Keeping control internally

Accounting board eases internal control rules **Interviewed by Steve Trusty**

A new standard has been issued that deals with the auditing of internal controls over financial reporting of publicly held companies. This final standard must be used by auditors and would be required for all audits of internal control for fiscal years ending on or after Nov. 15, 2007. It is the latest attempt by the Public Company Accounting Oversight Board (PCAOB) to provide guidance to companies and auditors on complying with the Sarbanes-Oxley Act (SOX). The Securities and Exchange Commission (SEC) approved the standard on July 25, 2007.

"There is a benefit to having stronger internal controls and guidance on auditing them," says Tracy Weintraub, senior audit partner in the CPA firm of Berenfeld, Spritzer, Shechter & Sheer, which is headquartered in Coral Gables. "Auditing Standard No. 5 accomplishes that. Management must take seriously the design and implementation of these controls. They must comply with SOX. In the long run, the controls will make the company better."

Smart Business talked with Weintraub for more insight into Auditing Standard No. 5.

Tracy Weintraub
Senior audit partner
Berenfeld, Spritzer, Shechter & Sheer

What is Standard No. 5 and what does it mean?

The full title to Standard No. 5 is 'An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements.' It replaces Standard No. 2, which was approved by the SEC in June 2004. In essence, each company is responsible for developing internal controls that assure that the information used to prepare financial statements is accurate. They must complete an audit of those controls to assure that they, in fact, accomplish what is needed to provide accurate information. Different company cultures, products and sizes are going to require different controls. This standard is principle-based and allows the auditor to use judgment in determining risks and how they might affect the reporting.

What prompted this new standard?

PCAOB has monitored the progress registered firms have made in implementing the Standard No. 2 requirements. PCAOB first determined that the audit of internal control over financial reporting has produced significant benefits. But, these benefits have come at a significant cost. These costs have been greater than expected and, at times, the related effort has appeared greater than necessary. The board issued new proposals and asked for comments.

The proposals were designed to both increase the likelihood that material weaknesses in companies' internal control will be found and steer the auditor away from procedures that are not necessary to achieve the intended benefits. PCAOB also sought to make the internal control audit more clearly scalable for smaller and less complex public companies. The board received 175 comment letters and considered all of them closely in formulating the final standard.

Doesn't this standard apply only to public companies?

Yes, but many other companies want to comply. This is especially true of those that might be considering going public or are thinking about selling. It requires management to do an assessment of their internal controls, and then have an outside person audit those.

What does this new standard do for costs?

While in effect, SOX requires two audits: one of the company's internal controls over financial reporting and one of the finances. Standard No. 5 should be less costly than Standard No. 2. Materiality has been defined more clearly. The new standard also allows the auditor to consider risks in planning and designing audit procedures, which will allow the auditor to focus time on the most important factors and less or no time on factors that have little or no risk.

It is also important to keep in mind that the major compliance and auditing costs will occur in the first year. Once the controls are determined and in place, subsequent audits should be much less detailed and time-consuming.

Companies should also review the guidance issued for management by the SEC in December 2006 on evaluating internal control. The proposed guidance was intended to assist companies of all sizes to complete their annual evaluation in an effective and efficient manner, and it provides guidance on a number of areas commonly cited as concerns since the inception of SOX.

The key is that the SOX compliance process and the audits concerning internal control over financial reporting will make the company stronger. They will give the public more assurance on the reporting. It is very clear that they are not going to go away, and they need to be taken seriously.

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