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Proposed statement on auditing standards :  
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1990; Exposure draft (American Institute of  
Certified Public Accountants), 1990, July 17

American Institute of Certified Public Accountants. Auditing Standards Board

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# **EXPOSURE DRAFT**

## **PROPOSED STATEMENT ON AUDITING STANDARDS**

### **OMNIBUS STATEMENT ON AUDITING STANDARDS—1990**

**JULY 17, 1990**

**Prepared by the AICPA Auditing Standards Board  
For comment from persons interested in auditing and reporting**

**Comments should be received by September 17, 1990, and addressed to  
Mark Beasley, Technical Manager, AICPA Auditing Standards Division, File 3860  
AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775**

600578

## SUMMARY

### **Why Issued**

This proposed statement on auditing standards contains three amendments to existing statements. These amendments—

- Make explicit the required language that the auditor should include in an explanatory paragraph of the report when he or she concludes that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time not to exceed one year from the balance-sheet date.
- Clarify language in the auditor's report to describe the level of service the successor auditor performs on adjustments made to restate prior-year financial statements audited by a predecessor auditor whose report is not presented.
- Clarify language in the auditor's report to describe the level of service the auditor performs on the combination of financial statements following a pooling-of-interests transaction when the auditor is asked to report on restated financial statements of one or more prior years when other auditors have audited one or more of the entities included in such financial statements.

### **What It Does**

This proposed Statement consists solely of amendments to existing statements. For each statement affected, the paragraph being amended is shown with a line drawn through the amended language and the new wording is presented in boldface italics. The proposed amendments are outlined in the following paragraphs.

*Paragraph 12 of SAS No. 59, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern (AICPA, Professional Standards, vol. 1, AU sec. 341.12)*

This proposed amendment—

- Makes explicit the required language for the explanatory paragraph (following the opinion paragraph) in the report that describes the auditor's conclusion that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time not to exceed one year from the balance-sheet date.
- Requires explicitly in the explanatory paragraph the use of the phrase "substantial doubt about its [the entity's] ability to continue as a going concern" or similar wording that includes the terms *substantial doubt* and *going concern*.

*Paragraph 83 of SAS No. 58, Reports on Audited Financial Statements (AICPA, Professional Standards, vol. 1, AU sec. 508.83)*

This proposed amendment—

- Modifies the explanatory language for the successor auditor when the prior-year financial statements audited by a predecessor auditor are restated and the predecessor auditor's report is not presented.
- Replaces the phrase "We also reviewed the adjustments" with the phrase "We also audited the adjustments." The Board, along with the staff of the Securities and Exchange Commission (SEC), believes that the use of the term *reviewed* confuses users of the successor auditor's report by connoting a different level of service than the service performed.

*Paragraph 16 of SAS No. 1, Codification of Auditing Standards and Procedures, section 543, "Part of Audit Performed by Other Independent Auditors" (AICPA, Professional Standards, vol. 1, AU sec. 543.16)*

This proposed amendment—

- Modifies the reporting guidance for the auditor who, following a pooling-of-interests transaction, is asked to report on the combination of restated financial statements for one or more prior years when other auditors have audited one or more of the entities included in such statements.

- Conforms the explanatory report language for the same reason the Board is proposing amendment to paragraph 83 of SAS No. 58 (discussed previously). This proposed amendment would replace the phrase “We also have applied procedures to the combination” with the phrase “We also audited the combination.”

### ***How It Would Change Existing Standards***

The proposed amendment solely amends the specific paragraphs of the three existing statements discussed previously.

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*This exposure draft has been sent to—*

- *Practice offices of CPA firms.*
  - *Members of AICPA Council and technical committees.*
  - *State society and chapter presidents, directors, and committee chairmen.*
  - *Organizations concerned with regulatory, supervisory, or other public disclosure of financial activities.*
  - *Persons who have requested copies.*
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July 17, 1990

Accompanying this letter is an exposure draft of a proposed statement on auditing standards titled Omnibus Statement on Auditing Standards — 1990. A summary of the proposed Statement also accompanies this letter.

This proposed Statement consists solely of three amendments to existing statements. The statements that would be affected by this proposed Statement are —

- Paragraph 12 of SAS No. 59, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern (AICPA, Professional Standards, vol. 1, AU sec. 341.12).
- Paragraph 83 of SAS No. 58, Reports on Audited Financial Statements (AICPA, Professional Standards, vol. 1, AU sec. 508.83).
- Paragraph 16 of SAS No. 1, Codification of Auditing Standards and Procedures, section 543, "Part of Audit Performed by Other Independent Auditors" (AICPA, Professional Standards, vol. 1, AU sec. 543.16).

The following is a description of the proposed amendments to these statements.

#### Paragraph 12 of SAS No. 59

SAS No. 59 requires an auditor to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time not to exceed one year from the balance-sheet date. If, as a result of this evaluation, the auditor concludes that there is substantial doubt about the entity's ability to continue as a going concern, paragraph 12 of SAS No. 59 requires the auditor to include an explanatory paragraph (following the opinion paragraph) in the report to reflect that conclusion.

The Auditing Standards Board (the "Board") has observed explanatory paragraphs in which it is unclear whether the auditor is expressing his or her conclusion that there is substantial doubt about the entity's ability to continue as a going concern. To clarify that the auditor is expressing such a conclusion, the proposed Statement explicitly requires the use of the phrase "substantial doubt about its [the entity's] ability to continue as a going concern" or similar wording that includes the terms substantial doubt and going concern.

As reported in a "Notice to Practitioners" in the June 8, 1990 issue of the CPA Letter, the staff of the Securities and Exchange Commission (SEC) has been following the Board's consideration of this matter and has recently notified the Board of its position, as follows:

Regulation S-X, Article 2-02, requires the auditor to clearly state the opinion expressed on the financial statements. Statement on Auditing Standards No. 59, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern, requires the auditor to conclude as to whether substantial doubt exists about an entity's ability to continue as a going concern. Accordingly, the staff's position is that when an auditor has concluded substantial doubt exists, an auditor's report should clearly convey that conclusion by

using the words "substantial doubt" and "going concern" as illustrated in SAS No. 59. Thus, pending completion of the Board's project, the staff will expect auditors' reports to clearly state their conclusions in a manner consistent with the preceding sentence.

Paragraph 83 of SAS No. 58

Paragraph 83 of SAS No. 58 contains reporting guidance for the successor auditor when the financial statements of a prior period have been audited by a predecessor auditor whose report is not presented. This proposed Statement contains an amendment that modifies the explanatory language for the successor auditor when the prior-year financial statements are restated. The proposed amendment replaces the phrase "We also reviewed the adjustments" with the phrase "We also audited the adjustments." The Board, along with the SEC staff, believes that the use of the term reviewed confuses users of the successor auditor's report by connoting a different level of service than the service performed; that is, the adjustments to restate the prior-year financial statements have been audited by the successor auditor in connection with the audit of the current-year financial statements. The Board believes the successor auditor's report should reflect the level of service performed for those adjustments.

Paragraph 16 of SAS No. 1, section 543

Paragraph 16 of SAS No. 1, section 543, provides reporting guidance for the auditor who, following a pooling-of-interests transaction, is asked to report on the combination of restated financial statements for one or more prior years when other auditors have audited one or more of the entities included in such statements. The proposed amendment conforms the explanatory report language for the same reason the Board is proposing amendment to paragraph 83 of SAS No. 58 (discussed previously). This proposed amendment would replace the phrase "We also have applied procedures to the combination" with the phrase "We also audited the combination."

Comments or suggestions on any aspect of this exposure draft will be appreciated. The Board's consideration of responses will be helped if the comments refer to the section and include supporting reasons for any suggestions or comments.

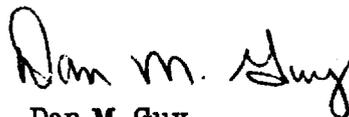
Written comments on the exposure draft will become part of the public record of the AICPA Auditing Standards Division and will be available for public inspection at the offices of the American Institute of Certified Public Accountants after October 17, 1990, for one year.

Responses should be sent to the AICPA Auditing Standards Division, File 3860, in time to be received by September 17, 1990. For your convenience, a postpaid mailer is attached to this exposure draft.

Sincerely,



Donald L. Neebes  
Chairman  
Auditing Standards Board



Dan M. Guy  
Vice President  
Auditing

# Proposed Statement on Auditing Standards

## OMNIBUS STATEMENT ON AUDITING STANDARDS—1990

### SAS No. 59, *The Auditor's Consideration of the Entity's Ability to Continue as a Going Concern*

(Supersedes SAS No. 59, paragraph 12)

*This amendment clarifies required language that the auditor should include in an explanatory paragraph that describes his or her substantial doubt about the entity's ability to continue as a going concern. New language is shown in bold-face italics.*

#### CONSIDERATION OF THE EFFECTS ON THE AUDITOR'S REPORT

12. If, after considering identified conditions and events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the audit report should include an explanatory paragraph (following the opinion

paragraph) to reflect that conclusion.<sup>4</sup> *The auditor's conclusion about the entity's ability to continue as a going concern should be expressed through the use of the phrase "substantial doubt about its [the entity's] ability to continue as a going concern" (or similar wording that includes the terms substantial*

*doubt and going concern) as illustrated in paragraph 13.*

13. An example follows of an explanatory paragraph (following the opinion paragraph) in the auditor's report describing an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

<sup>4</sup> The inclusion of an explanatory paragraph (following the opinion paragraph) in the auditor's report contemplated by this section should serve adequately to inform the users of the financial statements. Nothing in this section, however, is intended to preclude an auditor from declining to express an opinion in cases involving uncertainties. If he disclaims an opinion, the uncertainties and their possible effects on the financial statements should be disclosed in an appropriate manner (see paragraph 10), and the auditor's report should give all the substantive reasons for his disclaimer of opinion (see section 508, *Reports on Audited Financial Statements*).

## SAS No. 58, Reports on Audited Financial Statements

(Supersedes SAS No. 58, paragraph 83)

*This amendment modifies the explanatory language for the auditor when the financial statements reported on by the predecessor auditor are restated and the predecessor's audit report is not presented. New language is shown in boldface italics, and deleted language is shown by strike-through.*

### PREDECESSOR AUDITOR'S REPORT NOT PRESENTED

83. If the financial statements of a prior period have been audited by a predecessor auditor whose report is not presented, the successor auditor should indicate in the introductory paragraph of his report (a) that the financial statements of the prior period were audited by another auditor,<sup>32</sup> (b) the date of his report, (c) the

<sup>32</sup> The successor auditor should not name the predecessor auditor in his report; however, the successor auditor may name the predecessor auditor if the predecessor auditor's practice was acquired by, or merged with, that of the successor auditor.

type of report issued by the predecessor auditor, and (d) if the report was other than a standard report, the substantive reasons therefor. An example of a successor auditor's report when the predecessor auditor's report is not presented is shown below:

#### Independent Auditor's Report

We have audited the balance sheet of ABC Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of ABC Company as of December 31, 19X1, were audited by other auditors whose report dated March 31, 19X2, expressed an unqualified opinion on those statements.

[Same second paragraph as the standard report]

In our opinion, the 19X2 financial statements referred to above present fairly, in all material respects, the financial position of ABC Company as of December 31, 19X2, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

If the predecessor auditor's report was other than a standard report, the successor auditor should describe the nature of and reasons for the explanatory paragraph added to the predecessor's report or his opinion qualification. Following is an illustration of the wording that may be included in the successor auditor's report:

...were audited by other auditors whose report dated March 1, 19X2, on those statements included an explanatory paragraph that described the litigation discussed in Note X to the financial statements.

If the financial statements have been restated, the introductory paragraph should indicate that a predecessor auditor reported on the financial statements of the prior period before restatement. In addition, if the successor auditor is able to satisfy himself as to the appropriateness of the restatement, he may also include the following paragraph in his report:

~~We also reviewed~~ *We also audited* the adjustments described in Note X that were applied to restate the 19X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

**SAS No. 1, Codification of Auditing Standards and Procedures, Section 543,  
"Part of Audit Performed by Other Independent Auditors"**

**(Supersedes SAS No. 1, section 543, paragraph 16)**

*This amendment modifies the explanatory language for the auditor who, following a pooling-of-interests transaction, is asked to report on restated financial statements for one or more prior years when other auditors have audited one or more of the entities included in such financial statements. New language is shown in boldface italics, and deleted language is shown by strike-through.*

**RESTATED FINANCIAL STATEMENTS  
OF PRIOR YEARS FOLLOWING A  
POOLING OF INTERESTS**

16. Following a pooling-of-interests transaction, an auditor may be asked to report on restated financial statements for one or more prior years when other auditors have audited one or more of the entities included in such financial statements. In some of these situations the auditor may decide that he has not audited a sufficient portion of the financial statements for such prior year or years to

enable him to serve as principal auditor (see paragraph 2). Also, in such cases, it often is not possible or it may not be appropriate or necessary for the auditor to satisfy himself with respect to the restated financial statements. In these circumstances it may be appropriate for him to express his opinion solely with respect to the combining of such statements; however, no opinion should be expressed unless the auditor has audited the statements of at least one of the entities included in the restatement for at least the latest period presented. The following is an illustration of appropriate reporting on such combination that can be presented in an additional paragraph of the auditor's report following the standard introductory, scope, and opinion paragraphs covering the consolidated financial statements for the current year:<sup>o</sup>

<sup>o</sup> If restated consolidated balance sheets are also presented, the auditor may also express his opinion with respect to the combination of the consolidated balance sheets.

We previously audited and reported on the consolidated statements of income and cash flows of XYZ Company and subsidiaries for the year ended December 31, 19X1, prior to their restatement for the 19X2 pooling of interests. The contribution of XYZ Company and subsidiaries to revenues and net income represented....percent and....percent of the respective restated totals. Separate financial statements of the other companies included in the 19X1 restated consolidated statements of income and cash flows were audited and reported on separately by other auditors. We also ~~have applied procedures to audited~~ the combination of the accompanying consolidated statements of income and cash flows for the year ended December 31, 19X1, after restatement for the 19X2 pooling of interests; in our opinion, such consolidated statements have been properly combined on the basis described in Note A of notes to consolidated financial statements.

[As modified, October 1980, by the Auditing Standards Board.]