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## Auditing Standards Board (ASB) meeting, July 27-30, 2009, San Diego, CA

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## AUDITING STANDARDS BOARD (ASB) MEETING

July 27-30, 2009

San Diego, CA

### MEETING ATTENDANCE

#### ASB Members

Harold Monk, *Chair*

Ernie Baugh

Sheila Birch

Jacob Cohen

Walt Conn

Tony Costantini

Charles Frasier

Nick Mastracchio

Andy Mintzer

Thomas Ratcliffe

Randy Roberts

Darrel Schubert

Tom Stemlar

Mark Taylor

Phil Wedemeyer

Stephanie Westington

Art Winstead

Megan Zietsman

#### AICPA Staff

Mike Glynn, *Audit & Attest Standards (7/28-7/29)*

Ahava Goldman, *Audit & Attest Standards*

Chuck Landes, *Audit & Attest Standards*

Richard Miller, *General Counsel & Trial Board*

Hiram Hasty, *Audit & Attest Standards (7/29-7/30)*

David Scott, *PD-Course Development*

Judith Sherinsky, *Audit & Attest Standards (7/27-7/28)*

Linda Volkert, *PCPS Technical Issues Committee*

#### Absent

Jorge Milo (designated representative: Brian Richson)

#### Observers and Guests

Stephen Asare, *University of Florida (7/27)*

Ed Bryant *KPMG LLP*

Rob Chevalier, *KPMG LLP* (7/29-30)  
Julie Anne Dilley, *PricewaterhouseCoopers LLP* (7/28-7/30)  
Bob Dohrer, *McGladrey & Pullen LLP* (7/27 and 7/30)  
George Fritz (7/28 and 7/29 only)  
John Fogarty, *Deloitte & Touche LLP*  
Ulfert Gronewold (7/29 only)  
Diane Hardesty, *Ernst & Young LLP*  
Jennifer Haskell, *Deloitte & Touche LLP*  
Jan Herringer, *BDO Seidman LLP*  
Susan Jones, *Grant Thornton LLP* (7/28 and 7/30)  
Jason Keen, *Deloitte & Touche LLP*  
Maria Manasses, *Grant Thornton LLP*  
Jeff Markert, *KPMG* (7/28 and 7/29)  
Joanne Moores, *IFAC*  
Mark Nichols, *Mayer Hoffman McCann P.C.*  
Brian Richson, *PricewaterhouseCoopers LLP*  
Kevin Stout, *SEC*  
Mary Ann White, *Thomson Reuters (PPC)*  
Arnold Wright, *Boston College* (7/27)  
Gail Vallieres, *GAO*

## **AGENDA ITEMS PRESENTED AT MEETING**

### **Chair's Report**

Mssrs. Monk and Landes discussed items of interest to the ASB. The ASB approved unanimously the highlights of June 22-25, 2009 meeting.

#### **1. Auditor's Report Research**

The ASB is sponsoring four teams who are performing research on auditor's report. The last two teams presented the results of their research to the ASB; Professors Arnie Wright and Stephen Asare on Monday, July 27, and Professor Ulfert Gronewold on Wednesday, July 29.

#### **2. Group Audits**

Mr. Dohrer, chair of the Group Audits Task Force, led the ASB in a discussion of the issues raised in the agenda material and of the proposed SAS, *Audits of Group Financial Statements (Including the Work of Component Auditors)*.

The ASB directed the Task Force to:

- Use the extant reports, not the reports as revised in proposed Auditor’s Report SAS, in illustrations, because this ED is not the appropriate place to illustrate the changes proposed in that SAS. Illustrations will be revised through conforming changes at the end.
- Make the following editorial changes throughout:
  - Change *group auditor* to *group engagement partner* or *group engagement team* as appropriate
  - Change *group audit report* and *group audit opinion* to *auditor’s report on the group financial statements*
- Move the content of par. A1 to par. 7, and delete “When one or more components that are included in group financial statements are audited by component auditors” as unnecessary.
- Delete the second sentence in the definition of component auditor, and add the phrase “the financial information of” before “a component”.
- Par. 14, changed “sufficient” to “of an extent necessary to obtain sufficient appropriate audit evidence and accordingly”
- Combine paragraphs 25 and 24, and explicitly state that the auditor should not make reference to the audit of a component auditor unless the component’s financial statements are prepared using the same financial reporting framework as the group financial statements, and the component auditor has performed an audit in accordance with GAAS. The ASB believes that these requirements were implicit in extant AU section 543.
- Change the guidance in paragraph A50 to requirements following paragraph 27.
- Paragraph 28, revise wording to be consistent with proposed Auditor’s Report SASs.
- Paragraphs 50 and 60, change “fraud resulted in material misstatement” to “material misstatement has, or may have, resulted from fraud” to encompass suspected fraud.
- Move the last bullet of paragraph A40 to a separate paragraph before A43.
- Related to the changes in paragraphs 24 and 25, delete the related second sentence in the third bullet of paragraph A47, and add a paragraph of application material addressing financial statements prepared in accordance with GASB with components using a different financial reporting framework.
- Paragraph A57, add “considering all components”.
- Paragraph A60, revise the wording to make clear that the audit is performed in accordance with GAAS except for certain procedures.
- Make certain other editorial changes

Mr. Fogarty recommended that the ASB consider the use of an impact assessment to assist respondents in assessing the overall impact of a proposed new standard. The impact assessment is intended to communicate the impact of the incremental difference between the extant and proposed new standard, not between current and future practice. The impact assessment would be summarized in a template based on one prepared by the IAASB. The ASB agreed to pilot the use of the impact assessment template in the exposure draft of this proposed SAS.

The ASB voted unanimously to ballot the draft for exposure.

### **3. Financial Statements Prepared in Accordance with a Financial Reporting Framework Generally Accepted in Another Country**

Mr. Conn, Chair of the AU 534 Task Force (Task Force), led the discussion for Agenda Item 3, *Reporting on Financial Statements Prepared in Accordance with a Financial Reporting Framework Generally Accepted in Another Country*. The objective of the Task Force is to redraft AU Section 534, *Financial Statements Prepared for Use in Other Countries*, in accordance with the clarity conventions.

Following is a summary of the significant issues discussed at the meeting:

- At the April 2009 ASB meeting, it was discussed whether an unqualified opinion on foreign GAAP financial statements (unaccompanied by a modified opinion relative to U.S. GAAP) for use in the U.S. violates Rule 203. After discussion and input from legal counsel, it was determined that such an opinion would violate Rule 203. If financial statements are prepared in accordance with a financial reporting framework generally accepted in another country (i.e., from a standard setter not designated by the AICPA Council to set accounting standards), that will have more than limited use in the United States, the auditor should report using a modified opinion because of departures from U.S. GAAP. The ASB discussed changes made to the draft proposed standard to reflect this discussion and agreed with such changes.
- The ASB discussed the term “more than limited use” with respect to the distribution of the auditor’s report. Some ASB members believe the lack of specificity could create a practice issue and the treatment should be changed to a “restricted use” opinion. However, other ASB members believe this is not a practice issue currently and that use of this reporting approach will continue to decrease over time due to the use of IFRS as issued by the IASB. The ASB agreed to solicit feedback on this issue during the comment period.
- The ASB agreed to add an illustrative auditor’s report to the SAS, for situations when the financial statements prepared in accordance with a financial reporting framework generally accepted in another country will have more than limited use in the United States, modified as appropriate (qualified or adverse), because of departures from U.S. GAAP.

The ASB unanimously voted to ballot the proposed SAS for exposure.

#### **4. Service Organizations**

Mr. Conn, Chair of the Service Organizations Task Force, led the ASB in a discussion of a draft of Proposed SAS, *Audit Considerations Relating to an Entity Using a Service Organization*, which will replace the guidance in AU section 324, *Service Organizations*, for auditors of the financial statements of entities that use a service organization. The ASB issued an exposure draft of the proposed SAS in November 2008 which is based on ISA 402, *Audit Considerations Relating to an Entity Using a Third Party Service Organization*. The changes made to the ED included changes in response to comments on the ED as well as changes to conform with revisions to the final version of ISA 402, which was issued in April 2009. The ASB directed the task force to

- Delete the sentence, “Earlier application is permitted.” From paragraph 6.
- Consider revising the definitions, in paragraph 8, of service organization and subservice organization to conform with the language in paragraph 19 of the draft of Proposed SAS, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, presented at the July 2009 ASB meeting.
- Replace the words “concerning the service auditor’s” with the words “as to” in the lead-in of paragraph 13, and insert the words “the service auditor’s” at the beginning of bullet 13 a.
- Insert the word “authorizing” in the third bullet of paragraph A4 after the word “initiating.”
- Move the reference to Proposed SAS, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*, in paragraph A5, to a footnote.
- Change the words “each user entity” to “the user entities” in paragraph A22.
- Delete the words “maintained electronically from the user entity or another location,” and insert the word “electronic” before the word “interrogation” in the second sentence of paragraph A26. In the third sentence of that paragraph, add the word “also” before the word “obtain.”
- Revise the last sentence of paragraph A43, to conform with guidance in paragraphs 7–10 of Proposed SAS, *Modifications to the Opinion in the Independent Auditor’s Report*, with respect to when a disclaimer is issued and when a qualified opinion is issued.

#### **5. Related Parties**

Mr. Fritz, Chair of the Related Parties Task Force (Task Force), led a discussion of the draft proposed SAS, *Related Parties*.

Mr. Fritz explained that ISA 550, *Related Parties* and the proposed SAS are structured to address financial reporting frameworks such as US GAAP and IFRS, and special purpose frameworks as discussed in the proposed SAS, *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*. The applicability of some objectives, requirements and definitions in ISA 550 and the proposed SAS depend on whether a framework “establishes” related party requirements; other objectives and requirements apply irrespective of whether the framework establishes such requirements. Mr. Fogarty stated that the IAASB drafted ISA 550 in such a manner because certain financial reporting frameworks do not include a definition of related parties and the IAASB concluded

that it would not be appropriate to force preparers of financial statements in accordance with those financial reporting frameworks to use GAAP definitions. Mr. Fritz stated that, since financial statements prepared in accordance with special purpose frameworks would include the disclosures that are substantially equivalent to those in GAAP financial statements, the proposed SAS need not include related party definitions and other references to financial reporting frameworks that are necessary in the ISA.

Mr. Fritz advised the ASB that the Task Force prepared an alternative SAS which would be completely framework neutral – that is, the applicability, objectives, and requirements of the proposed SAS are the same, irrespective of the financial reporting framework in accordance with which the financial statements being audited were prepared. The ASB considered the separate presentations and concluded that the proposed SAS should be drafted to be framework neutral.

The ASB also determined that:

- The definition of *related party* should state simply that a related party is a party defined as a related party in GAAP.
- Paragraph 21 should be revised to make clear that the additional audit evidence that the auditor is required to obtain to respond to assessed risks should extend beyond inquiry of management.

The ASB unanimously voted to ballot the proposed SAS for exposure.

## **6. Auditor’s Reports – Special Reports**

Ms. Jones, Chair of the Special Reports Task Force, led a discussion of the following proposed SASs:

- *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*
- *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*
- *Engagements to Report on Summary Financial Statements.*

### *Special Purpose Frameworks*

With regard to the issue presented in July, the Board agreed with the inclusion of Exhibit A, which supersedes Interpretation 14, *Evaluating the Adequacy of Disclosure and Presentation in Financial Statements Prepared in Conformity With an Other Comprehensive Basis of Accounting*, and provides additional guidance on the adequacy of disclosures based on that Interpretation. The ASB also requested certain editorial revisions.

### *Single Financial Statements & Elements*

With regard to the issue presented in July, the ASB confirmed its decision to modify the extant requirement to perform an audit of the complete financial statements when a specified element, account, or item is, or is based upon, an entity's net income or stockholders' equity or the equivalent thereof. In the case of an audit of a specific element that is, or is based upon, the entity's stockholders' equity or net income (or the equivalents thereto), the ASB agreed to require the auditor to perform procedures necessary to obtain sufficient appropriate audit evidence to enable the auditor to express an opinion about financial position, or financial position and results of operations, respectively, because of the interrelationship between the element and the balance sheet accounts and the income statement accounts. However, matters related to classification or disclosure may not be relevant to the audit of the specific element and therefore, audit procedures on such matters may not be necessary in an audit of a specific element.

The ASB also agreed:

- In the case of an audit of a single financial statement, to add a new requirement for the auditor to determine materiality for the single financial statement as a whole.
- In the case of an audit of a specific element of a financial statement, when the opinion in the auditor's report on an entity's complete set of financial statements is modified and the modification is relevant to the audit of the specific element or interrelated item of the specific item, to require the auditor to (a) express an adverse opinion on the specific element when the modification on the complete set of financial statements arises from a material misstatement, and (b) disclaim an opinion on the specific element when the modification on the complete set of financial statements arises from an inability to obtain sufficient appropriate audit evidence.
- If it is necessary to express an adverse opinion or disclaim an opinion on the entity's complete set of financial statements as a whole, to clarify that an unmodified opinion on a specific element would contradict the adverse opinion or disclaimer of opinion on the entity's complete set of financial statements as a whole and would be tantamount to expressing a piecemeal opinion. Therefore, when the auditor nevertheless considers it appropriate to express an unmodified opinion on that element, the auditor should only do so if the requirements in paragraphs 18(a) and 18(b) are met.

The ASB also requested certain editorial revisions, including the use of numbering to better clarify the requirements.

#### Summary Financial Statements

With regard to the issue presented in July, the ASB agreed with the factors included in paragraph 8(a) of the proposed SAS that will serve as the basis for determining whether the applied criteria are acceptable. The Task Force was also to:

- Modify the requirement to obtain the agreement of management that it acknowledges and understands its responsibility to provide the auditor with written representations, not just representations related to subsequent events.



- Clarify within the requirement that when the auditor’s report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, the auditor may withdraw from the engagement, where withdrawal is possible under applicable law or regulation.

The ASB also requested certain editorial revisions.

The ASB unanimously voted to ballot the proposed SASs for exposure.

## 7. RSI/SI/OI

Mr. Markert, Chair of the RSI/OSI Task Force (Task Force), led a discussion of the significant issues raised in the comment letters on the exposure draft of the proposed Statements on Auditing Standards, *Required Supplementary Information* (the “RSI SAS”), *Other Supplementary Information in Documents Containing Audited Financial Statements* (the “OI SAS”), and *Supplementary Information in Relation to the Financial Statements as a Whole* (the “IRT SAS”).

The ASB discussed the applicability of each of the proposed SASs and concluded that each of the applicability paragraphs were clearly stated and appropriately referenced the other SASs.

The ASB discussed the draft proposed RSI SAS and concluded that it agreed with the Task Force’s decision:

- That additional outreach to the GASB or FASB is not necessary with respect to the classification of certain information as required supplementary information. The discussion was specific to the classification of information related to Common Interest Realty Associations (CIRAs) being classified as RSI in the FASB Codification. The ASB concluded that the proposed requirements with respect to RSI are not overly burdensome to auditors of CIRAs.
- To reference “limited procedures as prescribed by the American Institute of Certified Public Accountants” in the final SAS. The ED referenced “limited procedures prescribed by auditing standards generally accepted in the United States of America”. The reference to the AICPA is consistent with references to other unaudited material.
- To revise the reporting requirements when the auditor is unable to complete the prescribed procedures. The ED included a requirement that the auditor state that he or she is unable to determine whether material modifications should be made to the information for it to be in conformity with guidelines established by the designated accounting standard setter. The Task Force proposed to delete the requirement and instead be consistent with the requirement in extant AU 558.
- To delete the reporting decision trees that were included in the ED.

The ASB discussed the draft proposed OI SAS and concluded:

- That the effective date of the proposed SAS should be consistent with other clarified SASs. However, the ASB determined that early application should be permitted so that auditors can implement the proposed SAS simultaneous with the proposed RSI and IRT SASs.
- That it agreed with the Task Force that the objective—the auditor is to respond appropriately when the auditor becomes aware that documents containing audited financial statements and the auditor’s report thereon include OI that could undermine the credibility of those financial statements and the auditor’s report thereon—is appropriate. The ASB concluded that the inclusion of the language “that he or she becomes aware” is not inconsistent with the ISA but rather is due to the ASB’s interpretation of the ISA.

The ASB discussed the draft proposed IRT SAS and concluded:

- That the definition of *other information* included in both the proposed SAS as well as the proposed OI SAS which states that other information “is included in a document containing audited financial statements and the auditor’s report thereon” may create confusion amongst practitioners as the proposed IRT SAS provides requirements and guidance when the other information is not presented with the financial statements. The ASB directed the Task Force to consider a new term which would encompass RSI, OI, and any other information upon which an auditor may express an in relation to opinion.
- That it continues to agree with the Task Force that the inclusion of the phrase *including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements and other additional procedures* in the auditor’s report is necessary to prevent misunderstanding by readers of the auditor’s report as to the level of work performed by the auditor.
- That it continues to agree with the Task Force that the proposed SAS appropriately omits any guidance with respect to restricting the use of the auditor’s report.

The ASB directed the Task Force to bring a revised draft of the proposed IRT SAS to the August 2009 ASB meeting for further discussion.

## **8. Risk Assessments**

Mr. Schubert, Chair of the Risk Assessments Task Force (Task Force) led the discussion of the proposed Risk Assessment Standards. The objective of the presentation was to discuss with the Board the comment letters received in connection with the exposure draft released in January 2009.

The following are the highlights of the significant matters discussed.

- In general, the proposed SASs’ objectives, the revisions from the existing standards to converge with ISAs, and the differences between the proposed SASs and the ISAs identified in the exposure draft, are appropriate.

- Mr. Schubert led a discussion of the most significant comments received summarized in the cover memo.
  - With respect to the comment that it would be helpful if the ASB consider content in the PCAOB proposed Risk Assessment standards for inclusion in the proposed SASs, the ASB noted that there are instances where AT 501 addresses the same matters. In those cases, the proposed SASs should be consistent with AT 501 rather than with the proposed PCAOB standards.
  - With respect to the comments received about the use of the term “performance materiality,” the GAO continues to be concerned about the use of term “performance materiality” and believes that the changes made to address the comments are not enough. The suggestion was made that more guidance is needed to help auditors apply the concept.
- Mr. Schubert noted that consistent with ISA 315, the proposed SAS *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* contains a conforming amendment that establishes a requirement of the auditor to obtain an understanding of the entity’s internal audit function.
- Mr. Schubert reviewed with the ASB each proposed SAS. Significant matters discussed were as follows.
  - Proposed SAS *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
    - Replace the definition of the entity’s risk assessment process in A76 with paragraphs 76 and 77 of AU 314.
  - Proposed SAS *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
    - Move paragraph 7a to application guidance in A21.
    - Move paragraph 8 to follow paragraph 23.

The Task Force will bring revised proposed SASs to the ASB in October meeting for final issuance.

The meeting adjourned at 12:40pm.