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ASB meeting minutes, 1997, February 5-6

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ASB Meeting Minutes, February 5-6, 1997

Meeting: Auditing Standards Board

Date: February 5-6, 1997

Location: Rancho Las Palmas
41000 Bob Hope Drive
Rancho Mirage, CA 92270-4497

Meeting Attendance: Edmund R. Noonan, Chair
John L. Archambault
Luther E. Birdzell
John A. Fogarty, Jr.
James S. Gerson
Stephen D. Holton
J. Michael Inzina (*new member*)
Norwood J. Jackson, Jr.
John J. Kilkeary
Charles E. Landes (*new member*)
Stephen McEachern
Kurt Pany
Edward F. Rockman
Alan Rosenthal (*new member*)

W. Ronald Walton

Other Participants

Louis J. Barbich, Committee Operations
Committee

AICPA Staff

Alan Anderson, Senior Vice President,
Technical Services

Julie Anne Dilley, Technical Manager, Audit
and Attest Standards

Kim M. Gibson, Technical Manager, Audit and
Attest Standards

Thomas Ray, Director, Audit and Attest
Standards

Judith M. Sherinsky, Technical Manager,
Audit and Attest Standards

A. Louise Williamson, Technical Manager,
Audit and Attest Standards

New Member Orientation

A new member orientation session was held on February 5, 1997 from 9:30 a.m. to 10:30 a.m. The purpose of this session was to acquaint new Auditing Standards Board (ASB) members with the ASBs operating policies and expectations of members, to describe the ASBs current task force activities, and to review other administrative details.

Louis J. Barbich, the AICPA Committee Operations Committee (COCO) liaison to the ASB, explained that COCOs major purpose is to help committees operate more efficiently, for example, by using teleconferencing or conference calls to facilitate progress on a committees work when not all members can be physically present at a meeting.

Proposed Statement on Standards for Attestation Engagements, *Managements Discussion and Analysis*

John A. Fogarty, ASB member and chair of the Managements Discussion and Analysis (MD&A) Task Force, presented a briefing for new members from 10:45 to 12:00 p.m. on the proposed SSAE, *Managements Discussion and Analysis*, that will be exposed for comment in early March 1997. He described how the project embodied a proactive approach to changes in the business environment. The MD&A that public registrants are required to prepare contains some of the elements in the Comprehensive Model for Business Reporting that recently was proposed by the AICPA Special Committee on Financial Reporting. The ASB believes that the proposed guidance on performing and reporting on an examination or a review of MD&A provides a framework that would be useful in providing assurance on other forms of financial presentations that companies may experiment with in the future.

The proposed SSAE includes a comparison of the procedures that would be performed under SAS No. 8 versus those performed in an examination or a review of MD&A. Among the matters addressed is whether the presentation includes all the elements required by SEC regulations, whether the historical financial information in the MD&A is consistent with the financial statements, and whether the underlying information and assumptions provide a reasonable basis for disclosures.

The proposed SSAE requires the practitioner to have audited or reviewed the financial statements for at least the latest period to which the MD&A presentation applies. Therefore, the practitioner performing an engagement under this proposed SSAE must be independent.

If adopted, the SSAE would require amending various paragraphs of SAS No. 72, *Letters for Underwriters and Certain Other Requesting Parties*.

Chair's Report (File 1220)

Edmund R. Noonan, Chair of the Auditing Standards Board, welcomed Alan Anderson, the AICPA's new Senior Vice

President, Technical Services, and Louis J. Barbich to the ASB meeting. L. Barbich reiterated certain comments he had made at the new members orientation. A. Anderson remarked that his participation in the recent Audit Issues Task Force (AITF) planning retreat had deepened his appreciation for how the ASB works. He stated that he will work to foster communication between the ASB and the new Assurance Services Committee.

R. Noonan then reported the following matters to the ASB:

Audit Issues Task Force Activities

The AITF met for a planning retreat on January 14-15, 1997 in Clearwater Beach, Florida. The following are highlights of that retreat:

Objectives of the Retreat and Planning Process

R. Noonan, AITF Chair, outlined the overall objectives of the planning process as follows:

- Develop a "vision" or framework for the future activities of the ASB
- Identify objectives for the ASB for the next three to five years
- Establish a plan to achieve the identified objectives
- Create a vision/objectives/planning document

R. Noonan also proposed that the objectives of the retreat were to identify and agree on the key features of the ASB vision and objectives, and further, to establish a means to follow through with the results of the retreat.

Conclusions and Recommendations of the Special Committee on Assurance Services (SCAS, or the Elliott

Committee)

Don Pallais, Executive Director of the Special Committee on Assurance Services (SCAS), presented SCAS's conclusions and recommendations both for the ASB and the AICPA. He also described the work of the newly-established Assurance Services Committee and its Service Development Task Forces (SDTFs) that will identify and develop new services for practitioners, e.g., electronic commerce and elder care. SDTFs are responsible for building recognition of these new engagement opportunities and for developing measurement criteria for them if needed.

D. Pallais presentation triggered a spirited discussion that was revisited in different contexts over the next two days as the participants at the retreat moved through various topics in the agenda. Among the broader issues addressed were:

- SCAS's definition of assurance services, and whether existing services (audit, attest, and consulting) do or do not fit the definition
- whether "independent" as used in the definition has the same meaning as it has for audit and attest engagements and whether the Professional Ethics Committee has considered this matter
- whether existing professional standards, particularly the attest standards, fail to provide a performance and reporting framework for the kinds of services clients are seeking from practitioners and if so, can existing standards be "fixed"
- going forward, what the appropriate interaction between the ASB and the Assurance Services Committee should be, especially given the potential overlap of attest services and assurance engagements

The GAO Report

James Gerson, AITF member, summarized the observations on auditing issues made by the GAO in its recently-issued report on the accounting profession, and led a discussion on whether there were issues that needed to be addressed by the ASB. The GAO identified the following needs:

- Adoption of the corporate governance approach where the auditor looks to the board of directors, rather than to management, as its client
- Required auditor reporting on the condition of internal controls to improve auditor detection of fraud
- Better audit supervision (e.g. concurrent partner review)
- Inclusion on the ASB of members who are knowledgeable of standards but who are not public practitioners, although the GAO did note that users have not responded to AICPA actions to encourage more outside participation

Future of Current Services

Luther "Tom" Birdzell, AITF member, led a discussion on the future of current services and SCAS recommendations to the ASB not previously addressed, including the need for additional "how-to" guidance on "tough" issues (fraud, illegal acts, going concern, risks and uncertainties); performance guidance for auditor involvement in electronic commerce; and guidance regarding the auditors association with electronic reporting of financial information. The ASB recently has addressed or currently is addressing many of these issues.

ASBs Role in International Auditing Standards

Daniel Guy, Vice President, Professional Standards and Services, urged participants to consider whether the ASB should take a more assertive role in the development of international standards by the International Auditing Practices Committee (IAPC). Concerns were expressed about the tension

between serving the public interest and harmonization of auditing standards, and also about the lack of an infrastructure (i.e. peer review, professional ethics) in some countries to enforce adherence to standards. The possibility of establishing closer relations with specific countries like Canada or the UK was explored.

Impact of Technology on the Profession

Carol Langelier, Chair of the ASBs Computer Auditing Subcommittee (CAS), presented an update on the subcommittee's projects which recently have included the development of a series of Auditing Procedures Studies dealing with auditing and technology issues. The latest of these publications is *Audit Implications of EDI*, a joint project undertaken with the Canadian Institute of Chartered Accountants (CICA). C. Langelier also stated that part of CAS's role is to maintain the ASBs liaison with the Information Technology section on audit and attest matters. The participants considered ways in which technology expertise could be better integrated in the standards setting process.

Private Securities Legislation Act

John Kilkeary, AITF member, discussed the Private Securities Litigation Reform Act and the resultant section 10A addendum to the Securities Exchange Act of 1934. He pointed out that while the Commission is now empowered to modify or supplement audit requirements regarding illegal acts, related party transactions, and going concern, the language of section 10A now is directly lifted from the Statements on Auditing Standards (SASs). An item will be put on the AITF continuing agenda to discuss the possibility of issuing an interpretation to resolve the difference in the definition of illegal acts that appears in SAS 54 and section 10A (f).

Going Concern

T. Birdzell recapped the issues discussed in the Arthur

Andersen White Paper "Auditors Going Concern Evaluations." Several of the recommended changes to SAS 59 have been considered previously and rejected by the ASB, including defining substantial doubt and changing the one-year-from-the-balance-sheet-date requirement. A possibility would be to add some "how to" guidance to improve identification of going-concern problems and to determine what constitutes "substantial" doubt.

Performance Standard Framework

Thomas Ray, Director, Audit and Attest Standards, discussed the possibility of an overall recodification of the existing three sets of performance standards into a single set that will eliminate inconsistencies (i.e. SAS 71 reviews and SSARS reviews) and duplication (i.e. SAS 75 and SSAE 4) and also be easier to use. Participants concluded that while internal inconsistencies should be eliminated, the broader goal of developing a single standards framework probably should be put on hold given the greater urgency to do a "quick fix" on perceived attest standard deficiencies.

Reconsidering the Audit Model/ASB Initiatives

R. Noonan led a discussion on reconsidering the audit model and whether there is a need to "refresh" the audit standards. Participants generally agreed that the standards are not user-friendly. Several participants proposed that the appropriate solution was improved implementation guidance that communicates best practices. It was felt that the ASB should take the initiative to create more implementation guidance.

Outcomes of the Retreat

The retreat was more notable for its healthy airing of divergent views on a broad spectrum of topics than for its consensus-building. Participants concurred with the proposal by R. Noonan to create a "20/21 Task Force" to follow-up the output of the retreat, complete the planning process begun at the retreat,

and formalize conclusions in a strategic initiative document, perhaps entitled "Horizons 21", to be presented to the ASB for its approval by the end of this year.

Director's Report (File 1221)

Meeting with the National Credit Union Administration

On January 23, 1997, AICPA staff members and representatives from the AICPA's Credit Union Committee met with senior staff members of the NCUA. T. Ray briefed the ASB on the matters discussed.

Meeting with the Institute of Internal Auditors

On January 16, 1997, R. Noonan, S. Holton, J. Kilkeary, T. Ray, and J.A. Dilley met with representatives of the Institute of Internal Auditors (IIA). T. Ray briefed the ASB on the following highlights of that meeting:

Auditing Standards Board Activities

R. Noonan and T. Ray summarized the three recent Statements on Auditing Standards (SASs), SAS No. 80, *Amendment to Statement on Auditing Standards No. 31*, Evidential Matter, SAS No. 81, *Auditing Investments*, and SAS No. 82, *Consideration of Fraud in a Financial Statement Audit*.

J. Dilley described two drafts that will be exposed for comment in the first quarter of 1997, a proposed SAS titled *Communications Between Predecessor and Successor Auditors*, and a proposed SAS and SSAE titled *Establishing an Understanding with the Client*.

J. Kilkeary discussed a proposed SSAE, *Managements Discussion and Analysis*, that will be exposed for comment in March 1997.

R. Noonan, J. Kilkeary, and T. Ray gave a status report on the ASB task force projects currently in process. R. Noonan also described the recent AITF planning retreat, and explained that a new ASB task force will be created to continue the planning process begun at the retreat and draft a strategic plan for the ASBs approval.

R. Noonan concluded the ASB update with a discussion on internationalization of standards. He pointed out that auditor performance goes beyond written auditing standards and is dependent on "underpinnings" like enforcement of a code of professional conduct and practice monitoring.

IIA Activities

The IIA is an international organization with approximately 50,000 members, about half of whom are from the U.S. and Canada.

The IIA issued Statement on Internal Auditing Standards (SIAS) No. 15, *Supervision*, in December 1996. Two exposure drafts of proposed standards are outstanding. *Assessment of Performance of External Auditors* amends existing guidance to extend the assessment of external auditors on performance matters other than the coordination of internal and external audit work. The assessment would be done by the director of internal auditing only at the specific request of senior management or the board. *Auditing Compliance With Policies, Plans, Procedures, Laws, Regulations, and Contracts* expands existing guidance on compliance to include compliance with contracts.

The IIA currently is involved in the following projects:

- Development of a series of pamphlets on internal control and other matters
- Control Self-Assessment Center, the objective of which is to gather employee groups to discuss control objectives

and procedures

- Environmental auditing
- Continued expansion of IIA certification
- Technology auditing/Advanced Technology Forum

Meeting with the New York State Society of CPAs Auditing Standards and Procedures Committee

On January 21, 1997, R. Noonan and T. Ray met with representatives of the NYSSCPAs Auditing Standards and Procedures Committee. T. Ray briefed the ASB on the matters discussed.

SAS No. 19 Task Force (File Ref. No. 4308)

James Gerson, Chair of the SAS No. 19 Task Force (task force), led the Board in a discussion regarding SAS No. 19, *Client Representations*. The following issues were discussed by the Board:

- A draft of the revised standard which incorporated the threshold issues discussed at the December 17 - 19, 1996 Board meeting.
- A chart outlining the revisions made to SAS No. 19, paragraph 5. As a result of this discussion, the Board requested that the task force consider grouping the representations included in paragraph 5 into categories consistent to those illustrated in the management representation letter included in Appendix A.
- The appropriateness of Appendix B, "Additional Representations." Appendix B includes examples of representations that under certain circumstances may be appropriate in a representation letter. The appendix is not

intended to be all-inclusive, but is meant to be used as a guide to help practitioners identify the need for additional representations. The Board did not review Appendix B in its entirety; instead, they agreed that the content and approach of the appendix are appropriate guidance.

- A discussion paper regarding the lack of obtaining updated management representations for the period in which a predecessor auditor is reissuing a report. In addition to the paper, suggested wording to amend SAS No. 58, *Reports on Audited Financial Statements*, (AICPA, *Professional Standards*, AU sec. 508. 71) to expand the predecessor auditors responsibility when asked by a former client to reissue his or her report on the financial statement of a prior period, was reviewed. The predecessor auditors expanded responsibilities would include obtaining a letter of representation from management, in addition to the representation letter from the successor auditor, before reissuing a report previously issued on financial statements of a prior period. The Board agreed that this guidance is appropriate and requested that the task force draft a sample "Updating Representation Letter," to illustrate the requirements of the amendment.

The task force will meet to address the issues discussed and will present a revised standard, including an illustrative "Updating Representation Letter," to the Board at its next meeting.

Attestation Recodification (File Ref. No. 2155)

Ronald Walton, Chair of the Attestation Recodification Task Force (task force), led the Board in a discussion regarding recommendations developed by the task force that support amending the existing attestation standards regarding the requirement for a written assertion and the permission of "direct reporting." The proposed amendments include:

- a. changing the reporting elements in AT sec. 100 to include statements of managements and the practitioners responsibilities as currently required by SAS No. 58.
- b. revising the definition of an assertion in AT sec. 100 to incorporate the expanded definition included in AT sec. 600 (agreed-upon procedures).
- c. amending AT sec. 100 to eliminate the reference to managements assertion in the practitioners report.

The ASB discussed each of the above issues and reached the following conclusions:

- The reporting elements in AT sec. 100 should be changed to include statements of managements and the practitioners responsibilities.
- The definition of an assertion in AT sec. 100 should be revised to state that a written assertion may be presented by a responsible party to a practitioner in a number of ways, such as in a statement, narrative description or schedule appropriately identifying what is being presented and the point in time or period of time covered. (Accordingly, this expanded definition would apply to all attestation engagements.)
- The concepts in the illustrative report should be adopted. Therefore, the introductory paragraph should be amended to refer to managements responsibility and the opinion paragraph should be amended to report directly on the subject matter and not on managements assertion.

The task force is expected to present an amended draft of AT sec. 100 to the ASB at its April 1997 meeting.

Summary of Board Preference Vote

**Attestation Recodification For Against Abstain Absent
(File Ref. No. 2155)**

Should the illustrative reports currently in the attestation standards be amended to include a reference to managements responsibilities in the introductory paragraph and an opinion directly on the subject matter (and not on the assertion)?	14	1	0	0
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Ownership, Existence, and Valuation (File Ref. No. 2405)

The Ownership, Existence, and Valuation Task Force (task force) is considering the auditors responsibility for auditing financial-statement assertions about the ownership, existence, and valuation of financial instruments, commodity contracts, and similar instruments. The task force is currently developing auditor guidance in the following two areas:

- Evaluating financial-statement assertions about the fair value of financial instruments (Valuation)
- Evaluating financial-statement assertions about the existence and ownership of financial instruments when an entity uses a third party such as a broker/dealer to maintain custody of its financial instruments (Existence and Ownership)

Valuation

Tom Birdzell, Chair of the task force, led the ASB in a discussion of a revised draft of a proposed Statement on Auditing Standards (SAS) titled *Auditing Procedures to be Considered When Evaluating Assertions as to the Fair Value of*

Financial Instruments. The ASB recommended that the task force —

- Differentiate the term "active market" (a term used in the accounting literature) from the term "ready market" (a term used and defined in the proposed SAS). Consider approaches that would avoid the need for a defined term in the auditing literature.
- Delete the appendix of the proposed SAS which explains why SAS No. 57, *Auditing Accounting Estimates*, does not provide applicable guidance for auditing the fair value of financial instruments. The ASB also suggested that "valuation of securities" be deleted from the examples of accounting estimates in the appendix of SAS No. 57.
- Add a footnote to paragraph 5 of the proposed SAS to indicate that the guidance in paragraph 10 of AU section 311, *Planning and Supervision*, on planning an audit that involves the use of an EDP specialist, is also applicable to other persons with special expertise.
- Not incorporate the guidance in paragraphs 24 through 30 of SAS No. 81, *Auditing Investments*, on auditing the fair value of financial instruments, into the proposed SAS at this time. The proposed SAS will supplement rather than supersede SAS No. 81.

Existence and Ownership

Tom Birdzell also led the ASB in a discussion of a draft of a proposed SAS titled *Existence and Ownership*, that provides guidance on evaluating financial-statement assertions about the existence and ownership of financial instruments when an entity uses a third party such as a broker/dealer to maintain custody of its financial instruments. The ASB recommended that the task force —

- Revise the applicability section of the proposed SAS to

include cash.

- Footnote the word "ownership" to indicate that it refers to "rights and obligations" as that term is used in SAS No. 31, *Evidential Matter*.
- Revise the document to indicate that the auditor should consider audit risk, as described in SAS No. 47, *Audit Risk and Materiality in Conducting and Audit*, in determining whether the auditor needs to obtain an understanding of the custodians controls over the custody of financial instruments.
- Move paragraph 6 of the document, which discusses whether the auditor needs to obtain an understanding of the custodians controls over the custody of financial instruments, to a later point in the document.
- Revise paragraph 9 of the document to indicate that in most circumstances (rather than in some circumstances) confirmation with the custodian is a sufficient audit procedure if the only service provided by the custodian is custody of the financial instruments, and the entity maintains all of the necessary recordkeeping.
- Integrate the factors in paragraph 8, that the auditor considers in determining the extent of the understanding of the custodians controls over the custody of financial instruments that the auditor needs to obtain, into paragraph 10 of the proposed SAS.
- Delete the recommendation in paragraph 8c that the auditor consider the findings in regulatory reports on a broker/dealers internal control in determining whether the auditor needs to obtain an understanding of the custodians controls over the custody of financial instruments because such reports have restricted distributions and should not be used for purposes other than the intended purpose.

Summary of Board Preference Vote

Ownership, Existence, and Valuation (File Ref. No. 2405)

Valuation	For	Against	Abstain	Absent
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Should the appendix of the proposed SAS, <i>Auditing Procedures to be Considered When Evaluating Assertions as to the Fair Value of Financial Instruments</i> , be deleted from the document?	14	0		1
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Should a footnote be added to paragraph 5 of the proposed SAS that indicates that the guidance in paragraph 10 of AU section 311, <i>Planning and Supervision</i> , on planning an audit that involves the use of an EDP specialist, is also applicable to other persons with special expertise.	15	0		0
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