Auditing Derivative Instruments, Hedging Activities, and Investments in Securities"

SAS No. 92, "Auditing Derivative Instruments, Hedging Activities, and Investments in Securities" (AU sec. 332, "Auditing Derivative Instruments, Hedging Activities, and Investments in Securities"), is amended by adding the following note after paragraph 11:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, PCAOB Auditing Standard No. 2 states, "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." Therefore, in an integrated audit of financial statements and internal control over financial reporting, if a company's investment in derivatives and securities represents a significant account, the auditor's understanding of controls should include controls over derivatives and securities transactions from their initiation to

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their inclusion in the financial statements and should encompass controls placed in operation by the entity and service organizations whose services are part of the entity's information system.

### AU sec. 333, "Management Representations"

SAS No. 85, "Management Representations," as amended by SAS No. 89, "Audit Adjustments," and SAS No. 99 "Consideration of Fraud in a Financial Statement Audit" (AU sec. 333, "Management Representations"), is amended by adding the following note after paragraph 5:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 142-144 of PCAOB Auditing Standard No. 2 for additional required written representations to be obtained from management.

### AU sec. 342, "Auditing Accounting Estimates"

SAS No. 57, "Auditing Accounting Estimates" (AU sec. 342, "Auditing Accounting Estimates"), is amended by adding the following note after paragraph 10:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, the auditor may use any of the three approaches. However, the work that the auditor performs as part of the audit of internal control over financial reporting should necessarily inform the auditor's decisions about the approach he or she takes to auditing an estimate because, as part of the audit of internal control over financial reporting, the auditor would be required to obtain an understanding of the process management used to develop the estimate and to test controls over all relevant assertions related to the estimate.

### AU sec. 380, "Communication with Audit Committees"

SAS No. 61, "Communication with Audit Committees" (AU sec. 380, "Communication with Audit Committees"), is amended by replacing the title of Section 325 in the first bullet in footnote 1 in paragraph 1 with "Communications About Control Deficiencies in An Audit of Financial Statements" and adding the following after the last bullet in footnote 1 in paragraph 1:

- PCAOB Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements.

### AU sec. 508, "Reports on Audited Financial Statements"

SAS No. 58, "Reports on Audited Financial Statements," as amended by SAS No. 64, "Omnibus Statement on Auditing Standards – 1990," SAS No. 79, "Amendment

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to Statement on Auditing Standards No. 58, "Reports on Audited Financial Statements," SAS No. 85, "Management Representations," SAS No. 93, "Omnibus Statement on Auditing Standards – 2000," and SAS No. 98, "Omnibus Statement on Auditing Standards – 2002" (AU sec. 508, "Reports on Audited Financial Statements"), is amended as follows:

- a. The following note is added after paragraph 1:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, the auditor may choose to issue a combined report or separate reports on the company's financial statements and on internal control over financial reporting. Refer to paragraphs 162-199 of PCAOB Auditing Standard No. 2 for direction on reporting on internal control over financial reporting. In addition, see Appendix A, "Illustrative Reports on Internal Control Over Financial Reporting," of PCAOB Auditing Standard No. 2 which includes an illustrative combined audit report and examples of separate reports.

- b. The following subparagraph is added to paragraph 8:

k. When performing an integrated audit of financial statements and internal control over financial reporting, if the auditor issues separate reports on the company's financial statements and on internal control over financial reporting, the following paragraph should be added to the auditor's report on the company's financial statements:

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of X Company's internal control over financial reporting as of December 31, 20X3, based on *[identify control criteria]* and our report dated *[date of report, which should be the same as the date of the report on the financial statements]* expressed *[include nature of opinions]*.

### AU sec. 530, "Dating of the Independent Auditor's Report"

SAS No. 1, "Codification of Auditing Standards and Procedures," AU sec. 530, "Dating of the Independent Auditor's Report," as amended by SAS No. 29, "Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents," and SAS No. 98, "Omnibus Statement on Auditing Standards – 2002" (AU sec. 530, "Dating of the Independent Auditor's Report"), is amended by adding the following note after paragraph .01:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, the auditor's reports on the company's financial statements and on internal control over financial reporting should be dated the

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same date. Refer to paragraphs 171-172 of PCAOB Auditing Standard No. 2, which provide direction with respect to the report date in an audit of internal control over financial reporting.

AU sec. 532, "Restricting the Use of an Auditor's Report"

SAS No. 87, "Restricting the Use of an Auditor's Report," (AU sec. 532, "Restricting the Use of an Auditor's Report"), is amended by replacing "Section 325, Communication of Internal Control Related Matters Noted in an Audit" in the first bullet of paragraph .07 with "Section 325, Communications About Control Deficiencies in An Audit of Financial Statements."

AU sec. 543, "Part of Audit Performed by Other Independent Auditors"

SAS No. 1, "Codification of Auditing Standards and Procedures," AU sec. 543, "Part of Audit Performed by Other Independent Auditors," as amended by SAS No. 64, "Omnibus Statement on Auditing Standards – 1990" (AU sec. 543, "Part of Audit Performed by Other Independent Auditors"), is amended by adding the following note after paragraph .01:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 182-185 of PCAOB Auditing Standard No. 2, which provide direction with respect to opinions based, in part, on the report of another auditor in an audit of internal control over financial reporting.

AU sec. 9550, "Other Information in Documents Containing Audited Financial Statements: Auditing Interpretations of Section 550"

AU sec. 9550, "Other Information in Documents Containing Audited Financial Statements: Auditing Interpretations of Section 550," is amended by replacing the term "reportable conditions" with the term "significant deficiencies" in footnote 8 to paragraph 15 and also replaces in that footnote the reference to Section 325.17 with the reference Section 325.8.

AU sec. 560, "Subsequent Events"

SAS No. 1, "Codification of Auditing Standards and Procedures," AU sec. 560, "Subsequent Events," as amended by SAS No. 12, "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments," and SAS No. 98, "Omnibus Statement on Auditing Standards – 2002" (AU sec. 560, "Subsequent Events"), is amended by adding the following note after paragraph .01:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 186-189 of PCAOB Auditing

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Standard No. 2, which provide direction with respect to subsequent events in an audit of internal control over financial reporting.

AU sec. 561, "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report"

SAS No. 1, "Codification of Auditing Standards and Procedures," AU sec. 561, "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report," as amended by SAS No. 98, "Omnibus Statement on Auditing Standards – 2002" (AU sec. 561, "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report"), is amended by adding the following note after paragraph .01:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraph 197 of PCAOB Auditing Standard No. 2, which provides direction with respect to the subsequent discovery of information existing at the date of the auditor's report on internal control over financial reporting.

AU sec. 634, "Letters for Underwriters and Certain Other Requesting Parties"

SAS No. 72, "Letters for Underwriters and Certain Other Requesting Parties," as amended by SAS No. 76, "Amendments to Statement on Auditing Standards No. 72, Letters for Underwriters and Certain Other Requesting Parties," and SAS No. 86, "Amendment to Statement on Auditing Standards No. 72, Letters for Underwriters and Certain Other Requesting Parties" (AU sec. 634, "Letters for Underwriters and Certain Other Requesting Parties") is amended by replacing the reference to "Section 325, Communication of Internal Control Related Matters Noted in an Audit" with "Section 325, Communications About Control Deficiencies in An Audit of Financial Statements."

AU sec. 711, "Filings Under Federal Securities Statutes"

SAS No. 37, "Filings Under Federal Securities Statutes" (AU sec. 711, "Filings Under Federal Securities Statutes"), is amended by adding the following note after paragraph 2:

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 198-199 of PCAOB Auditing Standard No. 2, which provide direction when an auditor's report on internal control over financial reporting is included or incorporated by reference in filings under federal securities statutes.

AU sec. 722, "Interim Financial Information"

SAS No. 100, "Interim Financial Information" (AU sec. 722, "Interim Financial Information"), is amended as follows:

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- a. The following note is added after paragraph 3:

Note: When an auditor is engaged to perform an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 202-206 of PCAOB Auditing Standard No. 2, which provide direction regarding the auditor's evaluation responsibilities as they relate to management's quarterly certifications on internal control over financial reporting.

- b. In paragraph 9, the term "reportable conditions" is replaced by the term "significant deficiencies."
- c. In paragraph 33, the term "reportable conditions" is replaced by the term "significant deficiencies." Also, the third sentence is replaced by the following:

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected.

- d. The reference in footnote 22 to paragraph 33 to "Section 325, Communication of Internal Control Related Matters in an Audit" is replaced with "Section 325, Communications About Control Deficiencies in An Audit of Financial Statements."

### Attestation Standards

#### AT sec. 501, "Reporting on an Entity's Internal Control Over Financial Reporting"

Chapter 5, "Reporting on an Entity's Internal Control Over Financial Reporting," of Statement on Standards for Attestation Engagements No. 10, "Attestation Standards: Revision and Recodification" (AT sec. 501, "Reporting on an Entity's Internal Control Over Financial Reporting"), and its related interpretation (AT sec. 9501, "Reporting on an Entity's Internal Control Over Financial Reporting: Attest Engagements Interpretations of Section 501"), are superseded by the conforming amendments and, accordingly, are no longer interim standards of the Board.

### Independence Standards

#### ET sec. 101.05

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Rule 101, "Independence" (ET sec. 101.05) is amended by adding the following note after the second paragraph of interpretation 101-3, "Performance of Other Services:"

Note: Paragraph 33 of PCAOB Auditing Standard No. 2 contains an additional requirement related to audit committee pre-approval of internal control-related services.

Conforming Amendments To PCAOB Auditing and Related Professional Practice  
Standards Resulting from the Adoption of Auditing Standard No. 4

February 6, 2006

AUDITING AND RELATED PROFESSIONAL PRACTICE STANDARDS

***CONFORMING AMENDMENT TO PCAOB AUDITING AND  
RELATED PROFESSIONAL PRACTICE STANDARDS  
RESULTING FROM THE ADOPTION OF THE AUDITING  
STANDARD No. 4 – REPORTING ON WHETHER A  
PREVIOUSLY REPORTED MATERIAL WEAKNESS  
CONTINUES TO EXIST***

**PCAOB**  
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[Effective pursuant to SEC Release No. 34-53227, File No. PCAOB-2005-01 (February 6, 2006)]

***Conforming Amendment to PCAOB Auditing and Related Professional Practice Standards Resulting from the Adoption of the Auditing Standard No. 4 – Reporting on Whether a Previously Reported Material Weakness Continues to Exist***

**Attestation Standards**

The Board's interim attestation standards include the Statements on Standards for Attestation Engagements promulgated by the ASB, as in existence on April 16, 2003. The conforming amendment to the Board's interim attestation standards is as follows:

- *AT sec. 101, Attest Engagements*

AT sec. 101 is amended by adding as letter f. to paragraph .04, the following:

Engagements in which the practitioner is engaged to report on whether a material weakness in internal control over financial reporting continues to exist for any purpose other than the company's internal use. Such engagements must be conducted pursuant to PCAOB Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist*.

**Conforming Amendments to PCAOB Auditing Standards Resulting from the  
Adoption of Auditing Standard No. 5**

June 12, 2007

AUDITING AND RELATED PROFESSIONAL PRACTICE STANDARDS

***Conforming Amendments to PCAOB Auditing Standards RESULTING FROM THE ADOPTION OF PCAOB AUDITING STANDARD No. 5, "AN AUDIT OF INTERNAL CONTROL OVER FINANCIAL REPORTING THAT IS INTEGRATED WITH AN AUDIT OF FINANCIAL STATEMENTS"***

[Effective pursuant to SEC Release No. 34-56152, File No. PCAOB-2007-02 (July 27, 2007)]

***Conforming Amendments to PCAOB Auditing Standards***

AU sec. 230, "Due Professional Care in the Performance of Work"

Statement on Auditing Standards ("SAS") No. 1, "Codification of Auditing Standards and Procedures," section 230, "Due Professional Care in the Performance of Work" (AU sec. 230, "Due Professional Care in the Performance of Work"), as amended, is amended as follows –

- a. Paragraph .10 is replaced with –

The exercise of due professional care allows the auditor to obtain *reasonable assurance* about whether the financial statements are free of material misstatement, whether caused by error or fraud, or whether any material weaknesses exist as of the date of management's assessment. Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Although not absolute assurance, reasonable assurance is a high level of assurance. Therefore, an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) may not detect a material weakness in internal control over financial reporting or a material misstatement to the financial statements.

- b. The term "financial statements" within the first sentence of paragraph .13 is replaced with the term "financial statements or internal control over financial reporting."
- c. The second sentence of paragraph .13 is replaced with –

Therefore, the subsequent discovery that either a material misstatement, whether from error or fraud, exists in the financial statements or a material weakness in internal control over financial reporting exists does not, in and of itself, evidence (a) failure to obtain reasonable assurance, (b) inadequate planning, performance, or judgment, (c) the absence of due professional care, or (d) a failure to comply with the standards of the Public Company Accounting Oversight Board (United States).

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AU sec. 310, "Appointment of the Independent Auditor"

SAS No. 1, "Codification of Auditing Standards and Procedures," section 310, "Appointment of the Independent Auditor" (AU sec. 310, "Appointment of the Independent Auditor"), as amended, is amended as follows –

- a. The third bullet point of paragraph .06 is replaced with –

Management is responsible for establishing and maintaining effective internal control over financial reporting. If, in an integrated audit of financial statements and internal control over financial reporting, the auditor concludes that he or she cannot express an opinion on internal control over financial reporting because there has been a limitation on the scope of the audit, he or she should communicate, in writing, to management and the audit committee that the audit of internal control over financial reporting cannot be satisfactorily completed.

- b. The eighth bullet point of paragraph .06 is amended as follows –

Under Integrated audit of financial statements and internal control over financial reporting, the last sub-bullet point is replaced with the following –

To the board of directors – any conclusion that the audit committee's oversight of the company's external financial reporting and internal control over financial reporting is ineffective.

Under Audit of financial statements, the last sub-bullet is replaced with the following –

To the board of directors – if the auditor becomes aware that the oversight of the company's external financial reporting and internal control over financial reporting by the audit committee is ineffective, that conclusion.

AU sec. 311, "Planning and Supervision"

SAS No. 22, "Planning and Supervision" (AU sec. 311, "Planning and Supervision"), as amended, is amended as follows –

Within the note to paragraph 1, the reference to paragraph 39 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraph 9 of PCAOB

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*Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements.*

AU sec. 312, "Audit Risk and Materiality in Conducting an Audit"

SAS No. 47, "Audit Risk and Materiality in Conducting an Audit" (AU sec. 312, "Audit Risk and Materiality in Conducting an Audit"), as amended, is amended as follows –

- a. Within the note to paragraph 3, the reference to paragraphs 22-23 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraph 20 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- b. Within the note to paragraph 7, the reference to paragraphs 24-26 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs 14-15 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- c. The note to paragraph 12 is replaced with –

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs 9 and 20 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, regarding planning considerations and materiality, respectively.

- d. Within the note to paragraph 18, the reference to Appendix B, *Additional Performance Requirements and Directions; Extent-of-Testing Examples* of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs B10-B16 of Appendix B, *Special Topics*, of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- e. Within the note to paragraph 30, the reference to paragraphs 147-149 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs 6-8 and paragraphs B1-B5 of Appendix B, *Special Topics*, of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over*

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*Financial Reporting That Is Integrated with An Audit of Financial Statements.*

AU sec. 313, "Substantive Tests Prior to the Balance-Sheet Date"

SAS No. 45, "Omnibus Statement on Auditing Standards – 1983" (AU sec. 313, "Substantive Tests Prior to the Balance-Sheet Date"), is amended as follows –

Within the note to paragraph 1, the reference to paragraphs 98-103 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs 52-53 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements.*

AU sec. 315, "Communications Between Predecessor and Successor Auditors"

SAS No. 84, "Communications Between Predecessor and Successor Auditors" (AU sec. 315, "Communications Between Predecessor and Successor Auditors"), as amended, is amended as follows –

The last sentence of paragraph 16 is replaced with –

Furthermore, the predecessor auditor is not a specialist as defined in AU sec. 336, *Using the Work of a Specialist*, nor does the predecessor auditor's work constitute the work of others as described in AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, or paragraphs 16-19 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements.*

AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"

SAS No. 99, "Consideration of Fraud in a Financial Statement Audit" (AU sec. 316, "Consideration of Fraud in a Financial Statement Audit"), is amended as follows –

Within the note to paragraph 1, the reference to paragraphs 24-26 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs 14-15 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements.*

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AU sec. 319, "Consideration of Internal Control in a Financial Statement Audit"

SAS No. 55, "Consideration of Internal Control in a Financial Statement Audit" (AU sec. 319, "Consideration of Internal Control in a Financial Statement Audit"), as amended, is amended as follows –

- a. The note to paragraph 2 is replaced with –  
  
Note: Refer to paragraph A9 of Appendix A, *Definitions*, of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* for the definition of a relevant assertion and paragraphs 28-33 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* for discussion of identifying relevant assertions.
- b. Within the note to paragraph 9, the reference to Appendix B, *Additional Performance Requirements and Directions; Extent of Testing Examples*, of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs B10-B16 of Appendix B, *Special Topics*, of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- c. The last sentence of paragraph 33 is deleted.
- d. The note to paragraph 65 is deleted.
- e. The note to paragraph 83 is deleted.
- f. Within the note to paragraph 97, the reference to paragraphs 104-105 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraph 54 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- g. The appendix at paragraph 110 is deleted.

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AU sec. 322, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements"

SAS No. 65, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements" (AU sec. 322, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements"), is amended as follows –

- a. Within the note to paragraph 1, the reference to paragraphs 108-126 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs 16-19 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- b. The note to paragraph 20 is deleted.
- c. Within the note to paragraph 22, the reference to paragraph 122 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs 18-19 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

AU sec. 324, "Service Organizations"

SAS No. 70, "Service Organizations" (AU sec. 324, "Service Organizations"), as amended, is amended as follows –

Within the note to paragraph 1, the reference to Appendix B, *Additional Performance Requirements and Directions; Extent-of-Testing Examples*, of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs B17-B27 of Appendix B, *Special Topics*, of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

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AU sec. 325, "Communications About Control Deficiencies in an Audit of Financial Statements"<sup>1/</sup>

AU sec. 325, "Communications About Control Deficiencies in an Audit of Financial Statements" is amended as follows –

- a. The first bullet point before paragraph 1 is amended as follows –

The reference to paragraphs 207-214 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs 78-84 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

- b. The first bullet point in paragraph 1 is replaced with –

A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met.

- c. Paragraph 2 is replaced with –

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting, that is less severe than a material weakness yet important enough to merit attention by those responsible for oversight of the company's financial reporting.

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<sup>1/</sup> When the Board adopted Auditing Standard No. 2, it superseded SAS No. 60 in the context of an integrated audit of financial statements and internal control over financial reporting by paragraphs 207-214 of Auditing Standard No. 2. See PCAOB Release No. 2004-008, *Conforming Amendments to PCAOB Interim Standards Resulting From the Adoption of PCAOB Auditing Standard No. 2, "An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements"* (Sept. 15, 2004). As a result of superseding Auditing Standard No. 2, paragraphs 78-84 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, now supersede SAS No. 60 in the context of an integrated audit.

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d. The notes to paragraph 2 are deleted.

e. Paragraph 3 is replaced with –

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Note: There is a reasonable possibility of an event when the likelihood of the event is either "reasonably possible" or "probable," as those terms are used in paragraph 3 of Financial Accounting Standards Board Statement No. 5, *Accounting for Contingencies*.

Note: In evaluating whether a deficiency exists and whether deficiencies, either individually or in combination with other deficiencies, are material weaknesses, the auditor should follow the direction in paragraphs 62-70 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

f. Paragraph 5 is replaced with –

If oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee is ineffective, that circumstance should be regarded as an indicator that a material weakness in internal control over financial reporting exists. Although there is not an explicit requirement to evaluate the effectiveness of the audit committee's oversight in an audit of only the financial statements, if the auditor becomes aware that the oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee is ineffective, the auditor must communicate that information in writing to the board of directors.

g. The last sentence of paragraph 9 is replaced with –

In an audit of financial statements only, auditing interpretation 1 to AU sec. 325, "Reporting on the Existence of Material Weaknesses," continues to apply except that the term "reportable condition" means "significant deficiency" as defined in paragraph 2 of this standard.

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AU sec. 9325, "Communication of Internal Control Related Matters Noted in an Audit: Auditing Interpretations of Section 325"

AU sec. 9325, "Communication of Internal Control Related Matters Noted in an Audit: Auditing Interpretations of Section 325" is amended as follows –

The note prior to paragraph 1 is replaced with –

Note: In an audit of financial statements only, auditing interpretation 1 to AU sec. 325, "Reporting on the Existence of Material Weaknesses," continues to apply except that the term "reportable condition" means "significant deficiency" as defined in paragraph 2 of this standard. Within the example report within paragraph 4 of the interpretation, the third sentence is replaced with the definition of a material weakness in paragraph A7 of Appendix A, *Definitions*, of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

AU sec. 328, "Auditing Fair Value Measurements and Disclosures"

SAS No. 101, "Auditing Fair Value Measurements and Disclosures" (AU sec. 328, "Auditing Fair Value Measurements and Disclosures"), is amended as follows –

The first sentence of paragraph 41 is replaced with –

Events and transactions that occur after the balance-sheet date but before the date of the auditor's report (for example, a sale of an investment shortly after the balance-sheet date), may provide audit evidence regarding management's fair value measurements as of the balance-sheet date <sup>7/</sup>

<sup>7/</sup> The auditor's consideration of a subsequent event or transaction, as contemplated in this paragraph, is a substantive test and thus differs from the review of subsequent events performed pursuant to section 560, *Subsequent Events*.

AU sec. 332, "Auditing Derivative Instruments, Hedging Activities, and Investments in Securities"

SAS No. 92, "Auditing Derivative Instruments, Hedging Activities, and Investments in Securities" (AU sec. 332, "Auditing Derivative Instruments, Hedging Activities, and Investments in Securities"), is amended as follows –

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The note to paragraph 11 is replaced with –

Note: When performing an integrated audit of financial statements and internal control over financial reporting, paragraph 39 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, states "[t]he 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." Therefore, in an integrated audit of financial statements and internal control over financial reporting, if there are relevant assertions related to the company's investment in derivatives and securities, the auditor's understanding of controls should include controls over derivatives and securities transactions from their initiation to their inclusion in the financial statements and should encompass controls placed in operation by the entity and service organizations whose services are part of the entity's information system.

AU sec. 333, "Management Representations"

SAS No. 85, "Management Representations" (AU sec. 333, "Management Representations"), as amended, is amended as follows –

a. Within the note to paragraph 5, the reference to paragraphs 142-144 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs 75-77 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

b. The second sentence of paragraph 9 is replaced with –

Because the auditor is concerned with events occurring through the date of his or her report that may require adjustment to or disclosure in the financial statements, the representations should be made as of the date of the auditor's report.

AU sec. 9337, "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments: Auditing Interpretations of Section 337"

AU sec. 9337, "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments: Auditing Interpretations of Section 337" is amended as follows –

a. The last sentence of paragraph 4 is replaced with –

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What is the relationship between the effective date of the lawyer's response and the date of the auditor's report?

- b. Paragraph 5 is replaced with –

*Interpretation* – Section 560.10 through .12 indicates that the auditor is concerned with events, which may require adjustment to, or disclosure in, the financial statements, occurring through the date of his or her report. Therefore, the latest date of the period covered by the lawyer's response (the "effective date") should be as close to the date of the auditor's report as is practicable in the circumstances. Consequently, specifying the effective date of the lawyer's response to reasonably approximate the expected date of the auditor's report will in most instances obviate the need for an updated response from the lawyer.

AU sec. 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"

SAS No. 59, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern" (AU sec. 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"), as amended, is amended as follows –

- The second sentence of paragraph 2 is replaced with –

The auditor's evaluation is based on his or her knowledge of relevant conditions and events that exist at or have occurred prior to the date of the auditor's report.

AU sec. 342, "Auditing Accounting Estimates"

SAS No. 57, "Auditing Accounting Estimates" (AU sec. 342, "Auditing Accounting Estimates"), is amended as follows –

- a. Subparagraph c. of paragraph 10 is replaced with –

c. Review subsequent events or transactions occurring prior to the date of the auditor's report.

- b. Paragraph 13 is replaced with –

*Review subsequent events or transactions.* Events or transactions sometimes occur subsequent to the date of the balance sheet, but prior to the date of the auditor's report, that are important in identifying and evaluating the

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reasonableness of accounting estimates or key factors or assumptions used in the preparation of the estimate. In such circumstances, an evaluation of the estimate or of a key factor or assumption may be minimized or unnecessary as the event or transaction can be used by the auditor in evaluating their reasonableness.

### AU sec. 380, "Communication With Audit Committees"

SAS No. 61, "Communication With Audit Committees" (AU sec. 380, "Communication With Audit Committees"), as amended, is amended as follows –

Within footnote 1 to paragraph 1, the reference to PCAOB Auditing Standard No. 2 is replaced with a reference to PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

### AU sec. 508, "Reports on Audited Financial Statements"

SAS No. 58, "Reports on Audited Financial Statements" (AU sec. 508, "Reports on Audited Financial Statements"), as amended, is amended as follows –

Within the note to paragraph 1, the reference to paragraphs 162-199 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs 85-98 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* and Appendix C, *Special Reporting Situations*, of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. The sentence that reads "In addition, see Appendix A, *Illustrative Reports on Internal Control Over Financial Reporting*, of PCAOB Auditing Standard No. 2, which includes an illustrative combined audit report and examples of separate reports," is replaced with, "In addition, see paragraphs 86-88 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* which includes an illustrative combined audit report."

### AU sec. 530, "Dating of the Independent Auditor's Report"

SAS No. 1, "Codification of Auditing Standards and Procedures," section 530, "Dating of the Independent Auditor's Report" (AU sec. 530, "Dating of the Independent Auditor's Report"), as amended, is amended as follows –

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- a. Paragraph .01 is replaced with –

The auditor should date the audit report no earlier than the date on which the auditor has obtained sufficient competent evidence to support the auditor's opinion. Paragraph .05 describes the procedure to be followed when a subsequent event occurring after the report date is disclosed in the financial statements.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, the auditor's reports on the company's financial statements and on internal control over financial reporting should be dated the same date.

Note: If the auditor concludes that a scope limitation will prevent the auditor from obtaining the reasonable assurance necessary to express an opinion on the financial statements, then the auditor's report date is the date that the auditor has obtained sufficient competent evidence to support the representations in the auditor's report.

- b. Paragraph .05 is replaced with –

The independent auditor has two methods for dating the report when a subsequent event disclosed in the financial statements occurs after the auditor has obtained sufficient competent evidence on which to base his or her opinion, but before the issuance of the related financial statements. The auditor may use "dual dating," for example, "February 16, 20\_\_," except for Note \_\_, as to which the date is March 1, 20\_\_," or may date the report as of the later date. In the former instance, the responsibility for events occurring subsequent to the original report date is limited to the specific event referred to in the note (or otherwise disclosed). In the latter instance, the independent auditor's responsibility for subsequent events extends to the later report date and, accordingly, the procedures outlined in section 560.12 generally should be extended to that date.

- c. Within the heading before paragraph .03, the reference to "completion of field work" is replaced with "the date of the independent auditor's report."

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AU sec. 543, "Part of Audit Performed by Other Independent Auditors"

SAS No. 1, "Codification of Auditing Standards and Procedures," section 543, "Part of Audit Performed by Other Independent Auditors" (AU sec. 543, "Part of Audit Performed by Other Independent Auditors"), as amended, is amended as follows –

Within the note to paragraph .01, the reference to paragraphs 182-185 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs C8-C11 of Appendix C, *Special Reporting Situations*, of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

AU sec. 560, "Subsequent Events"

SAS No. 1, "Codification of Auditing Standards and Procedures," section 560, "Subsequent Events" (AU sec. 560, "Subsequent Events"), as amended, is amended as follows –

a. Within the note to paragraph .01, the reference to paragraphs 186-189 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs 93-97 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

b. The second sentence of paragraph .12 is replaced with –

These procedures should be performed at or near the date of the auditor's report.

AU sec. 561, "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report"

SAS No. 1, "Codification of Auditing Standards and Procedures," section 561, "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report" (AU sec. 561, "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report"), as amended, is amended as follows –

Within the note to paragraph .01, the reference to paragraph 197 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraph 98 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

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AU sec. 711, "Filings Under Federal Securities Statutes"

SAS No. 37, "Filings Under Federal Securities Statutes" (AU sec. 711, "Filings Under Federal Securities Statutes"), is amended as follows –

- a. Within the note to paragraph 2, the reference to paragraphs 198-199 of PCAOB Auditing Standard No. 2 is replaced with a reference to paragraphs C16-C17 of Appendix C, *Special Reporting Situations*, of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

- b. The third sentence of paragraph 10 is replaced with –

The likelihood that the auditor will discover subsequent events necessarily decreases following the date of the auditor's report, and, as a practical matter, after that time the independent auditor may rely, for the most part, on inquiries of responsible officials and employees.

AU sec. 722, "Interim Financial Information"

SAS No. 100, "Interim Financial Information" (AU sec. 722, "Interim Financial Information"), is amended as follows –

- a. The following is inserted after the first sentence of paragraph 3 –

The SEC also requires management, with the participation of the principal executive and financial officers (the certifying officers) to make certain quarterly and annual certifications with respect to the company's internal control over financial reporting.<sup>2/</sup>

<sup>2/</sup> See Section 302 of the Sarbanes-Oxley Act of 2002, and Securities Exchange Act Rule 13a-14(a) or 15d-14(a), (17 C.F.R. § 240.13a-14a or 17 C.F.R. § 240.15d-14a), whichever applies.

- b. The note to paragraph 3 is deleted.
- c. The following is added to the end of paragraph 7 –

Likewise, the auditor's responsibility as it relates to management's quarterly certifications on internal control over financial reporting is

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different from the auditor's responsibility as it relates to management's annual assessment of internal control over financial reporting. The auditor should perform limited procedures quarterly to provide a basis for determining whether he or she has become aware of any material modifications that, in the auditor's judgment, should be made to the disclosures about changes in internal control over financial reporting in order for the certifications to be accurate and to comply with the requirements of Section 302 of the Act.

Note: The auditor's responsibilities for evaluating management's certification disclosures about internal control over financial reporting take effect beginning with the first quarter after the company's first annual assessment of internal control over financial reporting as described in Item 308(a)(3) of Regulations S-B and S-K.

- d. The following lettered section is added to the end of paragraph 18 –
- g. Evaluating management's quarterly certifications about internal control over financial reporting by performing the following procedures –
- Inquiring of management about significant changes in the design or operation of internal control over financial reporting as it relates to the preparation of annual as well as interim financial information that could have occurred subsequent to the preceding annual audit or prior review of interim financial information;
  - Evaluating the implications of misstatements identified by the auditor as part of the auditor's other interim review procedures as they relate to effective internal control over financial reporting; and
  - Determining, through a combination of observation and inquiry, whether any change in internal control over financial reporting has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

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- e. Paragraph 29 is replaced with –

As a result of conducting a review of interim financial information, the accountant may become aware of matters that cause him or her to believe that –

- a. material modification should be made to the interim financial information for it to conform with generally accepted accounting principles;
- b. modification to the disclosures about changes in internal control over financial reporting is necessary for the certifications to be accurate and to comply with the requirements of Section 302 of the Act and Securities Exchange Act Rule 13a-14(a) or 15d-14(a), whichever applies; and
- c. the entity filed the Form 10-Q or Form 10-QSB before the completion of the review.

In such circumstances, the accountant should communicate the matter(s) to the appropriate level of management as soon as practicable.

- f. Paragraph 32 is replaced with –

If the auditor becomes aware of information indicating that fraud or an illegal act has or may have occurred, the auditor must also determine his or her responsibilities under AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*, AU sec. 317, *Illegal Acts by Clients*, and Section 10A of the Securities Exchange Act of 1934.<sup>1/</sup>

<sup>1/</sup> See 15 U.S.C. § 78j-1

- g. Within paragraph 33, the third sentence is replaced with –

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting, that is less severe than a material weakness yet important enough to merit attention by those responsible for oversight of the company's financial reporting.

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Auditing Standard No. 3, *Audit Documentation*

Auditing Standard No. 3, *Audit Documentation* is amended as follows –

Within footnote 2 to paragraph 6, the reference to paragraphs 68-70 of Auditing Standard No. 2 is replaced with a reference to paragraphs 28-33 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist*

Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist* is amended as follows –

- a. Within note 1 to paragraph 1, the reference to Auditing Standard No. 2 is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- b. Within paragraph 2, the two references to Auditing Standard No. 2 are replaced with references to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- c. Within the note to paragraph 2, the reference to Auditing Standard No. 2 is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- d. Within paragraph 4, the reference to Auditing Standard No. 2 is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- e. Paragraph 9 is replaced with –

The terms *internal control over financial reporting*, *deficiency*, *significant deficiency*, and *material weakness* have the same meanings as the definitions of those terms in Appendix A, *Definitions*, of Auditing Standard

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No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

- f. The first sentence of paragraph 10 is replaced with –

Paragraph 5 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, states “[t]he auditor should use the same suitable, recognized control framework to perform his or her audit of internal control over financial reporting as management uses for its annual evaluation of the effectiveness of the company's internal control over financial reporting.”

- g. Within the note to paragraph 10, the reference to Auditing Standard No. 2 in the first sentence is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, and the last sentence is amended as follows –

More information about the COSO framework is included within the COSO report.

- h. Paragraph 11 is replaced with –

The terms *relevant assertion* and *control objective* have the same meaning as the definitions of those terms in Appendix A, *Definitions*, of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

- i. Paragraph 13 is replaced with –

In an audit of internal control over financial reporting, the auditor should test the design 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.<sup>2/</sup>

<sup>2/</sup> See paragraph 42 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

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- j. Within the note to paragraph 17, the reference to Auditing Standard No. 2 is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- k. Within note 2 to paragraph 18, the reference to Auditing Standard No. 2 is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- l. Within paragraph 21, the last sentence is deleted.
- m. Within paragraph 23, the reference to paragraphs 22 and 23 of Auditing Standard No. 2 is replaced with a reference to paragraph 20 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. Additionally, the second sentence is deleted.
- n. Within paragraph 24, the reference to paragraph 39 of Auditing Standard No. 2 is replaced with a reference to paragraph 9 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- o. Within paragraph 25, the reference to Auditing Standard No. 2 is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- p. Within the note to paragraph 25, the two references to Auditing Standard No. 2 are replaced with references to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- q. Within subparagraph a. of paragraph 26, the reference to paragraphs 47 through 51 of Auditing Standard No. 2 is replaced with a reference to paragraphs 22-27 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- r. Subparagraph b. of paragraph 26 is replaced with –

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Perform the procedures described in paragraphs 34-38 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, for those transactions that are directly affected by controls specifically identified by management as addressing the material weakness.

- s. The note to subparagraph b. of paragraph 26 is deleted.
- t. Within paragraph 27, the reference to Auditing Standard No. 2 is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- u. The note to paragraph 28 is deleted.
- v. Within paragraph 31, the reference to paragraphs 88 through 91 of Auditing Standard No. 2 is replaced with a reference to paragraphs 42-43 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- w. Paragraph 32 is replaced with –

Consistent with the direction in paragraphs 44-45 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, the auditor should test the operating effectiveness of a specified control by determining whether the specified control operated as designed and whether the person performing the control possesses the necessary authority and qualifications to perform the control effectively. In determining the nature, timing, and extent of tests of controls, the auditor should apply paragraphs 50-54 of Auditing Standard No. 5.

- x. Paragraph 33 is replaced with –

The auditor should perform tests of the specified controls over a period of time that is adequate to determine whether, as of the date specified in management's assertion, the controls necessary for achieving the stated control objective are operating effectively. The timing of the auditor's tests should vary with the risk associated with the control being tested. For example, a transaction-based, daily reconciliation generally would permit the auditor to obtain sufficient evidence as to its operating effectiveness in

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a shorter period of time than a pervasive, entity-level control, such as any of those described in paragraphs 22-24 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. Additionally, the auditor typically will be able to obtain sufficient evidence as to the operating effectiveness of controls over the company's period-end financial reporting process only by testing those controls in connection with a period-end.

- y. Within paragraph 35, the reference to paragraphs B1 through B13 of Appendix B of Auditing Standard No. 2 is replaced with a reference to paragraphs B10-B16 of Appendix B, *Special Topics*, of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- z. Within paragraph 36, the reference to paragraphs 109 through 115 and 117 through 125 of Auditing Standard No. 2 is replaced with a reference to paragraphs 16-19 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- aa. The second sentence of paragraph 37 is replaced with –  

Therefore, if the auditor has been engaged to report on more than one material weakness or on more than one stated control objective, the auditor must evaluate whether he or she has obtained sufficient evidence that the control objectives related to each of the material weaknesses identified in management's assertion are achieved.
- bb. The first two sentences of paragraph 38 are replaced with –  

Paragraphs 18-19 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, should be applied in the context of the engagement to report on whether a previously reported material weakness continues to exist.
- cc. The note to paragraph 38 is deleted.
- dd. The note to paragraph 39 is deleted.
- ee. Paragraph 42 is replaced with –

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Management may conclude that a previously reported material weakness no longer exists because its severity has been sufficiently reduced such that it is no longer a material weakness.

- ff. Subparagraph f. of paragraph 44 is replaced with –
- Describing any fraud resulting in a material misstatement to the company's financial statements and any other fraud that does not result in a misstatement in the company's financial statements but involves senior management or management or other employees who have a significant role in the company's internal control over financial reporting and that has occurred or come to management's attention since the date of management's most recent annual assessment of internal control over financial reporting.
- gg. Within the note to subparagraph b. of paragraph 51, the reference to Auditing Standard No. 2 is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- hh. Within the note to subparagraph l. of paragraph 51, the reference to Auditing Standard No. 2 is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- ii. Within the note to the second bullet point of subparagraph o. of paragraph 51, the reference to Auditing Standard No. 2 is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- jj. Within paragraph 52, the reference to Auditing Standard No. 2 is replaced with a reference to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- kk. Within paragraph 63, the reference to paragraphs 202 through 206 of Auditing Standard No. 2 is replaced with a reference to paragraphs 7 and 29-32 of AU sec. 722, *Interim Financial Information*.

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- II. Within paragraph 64, the reference to paragraphs 202 through 206 of Auditing Standard No. 2 is replaced with a reference to paragraphs 7 and 29-32 of AU sec. 722, *Interim Financial Information*.

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**AMENDMENTS TO INTERIM AUDITING STANDARDS**

PCAOB Release 2008-001  
January 29, 2008

**AUDITING AND RELATED PROFESSIONAL PRACTICE STANDARDS**

***Amendments to Interim Auditing Standards***

[Effective pursuant to SEC Release No. 34-58555, File No. PCAOB-2008-01 (September 16, 2008)]

**Amendments to PCAOB Auditing Standards**

**Auditing Standards**

AU sec. 328, "*Auditing Fair Value Measurements and Disclosures*"

Statement on Auditing Standards ("SAS") No. 101, "Auditing Fair Value Measurements and Disclosures," (AU sec. 328, "Auditing Fair Value Measurements and Disclosures"), as amended, is amended as follows:

- a. The text of footnote 4 to paragraph .19 is replaced with the following:

Statement of Financial Accounting Standard No. 157, *Fair Value Measurements*, states that a change in valuation technique or its application is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances.

AU sec. 410, "*Adherence to Generally Accepted Accounting Principles*"

SAS No. 1, "Codification of Auditing Standards and Procedures," section 410 (AU sec. 410, "Adherence to Generally Accepted Accounting Principles"), as amended, is amended as follows:

- d. Paragraph .02 is replaced with following paragraph, and the reference to footnote 1 is moved to the end of the new paragraph .02.

The fourth standard of reporting is:

The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's work, if any, and the degree of responsibility the auditor is taking.

AU sec. 411, "*The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*"

SAS No. 69, "*The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*" (AU sec. 411, "*The Meaning of Present Fairly in*

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*Conformity With Generally Accepted Accounting Principles*"), as amended, is amended as follows:

- a. The third sentence of paragraph .01 is replaced with the following:

The purpose of this section is to explain the meaning of "present fairly" as used in the phrase "present fairly . . . in conformity with generally accepted accounting principles." In applying this section, the auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.

- b. Paragraphs .02, .05, .07, and .09-.18 are deleted.

AU sec. 9411, "The Meaning of *Present Fairly in Conformity With Generally Accepted Accounting Principles*, Auditing Interpretations of Section 411"

Auditing Interpretation No. 3, "The Auditor's Consideration of Management's Adoption of Accounting Principles for New Transactions or Events" of the auditing interpretations of AU sec. 411 (AU sec. 9411.11-.15) is deleted.

AU sec. 420, "Consistency of Application of Generally Accepted Accounting Principles," and AU sec. 9420, "Consistency of Application of Generally Accepted Accounting Principles, Auditing Interpretations of Section 420"

SAS No. 1, "Codification of Auditing Standards and Procedures," section 420 (AU sec. 420, "Consistency of Application of Generally Accepted Accounting Principles"), as amended, and the related auditing interpretations (AU sec. 9420) are superseded by PCAOB Auditing Standard No. 6, *Evaluating Consistency of Financial Statements*.

AU sec. 431, "Adequacy of Disclosure in Financial Statements"

SAS No. 32, "Adequacy of Disclosure in Financial Statements" (AU sec. 431, "Adequacy of Disclosure in Financial Statements") is amended as follows:

- a. Footnote 1 is deleted.
- b. Paragraph .04 is deleted.

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AU sec. 508, "Reports on Audited Financial Statements"

SAS No. 58, "Reports on Audited Financial Statements" (AU sec. 508, "Reports on Audited Financial Statements"), as amended, is amended as follows:

- a. In Paragraph .03, footnote 2 is deleted.
- b. In Paragraph .11, item .11b is deleted; item .11c is reordered as .11b; .11d is reordered as .11c; the paragraph references in .11c (formerly .11d) to paragraphs .16 through .18 are replaced with paragraph references .17A through .17E; and a new item .11d is added as follows:

"A material misstatement in previously issued financial statements has been corrected (paragraphs .18A through .18C)."

- c. Paragraphs .14-.15 are deleted, along with the preceding heading "Departure From a Promulgated Accounting Principle," and the note following the paragraph.

- d. The text of paragraph .16 is replaced with the following:

The auditor should recognize the following matters relating to the consistency of the company's financial statements in the auditor's report if those matters have a material effect on the financial statements:

- a. A change in accounting principle
- b. An adjustment to correct a misstatement in previously issued financial statements
- e. Paragraphs .17-.18 and related footnotes 12 and 13 are replaced with the following:

**Change in Accounting Principle**

.17A As discussed in PCAOB Auditing Standard No. 6, *Evaluating Consistency of Financial Statements*, the auditor should evaluate a change in accounting principle to determine whether (1) the newly adopted accounting principle is a generally accepted accounting principle, (2) the method of accounting for the effect of the change is in conformity with generally accepted accounting principles, (3) the disclosures related to the accounting change are adequate, and (4) the company has justified that the

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alternative accounting principle is preferable.<sup>12/</sup> A change in accounting principle that has a material effect on the financial statements should be recognized in the auditor's report on the audited financial statements through the addition of an explanatory paragraph following the opinion paragraph. If the auditor concludes that the criteria in this paragraph have been met, the explanatory paragraph in the auditor's report should include identification of the nature of the change and a reference to the note disclosure describing the change.

<sup>12/</sup> The issuance of an accounting pronouncement that requires use of a new accounting principle, interprets an existing principle, expresses a preference for an accounting principle, or rejects a specific principle is sufficient justification for a change in accounting principle, as long as the change in accounting principle is made in accordance with the hierarchy of generally accepted accounting principles. See FASB Statement 154, paragraph 14.

.17B Following is an example of an explanatory paragraph for a change in accounting principle resulting from the adoption of a new accounting pronouncement:

As discussed in Note X to the financial statements, the company has changed its method of accounting for [*describe accounting method change*] in [*year(s) of financial statements that reflect the accounting method change*] due to the adoption of [*name of accounting pronouncement*].

.17C Following is an example of an explanatory paragraph when the company has made a change in accounting principle other than a change due to the adoption of a new accounting pronouncement.

As discussed in Note X to the financial statements, the company has elected to change its method of accounting for [*describe accounting method change*] in [*year(s) of financial statements that reflect the accounting method change*].

.17D The explanatory paragraph relating to a change in accounting principle should be included in reports on financial statements in the year of the change and in subsequent years until the new accounting principle is applied in all periods presented. If the accounting change is accounted for by retrospective application to the financial statements of all prior periods presented, the additional paragraph is needed only in the year of the change.

.17E If the auditor concludes that the criteria in paragraph .17A for a change in accounting principle are not met, the auditor should consider the matter to be a

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departure from generally accepted accounting principles and, if the effect of the change in accounting principle is material, issue a qualified or adverse opinion.

**Correction of a Material Misstatement in Previously Issued Financial Statements**

.18A Correction of a material misstatement in previously issued financial statements should be recognized in the auditor's report through the addition of an explanatory paragraph following the opinion paragraph.<sup>13/</sup> The explanatory paragraph should include (1) a statement that the previously issued financial statements have been restated for the correction of a misstatement in the respective period and (2) a reference to the company's disclosure of the correction of the misstatement. Following is an example of an appropriate explanatory paragraph when there has been a correction of a material misstatement in previously issued financial statements.

As discussed in Note X to the financial statements, the 20X2 financial statements have been restated to correct a misstatement.

<sup>13/</sup> The directions in paragraphs .68-.69 apply when comparative financial statements are presented and the opinion on the prior-period financial statements differs from the opinion previously expressed.

.18B This type of explanatory paragraph in the auditor's report should be included in reports on financial statements when the related financial statements are restated to correct the prior material misstatement. The paragraph need not be repeated in subsequent years.

.18C The accounting pronouncements generally require certain disclosures relating to restatements to correct a misstatement in previously issued financial statements. If the financial statement disclosures are not adequate, the auditor should address the lack of disclosure as discussed beginning at paragraph .41 and in AU sec. 431.

- f. Paragraph .50 is deleted.
- g. The text of paragraph .51 is replaced with the following:

***Departures from generally accepted accounting principles related to changes in accounting principle.*** Paragraph .17A states the criteria for evaluating a change in accounting principle. If the auditor concludes that the criteria have not been met, he or she should consider that circumstance to be a departure from generally accepted accounting

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principles and, if the effect of the accounting change is material, should issue a qualified or adverse opinion.

h. In paragraph .52:

- The first three sentences of the paragraph are replaced with the following:

The accounting standards indicate that a company may make a change in accounting principle only if it justifies that the allowable alternative accounting principle is preferable. If the company does not provide reasonable justification that the alternative accounting principle is preferable, the auditor should consider the accounting change to be a departure from generally accepted accounting principles and, if the effect of the change in accounting principle is material, should issue a qualified or adverse opinion. The following is an example of a report qualified because a company did not provide reasonable justification that an alternative accounting principle is preferable:

- In the second sentence of the first paragraph of the example report, the phrase "for making this change" is replaced with the phrase "that this accounting principle is preferable."

In the text of footnote 17, the first two sentences are deleted; the word, "However" is deleted at the beginning of the third sentence; the word "because" at the beginning of the third sentence is capitalized; the phrase "the middle paragraph" is replaced with "this paragraph;" and the references to paragraphs ".16 through .18" are replaced with references to paragraphs "17A through 17E."

i. The text of paragraph .57 is replaced with the following:

If the auditor issues a qualified or adverse opinion because the company has not justified that an allowable accounting principle adopted in an accounting change is preferable, as described in paragraph .52, the auditor should continue to express that opinion on the financial statements for the year of change as long as those financial statements are presented and reported on. However, the auditor's qualified or adverse opinion relates only to the accounting change and does not affect the status of a

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newly adopted principle as a generally accepted accounting principle. Accordingly, while expressing a qualified or adverse opinion for the year of change, the independent auditor's opinion regarding the subsequent years' statements need not express a qualified or adverse opinion on the use of the newly adopted principle in subsequent periods.

- j. In the text of footnote 19 to paragraph .59, "(b)" is added to the beginning of the list of subsections.
- k. The first sentence of footnote 20 to paragraph .62 is deleted.
- l. In the second sentence of footnote 25 to paragraph .67, replace the phrase "section 420, *Consistency of Application of Generally Accepted Accounting Principles*," with the phrase "PCAOB Auditing Standard No. 6, *Evaluating Consistency of Financial Statements*"
- m. In the second sentence of paragraph .69:
  - Item (c) is inserted as follows:

(c) if applicable, a statement that the previously issued financial statements have been restated for the correction of a misstatement in the respective period,
  - Item (c) is changed to (d)
  - Item (e) is inserted as follows:

(e) if applicable, a reference to the company's disclosure of the correction of the misstatement,
  - Item (d) is changed to (f) and the words "the fact" are inserted at the beginning of the item
- n. In the third sentence of paragraph .73, the word "restated" is replaced with the word "adjusted."
- o. In paragraph .74:

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- In the first sentence of the third text paragraph, the word "restated" is replaced with the word "adjusted," and the word "restatement" is replaced with the words "the adjustments."
- In the second sentence of the third text paragraph, the word "restatement" is deleted, and the word "his" is replaced with the words "the auditor's."

*AU sec. 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*

SAS No. 1, "Codification of Auditing Standards and Procedures," section 561, "Subsequent Discovery of Facts Existing at the Date of Report," as amended, is amended as follows:

- a. The text of footnote 3 to paragraph .06 is replaced with the following:

See paragraphs 26 and 27 of Accounting Principles Board Opinion No. 9 and paragraphs 25 and 26 of FASB Statement No. 154, regarding disclosure of adjustments applicable to prior periods.

**Conforming Amendments to PCAOB Interim Quality Control Standards Resulting  
from the Adoption of Auditing Standard No. 7**

January 15, 2010

AUDITING AND RELATED PROFESSIONAL PRACTICE STANDARDS

***Conforming Amendments to PCAOB Interim  
Quality Control Standards RESULTING FROM THE  
ADOPTION OF PCAOB AUDITING STANDARD No. 7,  
"Engagement Quality Review"***

[Effective pursuant to SEC Release No. 34-61363, File No. PCAOB-2009-02 (January 15, 2010)]

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**Conforming Amendment to PCAOB Interim Quality Control Standards**

QC sec. 20, "System of Quality Control for a CPA Firm's Accounting and Auditing Practice"

QC section ("sec.") 20, "System of Quality Control for a CPA Firm's Accounting and Auditing Practice" of the Board's interim quality control standards is amended as follows –

The third sentence of paragraph .18 of QC sec. 20 is replaced with the following sentence:

These policies and procedures also should address engagement quality reviews pursuant to PCAOB Auditing Standard No. 7, *Engagement Quality Review*.