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Recommended Citation

American Institute of Certified Public Accountants. Auditing Standards Board, "ASB meeting minutes, 2001, February 6-7; Auditing Standards Board approved highlights, 2001, February 6-7" (2001). *Association Sections, Divisions, Boards, Teams*. 107.

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AUDITING STANDARDS BOARD

Meeting: Auditing Standards Board (ASB)

Date: February 6-7, 2001

Location: Four Points Hotel Miami Beach
Miami Beach, FL

Meeting

Attendance: James S. Gerson, Chair
Ray Whittington, Vice Chair
Linda Cheatham
Craig Crawford
Robert F. Dacey
Richard Dieter
Sally L. Hoffman
Michael P. Manspeaker
Scott McDonald
Susan Menelaides
Keith O. Newton
Alan G. Paulus
Robert C. Steiner
Bruce P. Webb
Chip Williams

Other Participants

Richard I. Miller, AICPA General Counsel
Chuck Landes, Director, Audit and Attest Standards
Susan Jones, Senior Technical Manager, Audit and Attest Standards
Julie Anne Dilley, Technical Manager, Audit and Attest Standards
Gretchen Fischbach, Technical Manager, Audit and Attest Standards
Jane Mancino, Technical Manager, Audit and Attest Standards

Observers

Joseph Bentz, Grant Thornton LLP
John Brolly, PriceWaterhouseCoopers LLP
Jennifer Burns, Deloitte & Touche LLP
Robert Dohrer, McGladrey & Pullen LLP
John Fogarty, Deloitte & Touche LLP, Chair, Risk Assessments Task Force
Cheryl Hatfield, Practitioner's Publishing Company
Aram Kostoglian, KPMG LLP
Laura Phillips, Ernst & Young LLP

Tom Ray, KPMG LLP
Kay Tatum, University of Miami
Jeffrey Thomson, Arthur Andersen LLP
George Tucker, Ernst & Young LLP, Chair, Technology Issues Task Force

I. CHAIR'S REPORT

J. Gerson, provided an update on the Audit Issues Task Force (AITF) conference call of January 16, 2001 and the New York State Society of CPAs Liaison meeting.

II. AGENDA ITEMS PRESENTED AT MEETING

Audit Documentation

W. Scott McDonald, chair of the Audit Documentation Task Force, led the ASB's discussion of the proposed guidance for a documentation standard as well as proposed amendments to SAS Nos. 56, *Analytical Procedures*, and 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, to add documentation requirements to both standards. At the December meeting, the ASB had asked the task force to consider broadening the guidance on extent of documentation and to further refine the proposed documentation guidance for SAS Nos. 56 and 59. S. McDonald presented documents reflecting the task force's consideration of the ASB's recommendation. After discussion, the ASB accepted the language for the proposed amendment to SAS No. 56 and recommended expanding/revising the guidance on content of documentation and SAS No. 59.

Technology Issues

George H. Tucker, Chair, Technology Issues Task Force (task force), reported that twenty-one comment letters had been received on the Exposure Draft, *Amendment to Statement on Auditing Standards No. 55, Consideration of Internal Control in a Financial Statement Audit*, on or shortly following the comment deadline of January 1, 2001. The task force met on January 24 to address the comments and to reflect in the document those changes with which the task force agreed. The task force also prepared a paragraph-by-paragraph table of comments received and the task force's recommended disposition of each.

G. Tucker led a discussion focused on several themes that emerged in the comments. One major theme concerned the scope of the project. Several commenters recommended changes that the task force concluded were beyond its stated objective of reflecting the impact of information technology (IT) on internal control. Furthermore, the ASB's Risk Assessments project already is underway and likely will revisit AU section 319 in the context of enhancing guidance on the auditor's risk assessment process. ASB members concurred that issues including the relationship of inherent and control risk, significant changes to documentation requirements, and the overall organization of the standard should be deferred for the Risk Assessments task force to consider.

A discussion followed about the possibility of delaying issuance of the amendment and incorporating it with guidance being developed by the Risk Assessments task force. ASB members concluded that the task force should finalize the document with the expectation that the ASB will vote it for issuance at its April meeting.

ASB members also recommended the following changes:

- Expand and clarify the guidance on standard and nonstandard journal entries in paragraphs 50-51
- Revise the guidance in paragraphs 66, 68, and 69 to eliminate redundancy and inconsistency
- Clarify the distinction between "placed in operation" and "operating effectiveness"
- Use the terminology "information systems" rather than "IT systems"
- Use the terminology "professional possessing IT skills" rather than "IT specialist"

Risk Assessment

John A. Fogarty, Chair, Risk Assessments Task Force (task force), updated the ASB about events since the December 2000 ASB meeting, and presented for discussion a revised pictorial of the audit process and a revised risk assessments framework that includes supporting text for the pictorial.

Audit Process Pictorial

J. Fogarty reported that significant changes had been made to the audit process pictorial and that the task force and IAPC Audit Risk Subcommittee (IAPC subcommittee) versions are now essentially the same.

One of the more significant changes to the pictorial is the addition of a box requiring the auditor to "evaluate the entity's response to address *key risks* and obtain evidence of their implementation" as part of obtaining and supporting an understanding of the entity and its environment. A subgroup comprised of task force and IAPC subcommittee members has been identified to develop a definition of *key risk* and to consider how to operationalize this guidance.

ASB members raised questions about the meaning of "evaluate" and "obtain evidence of implementation" and how these terms compare with existing requirements in the internal control literature to understand the design of controls and determine whether they have been placed in operation. In proposing the requirement, the task force intended that the concept of "entity's responses" would be broader than (but inclusive of) internal control, and thus the terms "evaluate" and "obtain evidence of implementation" were intended to encompass types of entity responses that may be other than controls. In the context of internal control, however, the terms are essentially equivalent to understanding the design of controls and determining whether they have been placed in operation.

The pictorial also has been "streamlined" to sharpen the focus on major objectives of audit process and to eliminate clutter.

Risk Assessments and Audit Response Framework

J. Fogarty led a discussion about the Risk Assessments and Audit Response Framework document that has supporting text for the pictorial. He noted that "should" statements appear in boldface type and are equivalent to IAPC "black lettering." The text has been marked in this way only to facilitate comparison with the related documents being drafted by the IAPC, since it is the intent of both groups to achieve consensus on the major concepts and requirements in the guidance that each group ultimately issues.

ASB members discussed the seven categories or aspects of the entity and its environment about which the auditor should obtain an understanding and their relation to the five components of internal control. J. Fogarty noted that a task force member had developed a diagram that illustrates how the internal control components and the categories or aspects of the entity and its environment do not exist in a one to one relationship but rather have considerable overlap. This diagram may be included in the standard when it is issued.

ASB members also discussed the proposed descriptions of the tests that an auditor might perform depending on the auditor's assessment of risk at the assertion level. Auditing procedures for both higher risk and lower risk assertions might be a combination of tests of controls and substantive tests. For higher risk assertions, however, the guidance proposes that the auditor should develop "specific" responses. Characteristics of "specific" responses include tests (either tests of controls or substantive tests) that are performed at or near the balance sheet date, very precise analytical procedures, and significant tests of details. The Linkage task force will further refine this guidance as a departure point for its project on linking the assessed level of risk with the appropriate audit response to that risk.

ASB members generally concurred with the direction of the proposed materials. J. Fogarty stated that an initial draft of an Audit Process overview document will be presented at the next ASB meeting

GAAS Hierarchy

Thomas Ray, chair of the GAAS Hierarchy Task Force (task force), led the Board's discussion of the proposed revisions to AU section 150, *Generally Accepted Auditing Standards*. T. Ray provided background on the task force's deliberations and noted that the task force had reviewed six selected AICPA Audit and Accounting Guides to see if the auditing guidance was consistent with that of the related Statement on Auditing Standards (SAS) and if there were any instances where the audit guidance in an A&A Guide went beyond that in the SASs. A few instances were noted where the task force would recommend closer review of the auditing guidance in the Guides by an appropriate group.

The board:

- Supported the task force's recommendation that the revised AU section 150 supersede existing guidance rather than presenting it as an amendment to the existing AU section.
- Directed the task force to revise the proposed redraft of AU section 150 based on the comments received for consideration at its April meeting.
- Directed the task force to develop an amendment presenting an authoritative framework for the attestation standards for the board's consideration at its April meeting.
- Directed the task force to bring revised wording for the headnotes to AU section 100 for the board's consideration at its April meeting.
- Directed the task force to consider whether the guidance in SAS No. 50, SAS No. 62 (byproduct reports), SAS No. 70, SAS No. 71, and SAS No. 72 makes it clear that the standards have to be complied with or whether any of this guidance requires amendment.

The Board plans to vote to ballot for exposure at its April meeting.