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## ASB meeting minutes, 2001, December 12-13; Auditing Standards Board approved highlights, 2001, December 12-13, meeting

American Institute of Certified Public Accountants. Auditing Standards Board

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**AUDITING STANDARDS BOARD**  
**Approved Highlights**  
**December 12-13, 2001 Meeting**  
**New York, NY**

**Meeting Attendance**

James S. Gerson, Chair  
Jeffery C. Bryan  
Linda K. Cheatham  
Craig Crawford  
Richard Dieter  
John A. Fogarty, Jr.  
Lynford Graham  
Auston G. Johnson  
Michael P. Manspeaker  
Susan Menelaides  
Alan G. Paulus  
Mark Scoles  
Bruce P. Webb  
Ray Whittington  
Carl Williams III

AICPA Staff

Chuck Landes, Director, Audit and Attest Standards  
Richard Miller, AICPA, General Counsel & Secretary  
Julie Anne Dilley, Technical Manager, Audit and Attest Standards  
Gretchen Fischbach, Technical Manager, Audit and Attest Standards  
Judith Sherinsky, Technical Manager, Audit and Attest Standards

Observers and Other Participants

David Landsittel, Fraud Task Force Chair  
W. Scott McDonald, Davis Kinard & Co. PC, Audit and Attest Documentation Task  
Force Chair  
Joseph Bentz, Grant Thornton LLP  
Robert Dohrer, McGladrey & Pullen LLP  
John M. Frech, Arthur Andersen LLP  
George P. Fritz, Public Oversight Board Staff  
Cheryl Hartfield, Practitioner's Publishing Company  
Donald J. Kirk, Public Oversight Board Member  
Aram Kostoglian, KPMG LLP  
David Noonan, Ernst & Young LLP  
Zoe-Vonna Palmrose, Fraud Task Force Member  
Aulana Peters, Public Oversight Board Member

## II. CHAIR AND STAFF REPORTS

J. Gerson and C. Landes provided updates on recent Audit Issues Task Force (AITF) meetings, the liaison meeting with the Technical Issues Committee and other.

## III. AGENDA ITEMS PRESENTED AT MEETING

### Fraud

David Landsittel, Chair of the Fraud Task Force, presented a revised draft of a proposed Statement on Auditing Standards (SAS) that would supersede SAS No. 82, *Consideration of Fraud in a Financial Statement Audit*. The ASB discussed the document and recommended that—

- The task force consider clarifying paragraph 7 by providing an example of how an entity could experience a significant economic loss from a misappropriation of assets and not have materially misstated financial statements. An example would be a situation in which there is a significant theft of inventory and the financial statements are adjusted through a physical inventory count to reflect the amount actually on hand.
- A footnote be inserted in paragraph 14 indicating that communication among the engagement team regarding the potential for material misstatement due to fraud may take place in a single discussion or during several discussions, and that it is preferable for the discussion be oral.
- The word “communication” (in paragraphs 14-17 and elsewhere) be replaced with the word “discussion” to better indicate that the communication among the engagement team is interactive and multidirectional.
- Paragraph 23 be modified to indicate that in addition to management, the audit committee, and internal audit personnel, the auditor also should inquire of others within the entity about the existence or suspicion of inappropriate activities. Examples of such others are provided in paragraph 23.
- Paragraph 27, which addresses sources of unusual or unexpected analytical relationships, be moved from the section titled “Obtaining the Information Needed to Identify the Risks of Material Misstatement Due to Fraud” to the section titled “Evaluating Audit Test Results.”

- Examples of the use of a specialist be added to the document where appropriate, for example, in paragraph 49 in the discussion of the determination of inventory quantities when the inventory consists of specialty chemicals.
- The following changes be made to the second sentence in paragraph 3 to clarify the meaning of the word “scope” in that sentence.

SAS No. 47 provides that the determination of the ~~scope~~ nature, timing, and extent of the auditing procedures to be performed is directly related to the consideration of audit risk and indicates that the risk of material misstatement due to fraud is a part of audit risk

- The SAS contain an explanation of how management of a nonpublic entity also might face incentives and pressures to commit fraud. For example. incentives and pressures to achieve a given level of financial performance to satisfy investors, or creditors, or to achieve compensation targets.
- The task force consider the utility of having the auditor consider the “attitudes/rationalizations” of an individual who might commit fraud. Paragraph 8 of the proposed SAS states—

....such individuals [perpetrators] may possess an *attitude*, character, or set of ethical values that allow them to knowingly and intentionally commit a dishonest act, or they are in an environment that imposes sufficient pressure on them to enable them to *rationalize* committing a dishonest act even though they are otherwise honest individuals.

Some members of the ASB questioned the utility of such information because of its subjectivity.

- The task force present a revised draft of the proposed SAS at the February 2002 ASB meeting, and also present ideas for “wrap-around” training to help auditors implement the new fraud standard.

## **Audit Documentation**

W. Scott McDonald, chair of the Audit and Attest Documentation Task Force, led the ASB’s discussion of the proposed documentation Statement on Auditing Standards (SAS) and Statement on Standard for Attestation Engagements (SSAE). S. McDonald’s discussion focused on the changes made to the drafts as a result of the discussion at the November 2001 ASB meeting.

After discussion, the ASB voted unanimously to issue as final the SAS and SSAE on documentation.

## **Fair Values**

R. Dieter, chair of the Fair Values Task Force, proposed to the ASB a process that would permit the ASB to issue a Statement on Auditing Standards using the International Auditing Practices Committee (IAPC) of the International Federation of Accountants' standard on fair values. The comment period on IAPC's exposure draft of the proposed standard, entitled *Auditing Fair Value Measurements and Disclosures*, ends on January 15, 2002. Among other things, the proposed process calls for the ASB to issue an invitation to comment on IAPC's exposure draft. The comment period will be 60 days. Comments received during this comment period will be discussed at ASB's public meetings and forwarded to IAPC for its consideration. AICPA also will submit a comment letter to IAPC by January 15, 2002 that will include comments submitted by members of the ASB, the International Auditing Standards Subcommittee, and the AICPA's Technical Issues Committee on IAPC's exposure draft.

After discussion, the ASB accepted the process that R. Dieter proposed for developing a fair value SAS based on IFAC's fair value ISA. Additionally, members discussed some issues they had with IAPC's exposure draft. The issues will be evaluated for inclusion in the comment letter that the ASB's International Auditing Standards Subcommittee will issue on IFAC's exposure draft of the proposed ISA.

## **Risk Assessment**

John Fogarty, co-chair, Joint Risk Assessments Task Force (task force), stated that the task force had met twice since the last ASB meeting and had made considerable progress in reaching consensus on several major issues. Mr. Fogarty described the draft "black letters," or required guidance, that will serve as the basis of proposed new standards on the analysis of risks in a financial statement audit, and on planning and performing procedures to respond to the risks. Mr. Fogarty also discussed the nature of the proposed "gray letters" being developed that will support and explain the black letters.

The guidance is expected to drive the following changes in practice by requiring that the auditor:

- Obtain an enhanced understanding of the entity and its environment and its internal control.
- Make inquiries and perform analytical procedures to obtain the understanding of the entity and its environment.
- When responses to inquiries are inconsistent, obtain additional information to understand the reasons and their implications.
- Discuss with other members of the audit team the susceptibility of the entity to material misstatements in the financial statements.

- Use the understanding of the entity and its environment and its internal control to identify risks that may result in material misstatement of the financial statements, in particular, considering whether there are any conditions or events that might indicate the such risks.
- Evaluate the entity’s response, including control procedures, to identified risks of material misstatement of the financial statements in specific circumstances, including identified risks of fraud.
- Plan and perform audit procedures whose nature is responsive to the identified risks of material misstatement.
- Determine the extent and timing of various audit procedures to be responsive to identified risks.

The ASB concurred with the above objectives and recommended that the guidance being developed should discuss the following matters:

- The understanding of the entity and its environment and its internal control should be thorough enough that the auditor is satisfied with regard to the quality and completeness of the information on which the risk assessments will be made. The process of obtaining the understanding is intended to more rigorous, but also will provide some evidential credit.
- Guidance needs to address that the auditor should cover what needs to be right in addition to developing procedures in response to what can go wrong.
- Restore the term “assess” instead of “analyze” and define it to mean a process rather than a conclusion.

The task force intends to bring draft documents to the February ASB meeting pending the outcome of the task force meeting in January.

## SAS 71

The SAS No. 71 Task Force (task force) is revising SAS No. 71, *Interim Financial Information*, in response to certain recommendations from the AICPA’s Practice Issues Task Force (PITF) and the Public Oversight Board’s Panel on Audit Effectiveness. Richard Dieter, chair of the task force, led the ASB in a discussion of a revised draft of SAS No. 71. The members of the ASB recommended that—

- The phrase “focused procedures” rather than “risk-based procedures” be used in describing the procedures an accountant performs in an interim review engagement.
- The task force determine whether—
  - There is a difference between the analytical procedures performed in an audit and those performed in a review.
  - The results of analytic procedures performed in an interim review can be used as audit evidence.

- References in the proposed SAS to other SASs, that provide guidance for audits, should be revised to better indicate how those citations are relevant to a review engagement. For example, any references to a SAS should identify the applicable paragraphs rather than the entire SAS, for example, paragraphs 5 and 6 of SAS No. 57.
- The task force develop an illustrative representation letter for a quarterly review that would be included in an appendix to the SAS.
- Item 15(f)(v) of the proposed SAS, in which the accountant determines whether the client has agreed or reconciled the accounting records to the interim financial information, be a separate mandatory procedure.
- The task force determine whether the accountant should be required to read all of the minutes in an interim review engagement. The ASB noted that this requirement should not exceed the requirements in the audit guidance.
- A footnote be added to the first bullet in appendix A indicating that the auditor should use caution in evaluating budgeted and actual amounts since either of these amounts may have been adjusted by management to reflect desired interim results.
- Appendix B, “Unusual or Complex Situations to be Considered by the Accountant” be kept current by revising it on an ongoing basis and considering those revisions to be conforming changes.
- The procedures in paragraph 11, to update the accountant’s knowledge of the entity and its business environment, be required rather than optional.
- The first procedure in paragraph 11 be revised as follows:
 

Reading the prior year audit documentation, including the summary of known and likely misstatements, the identified risks of material misstatement due to fraud that required further assessment, and any memoranda prepared concerning significant financial accounting and reporting matters that may be of continuing significance, such as weaknesses in internal control and documentation prepared in reviews of prior interim periods in the current year, if applicable, to identify matters that may affect the current period interim financial information
- This procedure also should be revised to require the accountant to read the documentation for reviews of corresponding interim periods of prior years (in addition to interim periods of the current year) because the current quarter under review may contain certain seasonal relationships and adjustments that make the results of the quarter unique when compared to any other quarter during the year.
- Paragraph 49 of the proposed SAS be revised to indicate that documentation for an interim review engagement should be sufficient to enable those with supervisory responsibility to determine what work has been performed.

- The reference to SAB 99 in paragraph 22 be deleted and that the task force determine which items in SAB 99 relate to interim reviews and would be helpful in an interim review engagement.
- The task force revise the report wording in paragraphs 8 and 32 to better indicate the objective of an audit.
- Paragraph 5 of the proposed SAS be deleted (*a*) because of independence problems and (*b*) because it only applies to retrospective situations that no longer exist.
- The task force determine whether the requirement in AU section 333.06, *Management Representations*, that management attach to its representation letter a list of items that the auditor believes should be corrected that management has not corrected, is applicable in an interim review engagement.
- The task force present a revised draft of the proposed SAS to the ASB in April 2002.