New Auditing Standards Impact Broker-Dealers
by Gerald A. Michelson, CPA

New auditing standards issued by the American Institute of Certified Public Accountants (AICPA) require auditors to focus on companies' internal controls. Statements on Auditing Standards 104-111, commonly referred to as the "risk assessment standards" and 114 are effective generally for audits of financial statements for the year ending December 31, 2007, and affect all private companies.

What do Standards 104-111 require?
Auditors need to develop a more thorough understanding of internal controls, including the control environment, key controls over significant transactions, and upper management oversight of the financial reporting process. We need to assess whether those controls have been implemented and are operating effectively. Additionally, we must obtain more detailed information about your operations, business objectives and strategies, and the risks to achieving these objectives.

Sound like SOX 404? The areas addressed are similar.

These Standards also provide guidance concerning our assessment of the risks of material misstatement in a financial statement audit, whether caused by error or fraud. They specify that the design and performance of audit procedures must be responsive to the assessed risks.

How does this impact our audit of your financial statements?
The new Standards require us to spend more time reviewing your processes. The audit procedures we need to perform will be determined by the control environment, and may be different than previous years. We'll be asking detailed questions about internal controls, requesting documentation demonstrating that controls are being performed and observing certain controls that cannot otherwise be verified.

Preparation may facilitate the process.
We have already begun to invest heavily to implement these changes, training our staff on the new audit methodology and incorporating the necessary changes into our audit process and practice aids.

To prepare for the audit, you should document your "significant" internal control cycles. Documentation should include both processes and controls. Typically, these significant cycles would include:

- Commission income/trading profits/due from broker
- Operating expenses/accounts payable/cash disbursements
- Payroll/commission expense
- General journal entries
- Financial statement close process/regulatory reporting and compliance.

SAS 114 requires more communication.
SAS 114 addresses communications with "those charged with governance." It builds on the SAS 112 internal control deficiency communications implemented last year. These Standards require us to communicate valuable information to those with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the entity's financial reporting process. We must now communicate:

- the auditors' responsibility under generally accepted auditing standards
- the planned scope and timing of the audit
- significant audit findings
- difficulties encountered in performing the audit
- corrected and uncorrected Misstatements
- disagreements with management
- management representations
- management consultations with other independent accountants

These new requirements may benefit your company.
Documentation and evaluation of internal controls is a best practice for all companies. Additionally, these new standards are designed to help improve corporate governance, which could protect your business from risk.

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